VMWARE, INC.
Form 10-K
February 27, 2013

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
Form 10-K
(Mark One)

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

For the fiscal year ended December 31, 2012
OR

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

For transition period from to
Commission File Number 001-33622

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

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

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

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Class A Common Stock, par value $0.01	New York Stock Exchange

Securities registered pursuant to section 12(g) of the Act:
None

Indicate by a check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes x No ¨

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ¨ No x

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

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements

incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer	x		Accelerated filer	¨
Non-accelerated filer	o	(Do not check if a smaller reporting company)	Smaller reporting company	¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x
At June 30, 2012, the aggregate market value of the registrant’s Class A common stock held by non-affiliates of the registrant (based upon the closing sale price of such shares on the New York Stock Exchange on June 30, 2012) was approximately $7,458,292,680. Shares of the registrant’s Class A common stock and Class B common stock held by each executive officer and director and by each entity or person, other than investment companies, that, to the registrant’s knowledge, owned 5% or more of the registrant’s outstanding Class A common stock as of June 30, 2012 have been excluded in that such persons may be deemed to be affiliates of the registrant. This determination of affiliate status is not necessarily a conclusive determination for other purposes.
As of February 13, 2013, the number of shares of common stock, par value $0.01 per share, of the registrant outstanding was 428,346,849 of which 128,346,849 shares were Class A common stock and 300,000,000 were Class B common stock.
DOCUMENTS INCORPORATED BY REFERENCE
Information required in response to Part III of Form 10-K (Items 10, 11, 12, 13 and 14) is hereby incorporated by reference to portions of the registrant’s Proxy Statement for the Annual Meeting of Stockholders to be held in 2013. The Proxy Statement will be filed by the registrant with the Securities and Exchange Commission no later than 120 days after the end of the registrant’s fiscal year ended December 31, 2012.

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VMware, VMworld, vSphere, VMware vCloud, Zimbra, SpringSource, vCenter, VMware vShield, Cloud Foundry, VMware View, VMware Horizon, VMware Fusion, vMotion, VMware vCloud Suite, VMware Workstation, ThinApp, vSphere Distributed Switch, Storage DRS, Horizon Suite, Site Recovery Manager, Cloud Infrastructure and Management Suite, Dynamic Ops, Storage vMotion, vCenter Operations Management, vCloud Automation Center, vCloud Connector, vCloud Director, vCloud Networking and Security, Application Director, vFabric Data Director, Horizon Application Manager, VMware Mirage, VMware Ready, VMware Ready Desktop Solutions, Rabbit MQ, GemFire, vCenter Server, Socialcast, SlideRocket, Digital Fuel, NeoAccel, PacketMotion, Shavlik, Wanova and WaveMaker are registered trademarks or trademarks of VMware, Inc. in the United States and other jurisdictions. All other marks and names mentioned herein may be trademarks of their respective companies.

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FORWARD-LOOKING STATEMENTS

This Annual Report on Form 10-K contains forward-looking statements, including, without limitation, statements regarding expectations of, or our plans for: achieving future business growth, including investing in research and development and expanding our business alliances; macroeconomic conditions; future product offerings; sources of revenues; future use of the software-defined data center ("SDDC"); the potential benefits of the Pivotal initiative; future acquisitions; future competition; the competitive landscape; maintaining our leadership position; the impact of seasonal factors; the impact of, costs associated with, and the timetable for streamlining our operations and implementing and completing our realignment plan; funding expansion of our industry segment share and developing long term relationships with our customers; managing our resources prudently while making key investment in support of long-term growth objectives; geographic expansion and adding additional channel partners; the ability of our 2013 selling and marketing efforts to improve the growth rate of our transactional business; the recognition of unearned revenue; our relationship with EMC Corporation ("EMC"); increasing employee headcount; our revenue outlook and mix; the number of large enterprise license agreements ("ELAs") expected in the first half of 2013; customer and partner demand for our products and services; the delivery of professional services to our customers; the sufficiency of our liquidity and capital reserves to fund our operations and business strategy; continuation of our stock repurchase program; continuation of our dividend policy; factors affecting our tax position; 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.; timing and amount of capitalized software development costs; interoperability among our future product offerings and for the increasing development of product suites; timing of filing tax returns; adequacy of our current facilities and the availability of additional or substitute space for future expansion; 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.

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PART I

ITEM 1. BUSINESS

Overview

VMware, Inc. is the leader in virtualization infrastructure solutions utilized by organizations to help transform the way they build, deliver and consume information technology (“IT”) resources. We pioneered the development and application of virtualization technologies with x86 server-based computing, separating application software from the underlying hardware. The benefits to our customers include 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. Our broad and proven suite of virtualization technologies addresses 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. Our solutions enable organizations to aggregate multiple servers, storage infrastructure and networks together into shared pools of capacity that can be allocated dynamically, securely and reliably to applications as needed, increasing hardware utilization and reducing spending. Once created, these internal computing infrastructures, or “clouds,” can be dynamically linked by our customers to external computing resources that run on a VMware virtualization platform. This results in a computing cloud of highly available internal and external computing resources that organizations can access on demand. Our customers' deployments range in size from a single virtualized server for small businesses to thousands of virtual machines for our Fortune 1000 enterprise customers.

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. Traditional data centers are loose collections of technology silos where each application type has its own vertical stack consisting of CPU and operating system, storage pool, networking and security, and management systems. Over time, the data center environment has become increasingly divergent, leading to higher complexity and driving the need for more and more resources to manage and keep infrastructure up-to-date, which ultimately drives a significant amount of expenses for customers. The SDDC, by abstracting the services that are required from the underlying hardware, pooling them, and automating them, is designed to turn the data center into an on-demand service that can take on the shape and size of application requirements. This promises to dramatically simplify data center operations and lowers costs. The VMware vCloud Suite is our first integrated solution toward realizing the SDDC vision, based upon our VMware vSphere virtualization platform. The VMware vCloud Suite addresses virtualization of not only CPU and memory but also networks and associated security services. In addition, the vCloud Suite delivers a new approach to management, leveraging policy-based automation. VMware vCloud Suite is engineered for hybrid cloud computing so that it federates with other pools of infrastructure. Since it is an integrated suite of products, all the components are updated and revised together, eliminating the need for customers to perform the work themselves.

We believe that as organizations look to operate their IT systems in a more cloud-like manner, they will seek to spend less time, effort and money on underlying infrastructure and devote more resources to transforming their businesses. Our strategy, focused on the SDDC, hybrid cloud computing, and client management capabilities for the post-PC era, provides customers an extended suite of software to address the integration, automation, and management capabilities they need. 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

In 2012, we acquired Nicira, a pioneer in network virtualization, which expands our network virtualization capabilities into heterogeneous environments. In December 2012 we launched the Pivotal Initiative with EMC Corporation (“EMC”), and plan to commit technology, people and programs from both companies focused on Big Data and Cloud Application Platforms.

We work closely with more than 1,900 technology partners, including leading server, microprocessor, storage, networking, software and security vendors. We have shared the economic opportunities surrounding virtualization with our partners by facilitating solution development through open application programming interface (“APIs”) formats and protocols and providing access to our source code and technology. The endorsement and support of our partners further enhances the awareness, reputation and adoption of our virtualization solutions.

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 revenues from our indirect sales channel, which includes distributors, resellers, system vendors and systems integrators. We believe that our partners benefit greatly from the sale of our solutions through additional services, software and hardware sales opportunities. We have trained a large number of partners and end users to deploy and leverage our solutions.

We incorporated in Delaware in 1998, were acquired by EMC in 2004 and conducted our initial public offering of our Class A common stock in August 2007. EMC holds approximately 79.6% of our outstanding common stock, including 41

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million shares of our Class A common stock as of December 31, 2012, and all of our Class B common stock, and we are considered a "controlled company" under the rules of the New York Stock Exchange. Total revenues in 2012 increased 22% to $4,605.0 million. This included license revenues of $2,087.0 million and services revenues of $2,518.0 million. In the years ended December 31, 2012, 2011, and 2010, our license revenues came primarily from sales of our Cloud Infrastructure and Management solutions. The balance of our license revenues came from our other solutions, including Cloud Application Platform, which largely will be part of the Pivotal Initiative, described below, and End-User Computing. Of our total services revenues in 2012, 86% were software maintenance revenues and 14% were professional services revenues, including training. For additional financial information on our business by product and geographic area, see Note O to the consolidated financial statements included elsewhere in this filing. Our corporate headquarters are located at 3401 Hillview Avenue, Palo Alto, California, and we have approximately 101 offices worldwide.

Background

Virtualization was first introduced in the 1970s to enable multiple business applications to share and fully harness the centralized computing capacity of mainframe systems. Virtualization was effectively abandoned during the 1980s and 1990s when client-server applications and inexpensive x86 servers and personal computers established the model of distributed computing. Rather than sharing resources centrally in the mainframe model, organizations used the low cost of distributed systems to build up islands of computing capacity, providing some benefits but also introducing new challenges. These challenges include a gross underutilization of hardware resources, an inability to easily assure quality of service to applications and unwieldy management processes made cumbersome by the tight coupling of applications to the underlying hardware.

Today, x86 hardware has become increasingly proficient with multi-core processors, growing memory capacity and higher speed interconnects shipping in standard servers. The complexity of applications continues to rise as multi-element, mixed operating system ("OS") applications become increasingly common, which makes it difficult to provide a uniform quality of service across all components. Virtualization has become accepted as a standard way of computing in data centers that enables highly efficient utilization of hardware.

VMware's infrastructure virtualization platform, 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. This approach enables organizations to build a computing infrastructure with high levels of utilization, availability, automation and flexibility using building blocks of inexpensive industry-standard servers.

In effect, VMware's virtualization platform converts IT infrastructure into a "computing cloud." Applications running in virtual machines can move across servers, storage and networks without disruption or downtime to dynamically match computing supply and demand while built-in services ensure high levels of availability, security and scalability.

Our focus on the SDDC, hybrid cloud computing, and client management capabilities for the post-PC era is an expansion of our role as a pioneer of virtualization technologies that simplify IT infrastructure throughout the data center and to the virtual workspace.

Products and Technology

Cloud Infrastructure and Management Products and Technology

VMware vSphere is our flagship data center platform. Users deploy the VMware vSphere hypervisor when they purchase VMware vSphere. A "hypervisor" is a layer of software that resides between the operating system and system hardware to enable compute virtualization. Other components of our VMware vSphere platform include key capabilities such as:

- vSphere vMotion and Storage vMotion enable the live migration of actively running virtual machines across servers or storage locations without disruption or downtime.
- vSphere High Availability enables cost-effective high availability for all applications against hardware and operating system failures.
- vSphere Storage DRS automatically manages the placement and balancing of a virtual machine across storage resources.
- vSphere Distributed Switch enables centralized point of control for cluster-level networking.

The management layer for vSphere is known as VMware vCenter Server. It provides the central management for vSphere environments.
The vCloud Suite, introduced in 2012, is an integrated solution for building and managing a complete cloud infrastructure optimized for use with the VMware vSphere platform. vCloud Suite is our first product designed to fulfill the promise of the

software-defined data center by pooling industry-standard hardware and running compute, networking, and management functions in the data center as software-defined services.

Our vCloud Suite offerings include combinations of the following components:

- vSphere Enterprise Plus - VMware's virtualization platform enabling server virtualization with its most robust feature set designed for policy-based automation.
- vCloud Director - enables self-service access to logical pools of compute, network and storage resources with policy-driven controls and service-level agreements.
- vCloud Connector - extends management to the hybrid cloud.
- vCloud Networking and Security - provides advanced networking and security for applications and the perimeter of virtual datacenters, end-user computing and cloud environments.
- VMware vCenter Site Recovery Manager - provides simplified, automated disaster recovery for virtualized environments.
- vCenter Operations Management - provides performance, capacity and configuration management for virtual or physical infrastructure.
- vFabric Application Director - accelerates and automates the configuration and deployment of multi-tier applications across private and public cloud infrastructures.
- vCloud Automation Center - enables customers to rapidly deploy and provision cloud services in the vCloud Suite.

Our VMware vCloud Service Provider initiative, which is directed to hosting and cloud computing vendors, enables organizations to choose more freely between running applications in virtual machines on their own “private clouds” inside their data center or on “public clouds” hosted by a service provider. With a common VMware vSphere platform available across public and private clouds, internal and external IT resources can be pooled into a hybrid cloud, and applications and data can be readily moved between the two based on economics and organizational need. External cloud capacity can be accessed on-demand without the need to customize or change applications.

End-User Computing

Enterprises are increasingly challenged to provide secure access to a growing mobile workforce while managing the diversity of data, applications and devices to run their business. VMware's End-User Computing solutions are designed to enable a user-centric approach to personal computing, ensuring secure access to applications and data from a variety of devices and locations. Our End-User Computing solutions address the needs of IT departments by enabling the delivery of existing end-user assets as a managed service.

VMware's End-User Computing strategy addresses the needs of corporate IT by enabling IT organizations to deliver an environment with high-quality service, improved availability and scalable performance while leveraging both legacy and cloud architectures. Elements of VMware End-User Computing solutions include:

- VMware View, an enterprise desktop virtualization platform designed to optimize application and desktop management and enable flexibility, security and mobility for end users. In 2012, VMware released VMware View 5.1, significantly enhancing user experience by optimizing storage performance and adding seamless support for unified communications, enhanced persona management and increased available mobile device support.
- VMware Horizon Application Manager, a SaaS or on-premise solution that centralizes application management allowing unified management of any SaaS, web and Windows applications through a centralized Application Catalog and securely delivers applications to end-users on the device of their choice, increasing user's flexibility and reducing IT management cost.
- VMware Mirage, a unique solution for managing laptops and desktops that combines centralized Windows image and data management for corporate IT with the ability for end users to run their local devices, fully leveraging local hardware and performance. Mirage provides an easy migration path from Windows XP, while also providing robust self-service image repair, and device backup/recovery.

We offer additional other end-user computing products, including VMware ThinApp, VMware Zimbra, VMware Workstation and VMware Fusion.

Cloud Application Platform and the Pivotal Initiative

VMware also offers Cloud Application Platform solutions to help organizations build, run and manage enterprise applications in public, private or hybrid clouds optimized for vSphere. Our Cloud Application Platform provides open source

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application frameworks, application run-time and data management solutions and an open platform as a service, or PaaS. Our SpringSource product group develops and supports the Spring application framework for enterprise Java applications and the Grails framework for high productivity web applications written in the Groovy programming language. Both of these frameworks are open source software.

Our VMware Cloud Application Platform runtime and data products enable developers to deploy and manage applications and databases in traditional server environments as well as on virtualized infrastructure based on vSphere. These products include VMware vFabric GemFire, which enables real-time data distribution, caching and management for high performance and cloud applications and vFabric Data Director, which enables simplified management and operation of databases on vSphere.

In December 2012, VMware and EMC launched the Pivotal Initiative, pursuant to which both companies plan to commit technology, people and programs to focus on Big Data and Cloud Application Platforms. The Pivotal Initiative is led by Paul Maritz, Chief Strategy Officer of EMC and VMware's former Chief Executive Officer, and is expected to include most employees and resources working within EMC's Greenplum and Pivotal Labs organizations, VMware's vFabric (including Spring and Gemfire), Cloud Foundry and Cetas organizations, as well as related efforts.

Technology Alliances

Consistent with our partner-centric strategy, we have engaged a broad group of hardware, software and cloud computing service vendors to cooperatively advance virtualization technology through joint marketing, product interoperability, collaboration and co-development. We create opportunity for partners by enabling them to build products that utilize our virtualization technology and create differentiated value through joint solutions.

We have more than 1,900 technology partners with whom we bring joint offerings to the marketplace and over 10,000 Service Provider partners. We classify our partners as follows:

- Independent Hardware Vendors (“IHVs”). We have established relationships with large system vendors, including Cisco, Dell, Fujitsu, Fujitsu-Siemens, HP, IBM, Lenovo and NEC for joint certification and co-development. We also work closely with AMD, Intel and other IHVs to provide input on product development to enable them to deliver hardware advancements that benefit virtualization users. We coordinate with the leading storage and networking vendors to ensure joint interoperability and enable our software to access their differentiated functionality.
- Independent Software Vendors (“ISVs”). We partner with leading systems management, infrastructure software and application software vendors - including the top healthcare, telecom, finance and retail market leaders - to deliver value-added products that integrate with our VMware products.
- VMware Service Providers. We have established partnerships with over 10,000 service providers including Bluelock, Colt, Sing Tel, CSC, Dell, Hitachi, Optus, OVH, Softbank and AT&T to enable them to host and deliver enterprise-class hybrid clouds as a way for enterprises to extend their datacenters to external clouds, while preserving security, compliance and quality of service.

The VMware Technology Alliance Partner program facilitates joint solution creation and coordinated go-to-market activities with our partners. Over 4,500 of the most widely used applications from ISVs support the VMware vSphere platform. These applications include business solutions for enterprise resource planning, human resource management, electronic medical records management, financial processing and middleware, such as application servers and databases. As an extension to this rapidly growing list, we have expanded our VMware Ready program to allow application software and desktop solution providers to qualify for the VMware Ready logo. The VMware Ready Desktop Solutions program validates the reference architecture and desktop specialization of solution providers that simplify VMware virtual desktop environments.

Our ISVs and other alliance partners, developers and additional VMware community members have distributed more than 900 software applications as virtual appliances. We invest significant capital in testing and certification of infrastructure to rigorously ensure our software works well with major hardware and software products. We have more than 9,100 servers, storage, I/O and thin-client devices that are VMware Ready. We have successfully tested approximately 670 operating system versions for use with our solutions. We believe that the scale and scope of this effort is a significant competitive advantage.

Research and Development

We have made, and expect to continue to make, significant investments in research and development ("R&D"). We have assembled an experienced group of developers with system level, systems management, desktop, mobile devices, security, application development, collaborative applications, networking, storage and open source software expertise. We also have strong ties to leading academic institutions around the world, and we invest in joint research with academia.

We prioritize our product development efforts through a combination of engineering-driven innovation and customer and market-driven feedback. Our R&D culture places high value on innovation, quality and open collaboration with our partners.

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We currently participate in numerous standards groups and VMware employees hold a variety of standards organization leadership positions, including with the Distributed Management Task Force, the Standard Performance Evaluation Corporation, the Open Networking Foundation and the Open Stack Foundation.

Our R&D expenses totaled $999.2 million, $775.1 million, and $653.0 million in 2012, 2011 and 2010, respectively. No R&D costs were capitalized in 2012. We capitalized $86.4 million and $71.6 million of R&D costs that were in addition to our R&D expenses in 2011 and 2010.

Sales and Marketing

We derive a significant majority of our sales from our indirect sales channel, which includes distributors, resellers, system vendors and systems integrators. The remainder of our sales is primarily derived from our direct sales force.

We have established ongoing business relationships with our distributors. Our distributors purchase software licenses and software support from us for resale to end-user customers via resellers.

A substantial majority of our resellers obtain software licenses and software support from our distributors and market and sell them to our end-user customers. These resellers are part of our VMware Partner Network (“VPN”), which offers these resellers sales and product training, pricing incentives, rebates and access to the worldwide network of VMware distributors and the VMware Partner Central Web portal.

We offer several levels of membership in our VPN depending on a reseller's interest and capability of providing demand generation, fulfillment, service delivery and education to customers and prospects. We also have certain resellers, as well as systems integrators, who obtain software licenses and software support directly from VMware. The VPN agreements signed by the resellers carry no obligation to purchase or sell VMware products and can be terminated at any time by either party.

We have a highly leveraged Go-to-Market strategy that includes a direct sales force that is complementary to our channel. Our sales force works with our channel partners to introduce them to end-user customer accounts and new sales opportunities.

In addition, our channel partner network includes certain systems integrators and resellers trained and certified to deliver consulting services and solutions leveraging VMware products.

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.

We primarily sell our software under perpetual licenses, and our sales contracts generally require end-user customers to purchase maintenance for the first year. Maintenance periods typically range from one to five years. Software maintenance and renewals are sold both directly to end-user customers and via our network of channel partners. The majority of professional services are sold via our channel, with some professional services sold directly. End users can obtain licenses to our products through individual discrete purchases to meet their immediate needs or through the adoption of enterprise license agreements (“ELAs”). ELAs are comprehensive volume license offerings that provide for multi-year maintenance and support at discounted prices. ELAs enable us to build long-term relationships with our customers as they commit to VMware's virtual infrastructure solutions in their data centers. Our sales cycle with end-user customers ranges from less than 90 days to over a year depending on several factors, including the size and complexity of the customer's infrastructure.

In establishing prices for our products, we take into account, among other factors, the value our products and solutions deliver and the cost of both alternative virtualization and hardware solutions.

Our marketing efforts focus on communicating the benefits of our solutions and educating our customers, distributors, resellers, system vendors, systems integrators, the media and analysts about the advantages of our innovative virtualization technology.

We raise awareness of our company and brands, market our products, and generate sales leads through VMware and industry events, public relations efforts, marketing materials, advertising, direct marketing, social media initiatives, free downloads and our website. We have invested in multiple online communities that enable customers and partners to share and discuss sales and development resources, best practices implementation, and industry trends among other topics. Our annual user conference, VMworld, which is held in both the U.S. and Europe, has grown in attendance each year. We also offer management presentations, seminars, and webinars on our products of virtualization and cloud computing. We believe the combination of these activities strengthens our brand and enhances our leading market position in our industry.

Our business is subject to seasonality in the sale of our products and services. For example, our fourth quarter revenues are affected by a number of seasonal factors, including fiscal year-end spending trends. Such factors historically have contributed to stronger fourth quarter revenues in any given year. We believe that seasonal factors are common within our industry.

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Customers

Our customer deployments range in size from a single virtualized server for small businesses to thousands of virtual machines for our largest enterprise customers.

During 2012, two distributors, who purchased software licenses and software support from us for resale to end-user customers directly or via resellers, each accounted for over 10% of our worldwide revenues. Arrow Electronics, Inc. and Tech Data Corporation accounted for 15% and 12%, respectively, of our worldwide revenues in 2012. Our distribution agreements are typically terminable at will 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 agreement. No other channel partner accounted for more than 10% of our revenues in 2012.

Competition

The cloud computing, end-user computing and virtualization markets are inter-related and rapidly evolving. We experienced increased competition during 2012 and expect it to significantly intensify in the future. We compete with large and small vendors in different segments of the cloud computing, end-user computing and virtualization markets, and expect that new entrants will continue to enter the market and develop technologies that, if commercialized, may compete with our products.

We believe the key competitive factors in the cloud computing, end-user computing and virtualization markets include:

- the level of reliability, interoperability and new functionality of product offerings;
- the ability to provide comprehensive solutions, including management 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;
- a proven track record of formulating and delivering a roadmap of compelling software and service capabilities;
- pricing of products, individually and in bundles;
- the ability to attract and preserve a large installed base of customers;
- the ability to attract and maintain a large number of application developers for 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.

The cloud computing market is in a high state of flux with both established and new technology companies vying for thought leadership and market share. Currently, Amazon EC2, Microsoft Azure and emerging open source efforts present alternatives to VMware's hybrid cloud computing vision.

Microsoft is also our primary competitor for data center virtualization solutions. In 2012, Microsoft released improved versions of its Hyper-V virtualization offering and System Center suite of virtualization management products and released further System Center enhancements in early 2013. Microsoft's offerings are positioned to compete with our virtual infrastructure, virtualization management and some of our free data center product offerings.

We also compete with Citrix and its collaborations with Microsoft for end-user computing solutions and with companies whose virtualization products are based on emerging open source technologies. In addition, we compete with companies that take different approaches to virtualization. Furthermore, our VMware vSphere editions compete with products that provide high availability clustering, workload management and resource management.

We also expect to compete with new entrants to the cloud computing, end-user computing and virtualization markets, which may include parties currently selling our products and our current technology partners. 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 cloud computing, end-user computing and virtualization products that are similar to features that presently differentiate our product offerings from theirs. Additionally, some of our competitors may make acquisitions or enter into partnerships or other strategic relationships with one another to offer more comprehensive solutions than those they individually had offered. Some

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competitors have in the past, and may in the future, take advantage of their existing relationships with our business partners to engage in business practices such as distribution and license restrictions that make our products less attractive to our channel partners and end users.

Information technology companies are also increasingly seeking to deliver top-to-bottom IT solutions to end users that combine enterprise-level hardware and software solutions that can offer alternatives to our cloud computing, end-user computing and virtualization platform. In addition, competitors who have existing relationships with our current or prospective end users could integrate competitive capabilities into their existing products and make them available without additional charge. Many of our current and potential competitors have longer operating histories, greater name recognition, a larger customer base and significantly greater financial, technical, sales and marketing and other resources than we do. Overall however, we believe our market position, large virtualization customer base, strong network of partners and indirect sales, broad and innovative solutions suite, and platform-agnostic approach position us to compete effectively.

Intellectual Property

As of December 31, 2012, approximately 300 patents issued by the United States Patent and Trademark Office have been granted or assigned to us. We also have been granted or assigned patents from other countries. These patents cover various aspects of our server virtualization and other technologies. The granted United States patents will expire beginning in 2018, with the last patent expiring in 2031. We also have numerous pending United States provisional and non-provisional patent applications, and numerous pending foreign and international patent applications, that cover other aspects of our virtualization and other technologies.

We have federal trademark registrations in the United States for “VMWARE,” “VMWORLD,” “VMWARE FUSION,” “VSPHERE,” “VMWARE VCLOUD,” “VMWARE VIEW,” “VMOTION,” “ZIMBRA” and numerous other trademarks. We have also registered trademarks in a number of foreign countries.

We rely on a combination of patent, trademark, copyright and trade secret laws in the United States and other jurisdictions, as well as confidentiality procedures and contractual provisions to protect our intellectual property rights and our brand.

We enforce our intellectual property rights in the United States and a number of foreign countries. 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. United States patent filings are intended to provide the holder with a right to exclude others from making, using, offering to sell, selling or importing into the United States products covered by the claims of granted patents.

Our granted United States patents, and any future patents (to the extent they are issued), 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 we may not be able to prevent third parties from infringing these patents. Therefore, the exact effect of our patents and the other steps we have taken to protect our intellectual property cannot be predicted with certainty.

Employees

As of December 31, 2012, we had approximately 13,800 employees in offices worldwide, less than 5% of which were contracted through EMC. None of our employees are represented by labor unions, and we consider current employee relations to be good.

We contract with EMC to utilize personnel who are dedicated to work for VMware on a full-time basis. These individuals are located in countries in which we do not currently have an operating subsidiary and are predominantly dedicated to our sales and marketing efforts. We use contractors from time to time for temporary assignments and in locations in which we do not currently have operating subsidiaries. In the event that these contractor resources were not available, we do not believe that this would have a material adverse effect on our operations.

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.);

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- 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 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 and end-user computing. We are also investing in the development of products and services for the emerging platform as a service, or "PaaS," and software as a service, or "SaaS," markets. 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, application development and end-user computing. As the market for our data center virtualization products mature and the scale of our business increases, the rate of growth in our product sales will likely be lower than those we have experienced in earlier periods 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, PaaS and SaaS 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

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- 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 connection with our 2009 acquisition of SpringSource, we announced our intention to use SpringSource solutions to extend VMware’s strategy to deliver solutions in the emerging PaaS market and have since also acquired GemFire and RabbitMQ as part of our overall PaaS strategy. Additionally, SpringSource’s current offerings and their underlying open source technology position us in the enterprise and web application development markets. In 2011, we announced CloudFoundry, a VMware-operated developer cloud service and a new open source PaaS project for the development of applications designed to utilize cloud computing, and in 2012, we announced that we planned to commit key resources and programs, including SpringSource, GemFire and CloudFoundry to the Pivotal Initiative, a virtual organization that also includes Big Data resources contributed by EMC.

We also continue to expand and enhance our end-user computing offerings, such as VMware View, and in 2012 announced the upcoming Horizon Suite, a solution that is expected to provide 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.

Our acquisitions of Zimbra and Socialcast in 2010 and 2011 were a part of VMware’s strategy to enter the emerging SaaS market. In 2011, we also acquired Digital Fuel, which provides IT financial and business management solutions.

The expansion of our offerings to deliver the SDDC and address IT management and automation, IaaS, PaaS and SaaS 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.

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- 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, IaaS (including software-defined networking), PaaS and SaaS 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 PaaS 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.
- 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, PaaS and SaaS, 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.

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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 strategic areas we have determined to be most compelling, we approved, subject to compliance with all applicable legal obligations, a plan to streamline our operations. The plan includes the elimination of approximately 900 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;

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- 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

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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

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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 2012 and 2011. 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 also 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.

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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

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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. Computer programmers 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 such computer programmers to access or sabotage networks change frequently and may not be recognized until launched against a target, we may be unable to anticipate these techniques. 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% of our total revenues in the years ended 2012 and 2011, respectively. 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;

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- 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 2012. 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 2012. 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 35% of our total accounts receivable as of December 31, 2012 was from our two 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

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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, 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

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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, including our SpringSource, Zimbra and Cloud Foundry 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, including our offerings that utilize our SpringSource, Zimbra and Cloud Foundry software. 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

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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. In 2011 we completed acquisitions of Digital Fuel, NeoAccel, Packet Motion, Shavlik, SlideRocket, Socialcast and WaveMaker. 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. Any difficulties we encounter in the integration process could divert management from day-to-day responsibilities, increase our expenses and have a material adverse effect on our business, financial condition and results of operations. We may also face difficulties due to the lack of experience in new markets, products or technologies or the initial dependence on unfamiliar supply or distribution partners. Other risks related to acquisitions include the assumption of the liabilities of the acquired business, including litigation-related liabilities.

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 includes a planned exit of certain lines of business, including SlideRocket. 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.

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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

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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, we expect that our income tax provision for the first quarter of 2013 will include an estimated discrete tax benefit reflecting the full year 2012 federal research credit, and our 2013 annual estimated effective tax rate will also include the benefit expected for 2013. Accordingly, we expect our 2013 effective tax rate 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.

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 December 31, 2012, EMC owned 41,050,000 shares of our Class A common stock and all 300,000,000 shares of our Class B common stock, representing 79.6% of the total outstanding shares of common stock or 97.2% 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,

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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

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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 proposed commitment to launch the Pivotal Initiative with EMC may not prove successful.

In December 2012, we launched the Pivotal Initiative with EMC, pursuant to which both companies plan to commit technology, people and programs to focus on Big Data and Cloud Application Platforms. The Pivotal Initiative is led by Paul Maritz, Chief Strategy Officer of EMC and VMware's former Chief Executive Officer, and is expected to include most employees and resources 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. While we and EMC have announced our intention to commit to this initiative, there is no assurance that we will be able to agree upon our commitment on reasonable terms with EMC. If we are unable to reach agreement, then we might not be able to realize the potential value we believe is possible through uniting these assets. Accordingly, it is possible that the Pivotal Initiative may not be implemented as planned, or that timing could be delayed. Should the initiative be launched, its 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;

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• the ability to have adequate financial resources to fund its operations.

In the event the initiative is not successful, any investment in the initiative we hold could become impaired, which could have a material adverse impact on our results of operations and financial condition. Further, funding requirements for the initiative could adversely impact our financial condition and detract from our ability to fund alternative strategies.

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;

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- 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 Annual Report on Form 10-K 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 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 year ended December 31, 2012, we recognized revenues of $267.0 million and as of December 31, 2012, $180.8 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 January 31, 2013, the closing trading price of our Class A common stock was very volatile, ranging between $76.48 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 Annual Report on Form 10-K. 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:

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- 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 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

As of December 31, 2012, we owned or leased the facilities described below:

Location		Approximate Sq. Ft.[1]		Principal Use(s)
Palo Alto, CA	owned: leased:	1,458,000 184,000	(2)	Executive and administrative offices, sales and marketing, R&D and data center
North and Latin American region (excluding Palo Alto, CA)	leased:	712,000	(3)	Administrative offices, sales and marketing, R&D and data center
Asia Pacific region	leased:	930,000		Administrative offices, sales and marketing, R&D and data center
Europe, Middle East and Africa region	leased:	334,000		Administrative offices, sales and marketing, R&D and data center

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(1) Of the total square feet owned or leased, approximately 1,016,000 square feet were under construction as of December 31, 2012.

(2) Represents all of the right, title and interest purchased in a ground lease covering the property and improvements located at VMware's Palo Alto, California campus.

(3) Includes leased space for a Washington data center facility, for which VMware is considered to be the owner for accounting purposes.

In 2011, VMware purchased all of the right, title and interest in a ground lease covering the property and improvements located adjacent to VMware's existing Palo Alto, California campus for $225.0 million. Concurrent with the closing of the transaction, VMware entered into an amended and restated ground lease for the new property which expires in 2046. VMware will possess the title to the interest and buildings during the duration of the lease. Upon termination of the lease, all title will revert to the lessor. As of December 31, 2012, 544,000 square feet remained under construction at this campus. See Note G to the consolidated financial statements for further information.

We believe that our current facilities, including those under construction at our expanded headquarters, are suitable for our current employee headcount and will sustain us through 2013, but we intend to add new facilities or expand existing facilities as we add employees and expand our operations. We believe that suitable additional or substitute space will be available as needed to accommodate expansion of our operations.

ITEM 3. LEGAL PROCEEDINGS

See Note L to the consolidated financial statements in Part II, Item 8 of this Annual Report on Form 10-K 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 I, Item 1A of this Annual Report on Form 10-K for a discussion of potential risks to our results of operations and financial condition that may arise from legal proceedings.

ITEM 4. MINE SAFETY DISCLOSURES

Not Applicable.

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EXECUTIVE OFFICERS OF THE REGISTRANT

The names of executive officers and their ages as of February 13, 2013, are as follows:

Name	Age	Position(s)
Patrick P. Gelsinger	51	Chief Executive Officer and Director
Carl M. Eschenbach	46	President and Chief Operating Officer
Jonathan C. Chadwick	47	Chief Financial Officer and Executive Vice President
Rangarajan (Raghu) Raghuram	50	Executive Vice President, Cloud Infrastructure and Management
S. Dawn Smith	49	Senior Vice President, General Counsel, Chief Compliance Officer and Secretary

Patrick P. Gelsinger has been the Chief Executive Officer and a Director of VMware since September 1, 2012. Prior to joining VMware, he served as President and Chief Operating Officer, EMC Information Infrastructure Products at EMC from September 2009 to August 2012. Mr. Gelsinger joined EMC from Intel Corporation, a designer and manufacturer of advanced integrated digital technology platforms, where he was Senior Vice President and Co-General Manager of Intel Corporation's Digital Enterprise Group from 2005 to September 2009 and served as Intel's Senior Vice President, Chief Technology Officer from 2002 to 2005. Prior to this, Mr. Gelsinger led Intel's Desktop Products Group.

Carl M. Eschenbach was appointed Chief Operating Officer and Co-President of VMware in April 2012 and became President and Chief Operating Officer in December 2012. Mr. Eschenbach had previously served as VMware's Co-President, Customer Operations from January 2011 to April 2012 and as VMware's Executive Vice President of Worldwide Field Operations from May 2005 to January 2011. Prior to joining VMware in 2002, he was Vice President of North America Sales at Inktomi from 2000 to 2002. He also held various sales management positions with 3Com Corporation, Lucent Technologies Inc. and EMC.

Jonathan C. Chadwick joined VMware as Chief Financial Officer and Executive Vice President on November 5, 2012. Mr. Chadwick had previously served as the Chief Financial Officer of Skype, a provider of Internet-based voice communication, since March 2011, and as a Corporate Vice President of Microsoft Corporation since its acquisition of Skype in October 2011. Mr. Chadwick joined Skype from McAfee, an antivirus software and computer security company, where he was the Executive Vice President and Chief Financial Officer from June 2010 until February 2011, when McAfee was acquired by Intel Corporation. From 1997 to 2010, Mr. Chadwick held various finance roles at Cisco Systems, a networking equipment company. At Cisco, Mr. Chadwick served as Senior Vice President, CFO - Global Customer Markets from July 2009 to June 2010, Senior Vice President, Corporate Controller and Principal Accounting Officer from June 2007 until July 2009, Vice President, Corporate Controller and Principal Accounting Officer from September 2006 to June 2007 and Vice President, Corporate Finance & Planning from February 2001 to September 2006. Mr. Chadwick currently serves on the board of F5 Networks, Inc., an application delivery networking company.

Rangarajan (Raghu) Raghuram has served as VMware's Executive Vice President of Cloud Infrastructure and Management since April 2012. Mr. Raghuram joined VMware in 2003 and has held multiple product management and marketing roles. Mr. Raghuram served as Senior Vice President and General Manager, Cloud Infrastructure and Management, Virtualization and Cloud Platforms, and Enterprise Products, from December 2009 through March 2012. Mr. Raghuram previously served as Vice President of VMware's Server Business Unit and of Product and Solutions Marketing from September 2003 through December 2009. Prior to VMware, Mr. Raghuram held product management and marketing roles at Netscape and Bang Networks.

S. Dawn Smith has been the Senior Vice President, General Counsel and Secretary at VMware since September 2009 and Chief Compliance Officer since August 2010. Prior to joining VMware, she was a partner at Morrison & Foerster LLP, a law firm, since January 2008 and served as an attorney since 2005. Prior to joining Morrison & Foerster LLP, she was an attorney at Wilson Sonsini Goodrich & Rosati P.C.

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PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Market Information

Our Class A common stock, par value $0.01 per share, trades on the New York Stock Exchange under the symbol VMW.

The following table sets forth the range of high and low sales prices of our Class A common stock on the New York Stock Exchange for the past two years during the fiscal periods shown. Our Class B common stock is not publicly traded.

	Market Prices	
	High	Low
Year ended December 31, 2012		
First Quarter	$113.76	$80.16
Second Quarter	118.79	82.56
Third Quarter	103.02	79.46
Fourth Quarter	99.55	81.50
Year ended December 31, 2011		
First Quarter	$97.61	$74.04
Second Quarter	102.74	77.76
Third Quarter	111.43	76.70
Fourth Quarter	104.38	74.69

Holders

We had 58 holders of record of our Class A common stock, and one holder of record, EMC Corporation ("EMC"), of our Class B common stock as of February 13, 2013.

Dividends

Subsequent to our initial public offering in August 2007, we have not declared or paid cash dividends on our common stock. We currently do not anticipate declaring any cash dividends in the foreseeable future. Any future determination to declare cash dividends will be made at the discretion of our board of directors, subject to the consent of the holders of our Class B common stock pursuant to our certificate of incorporation. Holders of our Class A common stock and our Class B common stock will share equally on a per share basis in any dividend declared on our common stock by our board of directors.

Recent Sales of Unregistered Securities

None.

Issuer Purchases of Equity Securities

Issuer purchases of Class A common stock during the quarter ended December 31, 2012:

	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)
October 1 – October 31, 2012	1,346,894	$86.78	873,613	$301,179,455
November 1 – November 30, 2012	1,482,293	87.23	932,073	469,904,310
December 1 – December 31, 2012	886,210	92.92	21,950	467,942,904
	3,715,397	88.42	1,827,636	467,942,904

(1) Includes 1,887,761 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

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purchaser” with respect to the VMware stock repurchase program discussed in the following footnote. Shares purchased by EMC remain issued and outstanding.

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.

(2) 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.

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Stock Performance Graph

The graph below compares the cumulative total stockholder return on our Class A common stock with the cumulative total return on the S&P 500 Index and the S&P 500 Systems Software index for the period beginning on December 31, 2007 through December 31, 2012, assuming an initial investment of $100. Historically, we have not declared or paid cash dividends on our common stock, while the data for the S&P 500 Index and the S&P 500 Systems Software Index assume reinvestment of dividends.

	Base Period 12/31/2007	12/31/2008	12/31/2009	12/31/2010	12/31/2011	12/31/2012
VMware, Inc.	$100.00	$27.87	$49.86	$104.61	$97.88	$110.77
S&P 500 Index	100.00	63.00	79.67	91.68	93.61	108.59
S&P 500 Systems Software Index	100.00	62.46	94.36	98.89	89.05	102.61

Note: The stock price performance shown on the graph above is not necessarily indicative of future price performance. This graph shall not be deemed “filed” for purposes of Section 18 of the Exchange Act or otherwise subject to the liabilities of that section nor shall it be deemed incorporated by reference in any filing under the Securities Act or the Exchange Act, regardless of any general incorporation language in such filing.

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ITEM 6. SELECTED FINANCIAL DATA
FIVE-YEAR SELECTED CONSOLIDATED FINANCIAL DATA
(in thousands, except per share amounts)

	For the Year Ended December 31, 2012	2011	2010	2009	2008
Summary of Operations:					
Revenues:					
License	$2,086,990	$1,841,169	$1,401,424	$1,029,442	$1,178,142
Services	2,518,057	1,925,927	1,455,919	994,495	702,885
Total revenues	$4,605,047	$3,767,096	$2,857,343	$2,023,937	$1,881,027
Operating income	871,943	735,171	427,993	219,295	312,525
Net income	745,702	723,936	357,439	197,098	290,133
Net income per weighted average share, basic, for Class A and Class B	$1.75	$1.72	$0.87	$0.50	$0.75
Net income per weighted average share, diluted, for Class A and Class B	$1.72	$1.68	$0.84	$0.49	$0.73
Weighted average shares, basic, for Class A and Class B	426,658	421,188	409,805	394,269	385,068
Weighted average shares, diluted, for Class A and Class B	433,974	431,750	423,446	399,776	397,185

	December 31, 2012	2011	2010	2009	2008
Balance Sheet Data:					
Cash, cash equivalents and short-term investments(1)	$4,630,834	$4,512,206	$3,323,640	$2,513,821	$1,840,812
Working capital(1)	3,159,805	3,276,266	2,508,503	1,888,438	1,510,338
Total assets	10,596,392	8,680,808	6,797,319	5,066,984	3,839,205
Total unearned revenues	3,460,565	2,708,418	1,860,094	1,325,298	869,989
Long-term obligations	450,000	450,000	450,000	450,000	450,000
Stockholders' equity	5,739,981	4,770,282	3,808,443	2,742,951	2,070,067
Cash Flow Data:					
Net cash provided by operating activities	$1,897,524	$2,025,633	$1,174,389	$985,616	$800,131
Free cash flows(2)	1,663,066	1,795,542	1,042,694	882,241	608,535

(1) In 2012, VMware acquired all of the outstanding capital stock of Nicira, Inc. ("Nicira") for $1,099.6 million, net of cash acquired, consisting of $1,083.0 million in cash and $16.6 million for the fair value of assumed equity attributed to pre-combination services. See Note B to the consolidated financial statements for further information.

(2) In 2012, VMware changed its methodology for calculating free cash flows. Free cash flows, a non-GAAP financial measure, are now defined as net cash provided by operating activities less capital expenditures. The amounts presented in the table above have been recast to reflect the change in methodology. See Item 7 of Part II, "Management's Discussion and Analysis of Financial Condition and Results of Operations—Non-GAAP Financial Measures" for further information.

ITEM 7. 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, ensuring 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 also offer Cloud Application Platform solutions to help organizations build, run and manage enterprise applications in public, private or hybrid clouds optimized for vSphere. In December 2012, we launched the Pivotal Initiative with EMC Corporation ("EMC"), our majority stockholder, pursuant to which both companies plan to commit technology, people and programs. The Pivotal Initiative is focused on Big Data and Cloud Application Platforms. Big Data, which is a primary contributor to the pace of overall data growth, refers to the large repositories of corporate and external data, including unstructured information created by new applications, social media and other web repositories.

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 application platform products, our end-user computing products and our cloud infrastructure and management products. ELAs comprised between one-quarter and one-third of our overall sales during 2012 and 2011, with the balance represented by our non-ELA, or transactional business. 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 also focus our selling and marketing efforts to improve the growth rate of our transactional business.

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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 customer's 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.

We also announced a business plan to streamline our operations, subject to compliance with applicable legal obligations, to rationalize our portfolio and scale back investments in some areas of our business that we do not believe are directly related to our core growth opportunities. The plan includes the elimination of approximately 900 positions and personnel, which is expected to result in a charge in the range of $70 to $80. Any such proposals in countries outside the United States will be subject to a review of efficiency, resources and performance. Additionally, we are planning an exit of certain lines of business and consolidation of facilities, which are expected to result in a charge in the range of $20 to $30. 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 total charge resulting from this plan is expected to be between $90 and $110, with total cash expenditures associated with the plan expected to be in the range of $80 to $90. Despite these changes, we expect our total headcount to increase during 2013 by approximately 1,000 as we continue to make key investments in support of our long-term growth objectives. Our plan to exit certain lines of business resulted from an evaluation of our business in January 2013. At the end of 2012, we had performed an impairment test and determined that the assets associated with these certain lines of business were not impaired.

We continue to see substantial market opportunities in 2013 and beyond to deliver software innovations that bring agility, efficiency and choice to our customers, while simplifying the infrastructure and IT experience for them. However, we currently expect our rate of year-over-year growth in both total revenues and license revenues to decline during the first half of 2013 due to several factors, including a difficult macroeconomic environment, the lack of large deals that we anticipate will close in the first quarter of 2013 as compared to the first quarter of 2012 and our business plan to streamline our operations, which we expect to have a short-term negative impact on our revenues. We currently expect stronger growth in the second half of 2013 versus the first half of 2013 on a year-over-year comparison basis. During 2013, we expect to continue to manage our resources prudently, while making key investments in support of our long-term growth objectives.

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. See “Critical Accounting Policies” for further information regarding the accounting for our revenues.

Our current financial focus is on long-term revenue growth to generate free cash flows 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. See “Non-GAAP Financial Measures” for further information on free cash flows. In evaluating our results, we also focus on operating margin excluding certain expenses which are included in our total operating expenses calculated in accordance with GAAP. The expenses excluded are stock-based compensation, the net effect of the amortization and capitalization of software development costs and certain other expenses consisting of amortization of acquired intangible assets, employer payroll taxes on employee stock transactions and acquisition-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.

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Revenues

Our revenues in the years ended 2012, 2011 and 2010 were as follows:

	For the Year Ended December 31,			2012 vs. 2011		2011 vs. 2010	
	2012	2011	2010	$ Change	% Change	$ Change	% Change
Revenues:							
License	$2,087.0	$1,841.2	$1,401.4	$245.8	13 %	$439.8	31 %
Services:							
Software maintenance	2,153.0	1,640.4	1,217.0	512.6	31	423.4	35
Professional services	365.0	285.5	238.9	79.5	28	46.6	20
Total services	2,518.0	1,925.9	1,455.9	592.1	31	470.0	32
Total revenues	$4,605.0	$3,767.1	$2,857.3	$837.9	22	$909.8	32
Revenues:							
United States	$2,228.6	$1,824.2	$1,452.7	$404.4	22 %	$371.5	26 %
International	2,376.4	1,942.9	1,404.6	433.5	22	538.3	38
Total revenues	$4,605.0	$3,767.1	$2,857.3	$837.9	22	$909.8	32

In both 2012 and 2011, we saw growth in license and services revenues, and growth in the United States and internationally, as compared with their respective prior years.

License Revenues

License revenues in both 2012 and 2011 increased due to continued demand for our product offerings. The increases in license revenues year-over year were primarily due to growth in our Cloud Infrastructure and Management product group, which increased 13.4% in 2012 and 31.9% in 2011. The Cloud Infrastructure and Management product group is based upon our flagship virtualization platform, vSphere, and also encompasses our vCloud Suite and various Cloud Management solutions, which are optimized to work with vSphere environments. Despite the year-over-year increases in license revenues, we are noting a slowing in the rate of license revenue growth both in 2012 and anticipated into 2013. We attribute this to a variety of factors, including challenges in the macroeconomic environment, both across the U.S. and internationally in Europe, as well as a slowing in the number of ELAs greater than $10 that were closed towards the end of 2012 and are expected in the first half of 2013.

Services Revenues

In 2012 and 2011, software maintenance revenues benefited from strong renewals, multi-year software maintenance contracts sold in previous periods, and additional maintenance contracts sold in conjunction with new software license sales. In each year 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 2012 and 2011, professional services revenues increased as growth in our license sales and installed-base led to additional demand for our professional services. As we continue to invest in our partners and expand our ecosystem of third-party professionals with expertise in our solutions to independently provide professional services to our customers, we do not expect our professional services revenues to constitute an increasing component of our revenue mix. As a result of this strategy, our professional services revenue can vary based on the delivery channels used in any given period as well as the timing of engagements.

Revenue Growth in Constant Currency

We 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

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revenue in the current period against the exchange rates used to recognize revenue in the comparable period. In 2012, the year-over-year growth in license revenues measured on a constant currency basis was 15% compared with 13% as reported. In 2011, the year-over-year growth in license revenues measured on a constant currency basis was 30% compared with 31% 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 December 31, 2012 and December 31, 2011 were as follows:

	December 31,	
	2012	2011
Unearned license revenues	$462.7	$389.2
Unearned software maintenance revenues	2,755.0	2,133.5
Unearned professional services revenues	242.9	185.7
Total unearned revenues	$3,460.6	$2,708.4

The complexity of our unearned revenues has increased over time as a result of acquisitions, an expanded product portfolio and a broader range of pricing and packaging alternatives. As of December 31, 2012, total unearned revenues increased by 28% from December 31, 2011. This increase was primarily due to growth in unearned software maintenance revenues, attributable to our growing base of maintenance contracts. As of December 31, 2012, 87% of our total unearned revenues are expected to be recognized ratably.

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 as a strategy 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 December 31, 2012, 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 December 31, 2012 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.

Operating Expenses

Information about our operating expenses for the years ended 2012, 2011 and 2010 is as follows:

	For the Year Ended December 31, 2012				
	Core Operating Expenses (1)	Stock-Based Compensation	Capitalized Software Development Costs, net	Other Operating Expenses	Total Operating Expenses
Cost of license revenue	$92.7	$2.1	$70.6	$71.6	$237.0
Cost of services revenue	450.6	28.2	—	5.5	484.3
Research and development	778.8	210.4	—	10.0	999.2
Sales and marketing	1,477.9	149.9	—	17.0	1,644.8
General and administrative	314.1	48.1	—	5.6	367.8
Total operating expenses	$3,114.1	$438.7	$70.6	$109.7	$3,733.1
Operating income					$871.9

Operating margin	18.9	%

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	For the Year Ended December 31, 2011				
	Core Operating Items (1)	Stock-Based Compensation	Capitalized Software Development Costs, net	Other Operating Items	Total Operating Items
Cost of license revenue	$74.9	$1.6	$84.7	$46.2	$207.4
Cost of services revenue	384.9	23.4	—	6.3	414.6
Research and development	661.9	174.3	(74.0)	12.9	775.1
Sales and marketing	1,222.8	95.7	—	15.8	1,334.3
General and administrative	256.2	40.2	—	4.1	300.5
Total operating expenses	$2,600.7	$335.2	$10.7	$85.3	$3,031.9
Operating income					$735.2
Operating margin					19.5 %

	For the Year Ended December 31, 2010				
	Core Operating Expenses (1)	Stock-Based Compensation	Capitalized Software Development Costs, net	Other Operating Expenses	Total Operating Expenses
Cost of license revenue	$52.4	$1.7	$99.5	$23.9	$177.5
Cost of services revenue	292.3	18.5	—	5.5	316.3
Research and development	537.8	164.4	(60.7)	11.5	653.0
Sales and marketing	931.7	73.1	—	8.5	1,013.3
General and administrative	230.1	34.0	—	5.2	269.3
Total operating expenses	$2,044.3	$291.7	$38.8	$54.6	$2,429.4
Operating income					$428.0
Operating margin					15.0 %

(1) Core operating expenses is a non-GAAP financial measure that excludes stock-based compensation, the net effect of the amortization and capitalization of software development costs and certain other expenses from our total operating expenses calculated in accordance with GAAP. The other operating expenses excluded are amortization of acquired intangible assets, employer payroll taxes on employee stock transactions and acquisition-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 18.9% in 2012 from 19.5% in 2011. The decrease in our operating margin in 2012 compared with 2011 primarily related to the year-over-year decrease in capitalized software development costs, partially offset by the year-over-year increase in our revenues, which outpaced the increase in our core operating expenses. Our operating margin on total operating expenses increased to 19.5% in 2011 from 15.0% in 2010. The increase in our operating margin in 2011 compared with 2010 primarily related to the increase in our revenues, which outpaced the increases in our expenses.

Core Operating Expenses

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

Core operating expenses increased by $513.4 or 20% in 2012 compared with 2011 and increased by $556.4 or 27% in 2011 compared with 2010. As quantified below, these increases were primarily due to increases in employee-related expenses, which include salaries and benefits, bonuses, commissions, and recruiting and training, and which increased largely as a result of increases in headcount. Our headcount as of December 31, 2012 was approximately 13,800, compared with approximately 11,200 as of December 31, 2011 and compared with approximately 9,000 as of December 31, 2010. These increases in headcount were driven by strategic hiring, business growth and business acquisitions. A portion of our core operating expenses, primarily the cost of personnel to deliver technical support on our products and professional services, marketing, and research

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and development, are denominated in foreign currencies and are thus exposed to foreign exchange rate fluctuations. Core operating expenses benefited by $53.6 in 2012 and were negatively impacted by $48.2 in 2011 as compared with their respective prior years 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 increased by $17.8 or 24% in 2012 compared with 2011 and by $22.4 or 43% in 2011 compared with 2010. The increases were due to increases of $8.0 and $7.6 in 2012 and 2011, respectively, for IT development costs. Additionally, cost of license revenues increased by $4.8 and $11.3 in 2012 and 2011, respectively, primarily related to royalty and licensing costs for technology licensed from third-party providers that is used in our products.

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 $65.8 or 17% in 2012 compared with 2011, and by $92.5 or 32% in 2011 compared with 2010. The increase in 2012 was primarily due to growth in employee-related expenses and travel and entertainment expenses of $61.4, which was largely driven by incremental growth in headcount to support increased revenues. Additionally, our third-party professional services costs increased by $17.0 to provide technical support and professional services primarily in connection with increased demand for services. These increases in 2012 were partially offset by a decrease of $8.0 due to the completion of certain IT development projects and the positive impact of fluctuations in the exchange rate between the U.S. Dollar and foreign currencies of $9.1. The increase in 2011 was primarily due to growth in employee-related expenses of $48.3, which was largely driven by incremental growth in headcount, as well as an increase in expenses of $16.2 for IT development costs. Additionally, our third-party professional services costs increased by $13.1 to provide technical support and professional services primarily in connection with increased services revenues. Fluctuations in the exchange rate between the U.S. Dollar and foreign currencies also contributed $9.4 to the overall increase in costs of services 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 $116.9 or 18% in 2012 compared with 2011, and by $124.1 or 23% in 2011 compared with 2010. The increases were primarily due to growth in employee-related expenses of $105.5 and $95.0 in 2012 and 2011, respectively, which were primarily driven by incremental growth in headcount from strategic hiring and business acquisitions. In 2012 and 2011, facility-related expenses of $11.5 and $9.1, respectively, further contributed to the year-over-year increases. Additionally, the positive impact of $9.5 from fluctuations in the exchange rate between the U.S. Dollar and foreign currencies partially offset the increases in 2012.

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 $255.0 or 21% in 2012 compared with 2011, and by $291.2 or 31% in 2011 compared with 2010. The increase in 2012 was primarily due to growth in employee-related expenses of $213.8, driven by incremental growth in headcount and by higher commission expense due to increased sales volumes, as well as an increase of $50.0 in the costs of marketing programs. The increases in 2012 were partially offset by the positive impact of $28.9 from fluctuations in the exchange rate between the U.S. Dollar and foreign currencies. The increase in 2011 was primarily due to growth in employee-related expenses of $168.8, driven by incremental growth in headcount and by higher commission expense due to increased sales volumes. Additionally, the costs of marketing programs increased by $33.3 and travel and entertainment expense increased by $18.0 in support of our expanding markets and sales efforts. The negative impact of $30.5 from fluctuations in the exchange rate between the U.S. Dollar and foreign currencies further contributed to the increase.

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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 $57.9 or 23% in 2012 compared with 2011, and by $26.1 or 11% in 2011 compared with 2010. The increase in 2012 was primarily due to an increase of $24.3 related to employee-related expenses mostly due to incremental growth in headcount. General and administrative expenses also increased in 2012 due to an increase of $14.3 in corporate expenses, including contributions to our charitable foundation. Also contributing to the increase in expenses in 2012 were equipment and depreciation expenses of $11.6 to support increased headcount and IT security initiatives and increased contractor costs of $11.2 related to IT security initiatives. The increase in 2011 was primarily due to an increase of $27.5 related to employee-related expenses primarily due to incremental growth in headcount.

Stock-Based Compensation

Stock-based compensation in the years ended 2012, 2011 and 2010 was as follows:

	For the Year Ended December 31,		
	2012	2011	2010
Stock-based compensation, excluding amounts capitalized	$438.7	$335.2	$291.7
Stock-based compensation capitalized	—	12.4	10.9
Total stock-based compensation expense	$438.7	$347.6	$302.6

Total stock-based compensation was $438.7 in 2012, $347.6 in 2011, and $302.6 in 2010, representing year-over-year increases of $91.1 and $45.0, respectively. In 2011 and 2010, we capitalized $12.4 and $10.9, respectively, of stock-based compensation to our software development projects. No costs were capitalized in 2012 for software development projects. The increase in total stock-based compensation expenses in 2012 compared with 2011 was primarily due to an increase of $112.4 for new awards issued to our existing employees, as well as an increase of $38.8 for awards made to new employees joining VMware in 2012. Additionally, total stock-based compensation expense increased by $45.7 in 2012 in connection with our acquisition of Nicira in August 2012. Partially offsetting these increases was a decrease of $96.0 related to grants that became fully vested over the past year.

The increase in stock-based compensation expense in 2011 over 2010 was primarily due to an increase of $74.3 from new awards issued to our existing employees both in the second half of 2010 and the second quarter of 2011, as well as an increase of $32.9 for awards made to new employees joining VMware in 2011. These increases were partially offset by a decrease of $71.7 primarily related to fully vested grants.

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 December 31, 2012, the total unamortized fair value of our outstanding equity-based awards held by our employees was $945.4, and is expected to be recognized over a weighted-average period of approximately 1.6 years.

Capitalized Software Development Costs, Net

Development costs of software to be sold, leased, or otherwise marketed are subject to capitalization beginning when the product's technological feasibility has been established and ending when the product is available for general release. Judgment is required in determining when technological feasibility is established, and as our business, products and go-to-market strategy have evolved, we have continued to evaluate when technological feasibility is established. Following the release of vSphere 5 and the comprehensive suite of cloud infrastructure technologies in the third quarter of 2011, we determined that our go-to-market strategy had changed from single solutions to product suite solutions. As a result of this change in strategy, and the related increased importance of interoperability between our products, the length of time between achieving technological feasibility and general release to customers significantly decreased. We expect our products to be available for general release soon after technological feasibility has been established. Given that we expect the majority of our product offerings to be suites or to have key components that interoperate with our other product offerings, the costs incurred subsequent to achievement of technological feasibility are expected to be immaterial in future periods. In 2012 and the fourth quarter of 2011, all software development costs related to product offerings were expensed as incurred and were included in R&D expenses on the accompanying consolidated statements of income. In 2011 and 2010, we capitalized $86.4 (including $12.4 of stock-based

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compensation) and $71.6 (including $10.9 of stock-based compensation), respectively, of costs for the development of software products. Capitalized software development costs increased by $14.7 in 2011 compared with 2010 primarily due to an increase in costs associated with products that had reached technological feasibility, including vSphere 5. The change in our go-to-market strategy and resulting decrease in the length of time between technological feasibility of our products and the date those products are available for general release to customers did not materially impact the amount of software development costs we capitalized in 2011.

Future changes in our judgment as to when technological feasibility is established, or additional changes in our business, including our go-to-market strategy, could materially impact the amount of costs capitalized. For example, if the length of time between technological feasibility and general availability were to increase in the future, the amount of capitalized costs would likely increase. Additionally, a transition to offering software as a service instead of via a license may also result in an increased level of software capitalization.

In 2012, 2011 and 2010, amortization expense from capitalized software development costs was $70.6, $84.7 and $99.5, respectively. The decrease in amortization of software development costs in 2012 compared with 2011 and 2011 compared with 2010 was primarily due to both the timing of new product releases and the completion of amortization for other product releases, including different 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 decline as these costs are expected to be recorded as R&D expense as incurred given our current go-to-market strategy.

Other Operating Expenses

Other operating expenses consist of intangible amortization 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-related items, which are recorded in general and administrative expense on our income statement.

Other operating expenses in the years ended 2012, 2011 and 2010 were as follows:

	For the Year Ended December 31,		
	2012	2011	2010
Intangible amortization	$92.0	$64.6	$34.8
Employer payroll tax on employee stock transactions	13.9	18.4	16.3
Acquisition-related items	3.8	2.3	3.5
Total other operating expenses	$109.7	$85.3	$54.6

Other operating expenses increased $24.4 in 2012 from 2011 and $30.7 in 2011 from 2010. The increase in 2012 was primarily due to an increase in intangible amortization of $27.4 resulting from new acquisitions, which was primarily recorded to cost of license revenues on our accompanying consolidated statement of income. The increase was partially offset by a decrease of $4.5 in employer payroll taxes on employee stock transactions, which was attributable to a decrease in the number of awards exercised, sold or vested. The increase in other operating expenses in 2011 was primarily due to additional intangible amortization of $29.8 resulting from new acquisitions, of which $22.3 was recorded to costs of license revenues on our income statement.

Investment Income

Investment income increased by $10.4 to $26.6 in 2012 from $16.2 in 2011 and increased by $9.5 to $16.2 in 2011 from $6.6 in 2010. 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 both 2012 and 2011 as compared with their respective prior years, investment income increased due to increased balances invested in our fixed income portfolio and higher yields.

Other Income (Expense), Net

Other expense, net of $0.7 in 2012 changed by $47.7 compared with other income, net of $47.0 in 2011. Other income, net of $47.0 in 2011 changed by $61.2 from other expense, net of $14.2 in 2010. The changes in 2012 compared with 2011 and in 2011 compared with 2010 were primarily due to a $56.0 gain recognized on the sale of our investment in Terremark Worldwide, Inc. in 2011.

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Income Tax Provision

Our effective tax rate was 16.5%, 8.9%, and 14.2% for 2012, 2011, and 2010, respectively. The effective tax rate in 2012 was higher than 2011 primarily due to the federal research credit, which expired at the end of 2011 and was unavailable in 2012. The rate was also negatively impacted by a greater proportion of earnings in the U.S., which are taxed at a higher rate than our earnings in foreign jurisdictions. The effective tax rate in 2011 was lower than 2010 primarily due to a shift in the mix of income before tax from the U.S. to international jurisdictions with lower tax rates compared to the U.S. rate, partially offset by a relative reduction in the benefit from the federal research credit.

In January 2013, the United States Congress retroactively enacted an extension of the federal research credit through December 31, 2013. As a result, we expect that our income tax provision for the first quarter of 2013 will include an estimated discrete tax benefit of approximately $38 reflecting the full year 2012 federal research credit. This estimated amount will be finalized in 2013. Our 2013 annual estimated effective tax rate will also include the benefit expected for 2013 and accordingly, we expect our 2013 effective tax rate to be lower than the 2012 effective tax rate.

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%. 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. 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.

As of December 31, 2012, our total cash, cash equivalents, and short-term investments were $4,630.8 of which $2,996.7 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.

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 we would 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.

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

Our future effective tax rate may be affected by such factors as changes in tax laws, changes in our business, 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 December 31, 2012, EMC owned 41,050,000 shares of Class A common stock and all 300,000,000 shares of Class B common stock, representing 79.6% of our total outstanding shares of common stock and 97.2% 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 years ended December 31, 2012, 2011 and 2010, we recognized revenues of $160.2, $72.0 and $48.5, respectively, from such contractual arrangement with EMC. As of December 31, 2012 and 2011, $149.5 and $105.6, respectively, of revenues from products and services sold under the reseller arrangement were included in unearned revenues.

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In the years ended December 31, 2012, 2011 and 2010, we recognized professional services revenues of $97.7, $66.2 and $60.6, respectively, from such contractual agreements with EMC. As of December 31, 2012 and 2011, $2.9 and $5.1, respectively, of revenues from professional services to EMC customers were included in unearned revenues.
In the years ended December 31, 2012, 2011 and 2010, we recognized revenues of $9.1, $3.2 and $6.1, respectively, from products and services purchased by EMC for internal use pursuant to our contractual agreements with EMC. As of December 31, 2012 and 2011, $28.4 and $23.4, respectively, 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 $42.2, $24.3 and $18.4 in the years ended December 31, 2012, 2011 and 2010, respectively.
Pursuant to the tax sharing agreement, we have made payments to EMC and EMC has made payments to us. The following table summarizes these payments made between us and EMC during the years ended December 31, 2012, 2011 and 2010:

	For the Year Ended December 31,		
	2012	2011	2010
Payments from us to EMC	$—	$12.1	$5.1
Payments from EMC to us	19.3	314.5	2.5

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. 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 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 recorded as a decrease in stockholders' equity of $4.4. In 2011 and 2010, the difference between the amount of tax calculated on a stand-alone basis and the amount of tax calculated per the tax sharing agreement was recorded as an increase in stockholders' equity of $7.8 and $6.5, respectively.
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 $106.3, $82.6 and $66.4 in the years ended December 31, 2012, 2011 and 2010, respectively.
In the years ended December 31, 2012, 2011 and 2010, $4.7, $3.9 and $4.1, respectively, of interest expense was recorded related to the note payable to EMC and included in interest expense with EMC on our consolidated statements of income. Our interest expense as a separate, stand-alone company may be higher or lower than the amounts reflected in the consolidated financial statements.
In the second quarter of 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. EMC continues to be responsible to Mozy customers for Mozy products and services and continues 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, are reimbursed to us by EMC. On the consolidated statements of income, in the years ended December 31, 2012 and 2011, such amounts were $65.0 and $39.0, respectively. These amounts were recorded as a reduction to the costs we incurred. As of December 31, 2012, the operational support agreement between us and EMC was amended such that we will no longer operate the Mozy service on behalf of EMC. Under the amendment, we will transfer substantially all

employees that support Mozy services to EMC and EMC will purchase certain assets from us in relation to transferred employees. The termination of service and related transfer of employees and sale of assets is anticipated to be substantially completed during the first quarter of 2013.

In 2010, we acquired certain software product technology and expertise from EMC's Ionix IT management business for cash consideration of $175.0. EMC retained the Ionix brand and will continue to offer customers the products acquired by us, pursuant to an ongoing reseller agreement between EMC and us. During the years ended December 31, 2011 and 2010, $14.4 and $10.6, respectively, of contingent amounts were paid to EMC. These payments were recorded as equity transactions and

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were offsets to the initial capital contribution from EMC. As of December 31, 2011, all contingent payments under the agreement had been made.

From time to time, we and EMC enter into agreements to collaborate on technology projects. In the years ended December 31, 2012, 2011 and 2010, we received $6.5, $2.3 and $2.3, 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 us, Pat Gelsinger was the President and Chief Operating Officer of EMC Information Infrastructure Products. Paul Maritz remains a board member of VMware and took on the role of Chief Strategy Officer of EMC. 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 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 as an expense by EMC.

As of December 31, 2012, we had $67.9 net due from EMC, which consisted of $111.5 due from EMC, partially offset by $43.6 due to EMC. As of December 31, 2011, we had $73.8 net due from EMC, which consisted of $101.4 due from EMC, partially offset by $27.6 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 $31.9 and $3.3 as of December 31, 2012 and 2011, which were included in accrued expenses and other on our consolidated balance sheets. 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.

In December 2012, we launched the Pivotal Initiative with EMC, pursuant to which both companies plan to commit technology, people and programs.

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

Liquidity and Capital Resources

At December 31, 2012 and 2011, we held cash, cash equivalents, and short-term investments as follows:

	December 31,	
	2012	2011
Cash and cash equivalents	$1,609.3	$1,955.8
Short-term investments	3,021.5	2,556.5
Total cash, cash equivalents and short-term investments	$4,630.8	$4,512.3

As of December 31, 2012, we held a diversified portfolio of money market funds and fixed income securities totaling $4,194.3. 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 $40.6 of foreign government and agencies securities, $10.4 of which was deemed sovereign debt, at December 31, 2012. 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 December 31, 2012, our total cash, cash equivalents and short-term investments were $4,630.8, of which $2,996.7 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

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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 2012, 2011 and 2010 were as follows:

	For the Year Ended December 31,		
	2012	2011	2010
Net cash provided by (used in):			
Operating activities	$1,897.5	$2,025.6	$1,174.4
Investing activities	(2,034.6)	(1,611.0)	(2,261.9)
Financing activities	(209.3)	(87.9)	230.1
Net increase (decrease) in cash and cash equivalents	$(346.4)	$326.7	$(857.4)

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 and other adjustments.

Cash provided by operating activities decreased by $128.1 to $1,897.5 in the 2012 from $2,025.6 in 2011. The decrease was primarily driven by the timing of tax payments we received from EMC under the tax sharing agreement. Under the tax sharing agreement, EMC is obligated to pay us an amount equal to the tax benefit generated by us and we are obligated to pay EMC an amount equal to the tax expense generated by us that EMC may recognize in a given year on its consolidated tax return. In 2012, we received $19.3 from EMC under the tax sharing agreement, but in 2011 we benefited from the net receipt of $302.3, which included amounts primarily related to refunds received for both the 2011 and 2010 tax years. In future periods, we expect to be in a net payable position to EMC.

In 2012, cash provided by operating activities benefited from increases in cash collections driven by growth in sales to our customers and was negatively impacted by increases in our core operating expenses, primarily due to headcount. In 2012, increases in cash collections from customers outpaced the increases in our core operating expenses. Additionally, the excess tax benefit from stock-based compensation decreased by $86.4 in 2012, which positively impacted our cash provided by operating activities. This change was primarily due to changes in the market value of our stock and the number of equity awards exercised, sold or vested.

Cash provided by operating activities increased by $851.2 to $2,025.6 in 2011 from $1,174.4 in 2010. The increase in operating cash flows for 2011 was primarily the result of an increase in cash collections from customers driven by strong sales volumes. In addition, we benefited from the net receipt of $302.3 from EMC related to income taxes. During 2010, there were no significant amounts collected from or paid to EMC under the tax sharing agreement. The net receipt of $302.3 in 2011 primarily related to refunds received for both the 2011 and 2010 tax years. The increase in cash collections and the benefit from the collection of the income tax receivable was partially offset by increases in our core operating expenses, primarily related to incremental headcount from strategic hiring and business acquisitions.

In evaluating our liquidity internally, we focus on long-term, sustainable growth in free cash flows over trailing twelve months periods, which we consider to be a relevant measure of our long-term 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 for 2012, 2011 and 2010 were as follows:

	For the Year Ended December 31,		
	2012	2011	2010
Net cash provided by operating activities	$1,897.5	$2,025.6	$1,174.4
Capital expenditures	(234.5)	(230.1)	(131.7)
Free cash flows	$1,663.0	$1,795.5	$1,042.7

Free cash flows decreased by $132.5 or 7% to $1,663.0 for 2012 from $1,795.5 in 2011. The decrease was primarily due to a decrease of $283.0 for net amounts we received from EMC under the tax sharing agreement as described above. This decrease was partially offset by the net benefit received from increased sales and related cash collections that outpaced our growth in operating expenses. Free cash flows increased by $752.8 or 72% to $1,795.5 for 2011 from $1,042.7 in 2010. The

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increase was primarily due to increased sales and related cash collections that outpaced our growth in operating expenses. Additionally, we benefited from the net receipt of $302.3 from EMC under the tax sharing agreement in 2011.

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.

Total fixed income securities of $3,188.7, $2,667.9 and $2,101.9 were purchased in 2012, 2011 and 2010, 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 $2,782.3, $1,790.8 and $516.3 in 2012, 2011 and 2010, respectively, as a result of the sales and maturities of fixed income securities. Activity in the fixed income portfolio increased each year primarily from increased cash and cash equivalent and short-term investment balances available for investment, including a reallocation of funds from cash equivalents to fixed income securities.

We did not capitalize any development costs for software to be sold, leased, or otherwise marketed in 2012 as compared to $74.0 and $64.1 of costs capitalized in 2011 and 2010, respectively. Following the release of vSphere 5 and the comprehensive suite of cloud infrastructure technologies in the third quarter of 2011, we determined that our go-to-market strategy had changed from single solutions to product suite solutions. As a result of this change in strategy, and the related increased importance of interoperability between our products, the length of time between achieving technological feasibility and general release to customers significantly decreased.

In 2012, 2011 and 2010, we paid $1,344.2, $303.6 and $293.0, respectively, for business acquisitions. The increase in 2012 is primarily related to the acquisition of Nicira which was completed in the third quarter of 2012 and included $1,083.0 of cash consideration. Refer to 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.

In 2011, we closed an agreement to purchase all of the right, title and interest in a ground lease covering the property and improvements located adjacent to our existing Palo Alto, California campus for $225.0. Based upon the respective fair values, $73.9 of the purchase price was included within additions to property and equipment, and the remaining $151.1 paid and attributed to the intangible assets was separately disclosed within net cash used in investing activities on the consolidated statement of cash flows. Refer to Note G to the consolidated financial statements for further information. Our renovation of the new property will be a multi-year project with capital investment extending into future periods.

In the second quarter of 2011, we sold our investment in Terremark Worldwide, Inc. for $76.0.

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 $253.2, $337.6 and $431.3 in 2012, 2011 and 2010, respectively.

In 2012, 2011 and 2010, as part of our share repurchase programs, we repurchased and retired shares of our Class A common stock as shown below (table in millions, except per share amounts):

	For the Years Ended December 31,		
	2012	2011	2010
Aggregate purchase price	$467.5	$526.2	$338.5
Class A common shares repurchased	5.1	6.0	4.9
Weighted-average price per share	$91.10	$88.37	$68.96

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 December 31, 2012, the authorized amount remaining available for repurchase was $467.9. This amount is authorized for repurchases through the end of 2014.

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There were additional cash outflows of $133.1, $123.8 and $86.2 in 2012, 2011 and 2010, respectively, to cover tax withholding obligations in conjunction with the net share settlement upon the vesting of restricted stock units and restricted stock. Additionally, the excess tax benefit from stock-based compensation was $138.1, $224.5 and $223.4 in 2012, 2011 and 2010, respectively, and is shown as a reduction to cash flows from operating activities and an increase to cash flows from financing activities. The year-over-year changes in the repurchase of shares to cover tax withholding obligations and the excess tax benefit from stock-based compensation in 2012 and 2011 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.

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

Note Payable to EMC

As of December 31, 2012, $450.0 remained outstanding on a note payable to EMC, with interest payable quarterly in arrears. In June 2011, we and EMC amended and restated the note to extend the maturity date of the note to April 16, 2015 and to modify the principal amount of the note to reflect the outstanding balance of $450.0. The interest rate continues to reset quarterly and bears an interest rate of the 90-day LIBOR plus 55 basis points.

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 and capitalization of software development costs. 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 during 2012. 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. For additional information, see “Results of Operations - Capitalized Software Development Costs, Net” above.

- Other expenses. Other expenses excluded are amortization of acquired intangible assets, employer payroll taxes on employee stock transactions and other acquisition-related items. Regarding the 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. 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. Additionally, the amount of an acquisition's purchase price allocated to intangible assets and the term of its related amortization can vary significantly and are unique to each acquisition. Acquisition-related items include direct costs of acquisitions, such as transaction fees, which vary significantly and are unique to each acquisition. We also do not acquire businesses on a predictable cycle.

Free cash flows

In evaluating our liquidity internally, we focus on long-term, sustainable growth in free cash flows over trailing twelve month periods, which we consider to be a relevant measure of our long-term 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 years ended December 31, 2012, 2011, and 2010.

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 years ended December 31, 2012, 2011 and 2010.

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

Guarantees and Indemnification Obligations

We enter into agreements in the ordinary course of business with, among others, customers, distributors, resellers, system vendors and systems integrators. Most of these agreements require us to indemnify the other party against third-party claims alleging that one of our products infringes or misappropriates a patent, copyright, trademark, trade secret or other intellectual property right. Certain of these agreements require us to indemnify the other party against certain claims relating to property damage, personal injury, or the acts or omissions by us and our employees, agents or representatives.

We have agreements with certain vendors, financial institutions, lessors and service providers pursuant to which we have agreed to indemnify the other party for specified matters, such as acts and omissions by us and our employees, agents, or representatives.

We have procurement or license agreements with respect to technology that we have obtained the right to use in our products and agreements. Under some of these agreements, we have agreed to indemnify the supplier for certain claims that may be brought against such party with respect to our acts or omissions relating to the supplied products or technologies.

We have agreed to indemnify our directors and executive officers, to the extent legally permissible, against all liabilities reasonably incurred in connection with any action in which such individual may be involved by reason of such individual being

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or having been a director or officer. Our by-laws and charter also provide for indemnification of our directors and officers to the extent legally permissible, against all liabilities reasonably incurred in connection with any action in which such individual may be involved by reason of such individual being or having been a director or executive officer. We also indemnify certain employees who provide service with respect to employee benefits plans, including the members of the Administrative Committee of the VMware 401(k) Plan, and employees who serve as directors or officers of our subsidiaries.

In connection with certain acquisitions, we have agreed to indemnify the former directors and officers of the acquired company in accordance with the acquired company's by-laws and charter in effect immediately prior to the acquisition or in accordance with indemnification or similar agreements entered into by the acquired company and such persons. We typically purchase a "tail" directors' and officers' insurance policy, which should enable us to recover a portion of any future indemnification obligations related to the former officers and directors of an acquired company.

It is not possible to determine the maximum potential amount under these indemnification agreements due to our limited history with prior indemnification claims and the unique facts and circumstances involved in each particular agreement. Historically, payments made by us under these agreements have not had a material effect on our consolidated financial position, results of operations or cash flows.

Contractual Obligations

We have various contractual obligations impacting our liquidity. The following represents our contractual obligations as of December 31, 2012:

	Payments Due by Period				
	Total	Less than 1 year	1-3 years	3-5 years	More than 5 years
Note payable to EMC[1]	$450.0	$—	$450.0	$—	$—
Operating leases[2]	757.1	54.6	90.0	65.3	547.2
Other agreements[3]	67.1	17.7	25.6	7.1	16.7
Sub-Total	1,274.2	72.3	565.6	72.4	563.9
Uncertain tax positions[4]	156.0				
Total	$1,430.2				

(1) The note is due and payable in full on April 16, 2015; however, we can pay down the note at an earlier date in full or in part at our election.

(2) Our operating leases are primarily for office space and land around the world.

(3) Consisting of various contractual agreements, which include commitments on the lease for our Washington data center facility.

(4) As of December 31, 2012, we had $156.0 of non-current net unrecognized tax benefits. We are not able to provide a reasonably reliable estimate of the timing of future payments relating to these obligations.

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 below may involve a higher degree of judgment and complexity in their application than our other significant accounting policies and represent the critical accounting policies used in the preparation of our financial statements. If different assumptions or conditions were to prevail, the results could be materially different from our reported results. Our significant accounting policies are presented within Note A, "Overview and Basis of Presentation," to our consolidated financial statements appearing in this Annual Report on Form 10-K.

Revenue Recognition

We derive revenues from the licensing of software and related services. We recognize revenues when persuasive evidence of an arrangement exists, delivery has occurred, the sales price is fixed or determinable, and collectibility is probable. Determining whether and when some of these criteria have been satisfied often involves assumptions and judgments that can have a significant impact on the timing and amount of revenue we report.

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We recognize license revenues from the sale of software licenses when risk of loss transfers, which is generally upon electronic shipment. We primarily license our software under perpetual licenses through our channel of distributors, resellers, system vendors, systems integrators and our direct sales force. To the extent we offer product promotions and the promotional products are not yet available and VSOE of fair value cannot be established, the revenue for the entire order is deferred until such time as all product obligations have been fulfilled. We defer revenues relating to products that have shipped into our channel until our products are sold through to the next tier of the channel. We estimate and record reserves for products that are not sold through the channel based on historical trends and relevant current information. For software sold by system vendors that is bundled with their hardware, unless we have a separate license agreement which governs the transaction, revenue is recognized in arrears upon the receipt of binding royalty reports. The accuracy of our reserves depends on our ability to estimate the product sold through the channels and could have a significant impact on the timing and amount of revenue we report.

We offer rebates to certain channel partners, which are recognized as a reduction of revenue at the time the related product sale is recognized. When rebates are based on the set percentage of actual sales, we recognize the costs of the rebates as a reduction of revenue when the underlying revenue is recognized. In cases where rebates are earned if a cumulative level of sales is achieved, we recognize the cost of the rebates as a reduction of revenue proportionally for each sale that is required to achieve the target. The estimated reserves for channel rebates and sales incentives are based on channel partners' actual performance against the terms and conditions of the programs, historical trends and the value of the rebates. The accuracy of these reserves for these rebates and sales incentives depends on our ability to estimate these items and could have a significant impact on the timing and amount of revenue we report.

With limited exceptions, VMware's return policy does not allow product returns for a refund. Certain distributors and resellers may rotate stock when new versions of a product are released. We estimate future product returns at the time of sale. Our estimate is based on historical return rates, levels of inventory held by distributors and resellers and other relevant factors. The accuracy of these reserves depends on our ability to estimate sales returns and stock rotation among other criteria. If we were to change any of these assumptions or judgments, it could cause a material increase or decrease in the amount of revenue that we report in a particular period. Returns have not been material to date and have been in line with our expectations.

Our services revenues consist of software maintenance, professional services and software as a service subscriptions. Software as a service subscriptions were not material in any period presented. We recognize software maintenance revenues ratably over the contract period. Typically, our software maintenance contract periods range from one to five years. Professional services include design, implementation and training. Professional services are not considered essential to the functionality of our products because services do not alter the product capabilities and may be performed by customers or other vendors. Professional services engagements performed for a fixed fee, for which we are able to make reasonably dependable estimates of progress toward completion are recognized on a proportional performance basis based on hours and direct expenses incurred. Professional services engagements that are on a time and materials basis are recognized based upon hours incurred. Revenues on all other professional services engagements are recognized upon completion. Software as a service revenues are recognized ratably over the subscription period. If we were to change any of these assumptions or judgments regarding our services revenues, it could cause a material increase or decrease in the amount of revenue that we report in a particular period.

Our software products are typically sold with software maintenance services. VSOE of fair value for software maintenance services is established by the rates charged in stand-alone sales of software maintenance contracts. Our software products may also be sold with professional services. VSOE of fair value for professional services is based upon the standard rates we charge for such services when sold separately. The revenues allocated to the software license included in multiple-element contracts represent the residual amount of the contract after the fair value of the other elements has been determined.

Our multiple element arrangements typically fall into one or more of the following categories:

- Arrangements including undelivered elements for which VSOE of fair value has been established. Revenue for those undelivered items is recognized ratably over the service period, or as the services are delivered. Revenue allocated to the delivered elements is recognized upfront;
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- Arrangements including specified product elements for which VSOE of fair value cannot be established. The entire arrangement fee is deferred until either VSOE of fair value is established or the specified products are delivered;
- Arrangements including undelivered elements without VSOE of fair value that are not essential to the functionality of the delivered products where all of the undelivered elements are delivered ratably over time. Revenue for the entire arrangement fee is recognized ratably, once the services have commenced, over the longest delivery period;
- Arrangements including undelivered elements without VSOE of fair value that are not essential to the functionality of the delivered products where one or more of the elements are not delivered ratably over time. The entire arrangement fee is deferred until VSOE of fair value is established or only elements that are delivered ratably over time remain. At

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such time, a pro-rated share of revenue is recognized immediately with any remaining fee recognized ratably over the longest remaining ratable delivery period.

Customers under software maintenance agreements are entitled to receive updates and upgrades on a when-and-if-available basis, as well as various types of technical support based on the level of support purchased. In the event specific features or functionalities, entitlements or the release number of an upgrade have been announced but not delivered, and customers will receive that upgrade as part of a current software maintenance contract, a specified upgrade is deemed created. As a result of the specified upgrade, product revenues are deferred on purchases made after the announcement date until delivery of the upgrade for those purchases that include the current version of the product subject to the announcement. The amount and elements to be deferred are dependent on whether the company has established VSOE of fair value for the upgrade. VSOE of fair value of these upgrades is established based upon the price set by management. We have a history of selling such upgrades on a stand-alone basis. We are required to exercise judgment in determining whether VSOE exists for each undelivered element based on whether our pricing for these elements is sufficiently consistent with the sale of these elements on a stand-alone basis. Our determination of VSOE is based on an analysis of the sales of our products, primarily maintenance and professional services on a stand-alone basis. However, judgment is required in assessing whether fluctuations in sales prices represent anomalies or whether the product pricing is changing on a more consistent basis. This determination could cause a material increase or decrease in the amount of revenue that we report in a particular period.

For multiple-element arrangements that contain software and non-software elements such as our software as a service subscription offerings, we allocate revenue to software or software-related elements as a group and any non-software elements separately based on the selling price hierarchy. We determine the relative selling price for each deliverable using VSOE of selling price, if it exists, or third-party evidence (“TPE”) of selling price. If neither VSOE nor TPE of selling price exist for a deliverable, we use our best estimate of selling price (“BESP”) for that deliverable. Once revenue is allocated to software or software-related elements as a group, it follows historic software accounting guidance. Revenue is then recognized when the basic revenue recognition criteria are met for each element.

The objective of BESP is to determine the price at which we would transact a sale if the product or service were sold on a stand-alone basis. We determine BESP by considering our overall pricing objectives and market conditions. At this time, we use BESP to determine the relative selling price of our license elements and software as a service elements based upon rates charged in both multi-element and stand-alone arrangements. If we modify our pricing practices in the future, this could result in changes in relative selling prices. Additionally, as our go-to-market strategies evolve, we may modify our pricing practices in the future, which could result in changes in relative selling prices, including both VSOE and BESP.

Asset Valuation

Asset valuation includes assessing the recorded value of certain assets, including accounts receivable, other intangible assets and goodwill. We use a variety of factors to assess valuation, depending upon the asset. Accounts receivable are evaluated based upon the creditworthiness of our customers, historical experience, the age of the receivable and current market and economic conditions. Should current market and economic conditions deteriorate, our actual bad debt expense could exceed our estimate. Whenever indicators of potential impairment are present, our analysis of potential impairment involves judgment in grouping our intangible assets based on the expected period during which the assets will be utilized, forecasted cash flows, changes in technology and customer demand. Changes in judgments on any of these factors could materially impact the value of the asset. As we operate our business in one operating segment and one reporting unit, our goodwill is assessed at the consolidated level for impairment in the fourth quarter of each year or more frequently if events or changes in circumstances indicate that the asset might be impaired. The assessment is performed by comparing the market value of our reporting unit to its carrying value.

Accounting for Income Taxes

In calculating our income tax expense, management judgment is necessary to make certain estimates and judgments for financial statement purposes that affect the recognition of tax assets and liabilities.

In order for us to realize our deferred tax assets, we must be able to generate sufficient taxable income in those jurisdictions where the deferred tax assets are located. We record a valuation allowance to reduce our deferred tax assets to the amount that is more likely than not to be realized. We consider future market growth, forecasted earnings, future taxable income, and prudent and feasible tax planning strategies in determining the need for a valuation allowance. In the event we were to determine that we would not be able to realize all or part of our net deferred tax assets in the future, an adjustment to the deferred tax assets would be charged to earnings in the period in which we make such determination. Likewise, if we later determine that it is more likely than not that the net deferred tax assets would be realized, we would reverse the applicable portion of the previously provided valuation allowance.

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We calculate our current and deferred tax provision based on estimates and assumptions that could differ from the actual results reflected in income tax returns filed during the subsequent year. Adjustments based on filed returns are generally recorded in the period when the tax returns are filed.

The amount of income tax we pay is subject to audits by federal, state and foreign tax authorities, which may result in proposed assessments. Our estimate of the potential outcome for any uncertain tax issue is highly judgmental. We believe that we have adequately provided for any reasonably foreseeable outcome related to these matters. However, our future results may include favorable or unfavorable adjustments to our estimated tax liabilities in the period the assessments are made or resolved, audits are closed or when statutes of limitation on potential assessments expire. Additionally, the jurisdictions in which our earnings or deductions are realized may differ from our current estimates. As a result, our effective tax rate may fluctuate significantly on a quarterly basis.

We do not provide for a U.S. income tax liability on undistributed earnings of our foreign subsidiaries. The earnings of non-U.S. subsidiaries, which reflect full provision for non-U.S. income taxes, are indefinitely reinvested in non-U.S. operations or will be remitted substantially free of additional tax. If these overseas funds are needed for our operations in the U.S., we would be required to accrue and pay U.S. taxes on related undistributed earnings to repatriate these funds. However, our intent is to indefinitely reinvest our non-U.S. earnings in our foreign operations and our current plans do not demonstrate a need to repatriate them to fund our U.S. operations. We will meet our U.S. liquidity needs through ongoing cash flows generated from our U.S. operations, external borrowings, or both. We utilize a variety of tax planning strategies in an effort to ensure that our worldwide cash is available in locations in which it is needed.

Income taxes are calculated on a separate tax return basis, although we are included in the consolidated tax return of EMC. The difference between the income taxes payable that is calculated on a separate return basis and the amount actually paid to EMC pursuant to our tax sharing agreement with EMC is presented as a component of additional paid-in capital.

Capitalized Software Development Costs

Development costs of software to be sold, leased, or otherwise marketed are subject to capitalization beginning when the product's technological feasibility has been established and ending when the product is available for general release. Judgment is required in determining when technological feasibility is established and as our business, products and go-to-market strategy have evolved, we have continued to evaluate when technological feasibility is established. Following the release of vSphere 5 and the comprehensive suite of cloud infrastructure technologies in the third quarter of 2011, we determined that VMware's go-to-market strategy had changed from single solutions to product suite solutions. As a result of this, and the related increased importance of interoperability between our products, the length of time between achieving technological feasibility and general release to customers significantly decreased. For future releases, we expect our products to be available for general release soon after technological feasibility has been established. Given that we expect the majority of our product offerings to be suites or to have key components that interoperate with our other product offerings, the costs incurred subsequent to achievement of technological feasibility are expected to be immaterial in future periods. In 2012, all software development costs were expensed as incurred.

Our R&D expenses and amounts that we have capitalized as software development costs may not be comparable to our peer companies due to differences in judgment as to when technological feasibility has been reached or differences in judgment regarding when the product is available for general release. Additionally, future changes in our judgment as to when technological feasibility is established, or additional changes in our business, including our go-to-market strategy, could materially impact the amount of costs capitalized. For example, if the length of time between technological feasibility and general availability was to increase again in the future, the amount of capitalized costs would likely increase. Additionally, a transition to offering software as a service instead of via a license may also result in an increased level of software capitalization.

Generally accepted accounting principles require annual amortization expense of capitalized software development costs to be the greater of the amounts computed using the ratio of current gross revenue to a product’s total current and anticipated revenues, or the straight-line method over the product’s remaining estimated economic life. To date, we have amortized these costs using the straight-line method as it is the greater of the two amounts. The costs are amortized over 18 to 24 months, which represent the product's estimated economic life. The ongoing assessment of the recoverability of these costs requires considerable judgment by management with respect to certain external factors such as anticipated future revenue, estimated economic life, and changes in software and hardware technologies. Material differences in amortization amounts could occur as a result of changes in the periods over which we actually generate revenues or the amounts of revenues generated.

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ITEM 7A. 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 51.6%, 51.6% and 49.2% in 2012, 2011 and 2010, 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 $27.6 million in 2012 and benefited by $24.7 million in 2011 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. Given that we began to invoice and collect in currencies other than the U.S. Dollar during the second quarter of 2009, we are not able to calculate a full year-over-year impact of foreign currency fluctuations on our revenues for 2010. Additionally, core operating expenses benefited by $53.6 million in 2012 and were negatively impacted by $48.2 million and $4.1 million in 2011 and 2010, respectively, 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 entered into foreign currency forward contracts starting in the fourth quarter of 2011. We typically enter into cash flow hedges semi-annually with maturities of six months or less. As of December 31, 2012 and 2011, we had foreign currency forward contracts to purchase approximately $9.3 million and $47.1 million, respectively, in foreign currency. The fair value of these forward contracts was immaterial as of December 31, 2012 and 2011.

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 December 31, 2012 and 2011, we had outstanding forward contracts with a total notional value of $439.8 million and $324.1 million, respectively. The fair value of these forward contracts was immaterial as of December 31, 2012 and 2011.

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 $40.8 million in fair value of our foreign currency forward contracts used in both the cash flow hedging and balance sheet hedging activities as of December 31, 2012. 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 F 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 December 31, 2012 by $21.5 million and $42.9 million, respectively. This sensitivity analysis assumes a parallel shift of all interest rates; however, interest rates do not always move in such a manner and actual results may differ materially. We monitor our interest rate and credit risk, including our credit exposures to specific rating categories and to individual issuers. There were no impairment charges on our cash equivalents and fixed income securities during 2012. These instruments are not leveraged and we do not enter into speculative securities for trading purposes. See Notes D and E to the consolidated financial statements for further information.

Note Payable to EMC

As of December 31, 2012, $450.0 million was outstanding on our consolidated balance sheet for the note payable to EMC. The interest rate on the note payable was 0.91% as of December 31, 2012, 0.92% as of December 31, 2011 and 0.84% as of December 31, 2010. In 2012, 2011 and 2010, $4.7 million, $3.9 million and $4.1 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 December 31, 2012 rate, and assuming no additional repayments on the principal were made, our annual interest expense would change by $4.5 million.

Equity Price Risk

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

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

VMware, Inc.
INDEX TO CONSOLIDATED FINANCIAL STATEMENTS AND SCHEDULE

Note: All other financial statement schedules are omitted because they are not applicable or the required information is included in the consolidated financial statements or notes thereto.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Stockholders and Board of Directors of VMware, Inc.:

In our opinion, the consolidated financial statements listed in the accompanying index present fairly, in all material respects, the financial position of VMware, Inc. and its subsidiaries at December 31, 2012 and 2011, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2012 in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedule listed in the accompanying index presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2012, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for these financial statements and financial statement schedule, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in Management's Report on Internal Control over Financial Reporting appearing under Item 9A. Our responsibility is to express opinions on these financial statements, on the financial statement schedule, and on the Company's internal control over financial reporting based on our integrated audits. We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed 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. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ PricewaterhouseCoopers LLP
San Jose, California
February 27, 2013

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

	For the Year Ended December 31,		
	2012	2011	2010
Revenues:			
License	$2,086,990	$1,841,169	$1,401,424
Services	2,518,057	1,925,927	1,455,919
Total revenues	4,605,047	3,767,096	2,857,343
Operating expenses (1):			
Cost of license revenues	237,027	207,398	177,458
Cost of services revenues	484,296	414,589	316,257
Research and development	999,214	775,051	652,968
Sales and marketing	1,644,849	1,334,346	1,013,281
General and administrative	367,718	300,541	269,386
Operating income	871,943	735,171	427,993
Investment income	26,557	16,157	6,633
Interest expense with EMC	(4,654)	(3,906)	(4,069)
Other income (expense), net	(732)	46,991	(14,182)
Income before income taxes	893,114	794,413	416,375
Income tax provision	147,412	70,477	58,936
Net income	$745,702	$723,936	$357,439
Net income per weighted-average share, basic for Class A and Class B	$1.75	$1.72	$0.87
Net income per weighted-average share, diluted for Class A and Class B	$1.72	$1.68	$0.84
Weighted-average shares, basic for Class A and Class B	426,658	421,188	409,805
Weighted-average shares, diluted for Class A and Class B	433,974	431,750	423,446

(1) Includes stock-based compensation as follows:

Cost of license revenues	$2,072	$1,606	$1,653
Cost of services revenues	28,220	23,389	18,478
Research and development	210,377	174,264	164,435
Sales and marketing	149,879	95,688	73,146
General and administrative	48,107	40,206	33,979

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

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

	For the Year Ended December 31,		
	2012	2011	2010
Net income	$745,702	$723,936	$357,439
Other comprehensive income:			
Changes in market value of available-for-sale securities:			
Unrealized gains, net of taxes of $2,950, $944 and $9,239	4,811	1,540	15,341
Reclassification of gains realized during the period, net of taxes of $(232), $(12,220) and $(102)	(378)	(19,938)	(269)
Net change in market value of available-for-sale securities	4,433	(18,398)	15,072
Changes in market value of effective foreign currency forward exchange contracts:			
Unrealized gains (losses), net of taxes of $1, $(17) and $0	23	(61)	—
Reclassification of losses realized during the period, net of taxes of $17, $0 and $0	44	—	—
Net change in market value of effective foreign currency forward exchange contracts	67	(61)	—
Total other comprehensive income (loss)	4,500	(18,459)	15,072
Total comprehensive income, net of taxes	$750,202	$705,477	$372,511

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

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

	December 31, 2012	December 31, 2011
ASSETS		
Current assets:		
Cash and cash equivalents	$1,609,322	$1,955,756
Short-term investments	3,021,512	2,556,450
Accounts receivable, net of allowance for doubtful accounts of $4,267 and $3,794	1,150,906	882,857
Due from EMC, net	67,934	73,799
Deferred tax asset	179,430	128,471
Other current assets	90,935	80,439
Total current assets	6,120,039	5,677,772
Property and equipment, net	664,669	525,490
Other assets, net	128,701	154,236
Deferred tax asset	103,001	156,855
Intangible assets, net	731,852	407,375
Goodwill	2,848,130	1,759,080
Total assets	$10,596,392	$8,680,808
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$89,562	$49,747
Accrued expenses and other	674,746	587,650
Unearned revenues	2,195,926	1,764,109
Total current liabilities	2,960,234	2,401,506
Note payable to EMC	450,000	450,000
Unearned revenues	1,264,639	944,309
Other liabilities	181,538	114,711
Total liabilities	4,856,411	3,910,526
Commitments and contingencies (see Note L)		
Stockholders' equity:		
Class A common stock, par value $.01; authorized 2,500,000 shares; issued and outstanding 128,688 and 123,610 shares	1,287	1,236
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	3,431,710	3,212,264
Accumulated other comprehensive income	5,676	1,176
Retained earnings	2,298,308	1,552,606
Total stockholders' equity	5,739,981	4,770,282
Total liabilities and stockholders' equity	$10,596,392	$8,680,808

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

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

	For the Year Ended December 31,		
	2012	2011	2010
Operating activities:			
Net income	$745,702	$723,936	$357,439
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	354,868	315,871	260,551
Stock-based compensation, excluding amounts capitalized	425,995	335,153	291,691
Excess tax benefits from stock-based compensation	(138,139)	(224,503)	(223,457)
Gain on sale of Terremark investment	—	(56,000)	—
Other	2,355	21,420	13,083
Changes in assets and liabilities, net of acquisitions:			
Accounts receivable	(267,639)	(263,366)	(77,121)
Other assets	(112,266)	(75,879)	(79,431)
Due to/from EMC, net	5,865	(18,370)	(28,508)
Accounts payable	23,692	(16,513)	8,881
Accrued expenses	21,997	115,025	120,880
Income taxes receivable from EMC	19,488	269,258	2,508
Income taxes payable	138,508	79,183	89,439
Deferred income taxes, net	(74,060)	(19,663)	(56,948)
Unearned revenues	751,158	840,081	495,382
Net cash provided by operating activities	1,897,524	2,025,633	1,174,389
Investing activities:			
Additions to property and equipment	(234,458)	(230,091)	(131,695)
Purchase of leasehold interest (see Note G)	—	(151,083)	—
Capitalized software development costs	—	(73,998)	(64,149)
Purchases of available-for-sale securities	(3,188,684)	(2,667,888)	(2,101,907)
Sales of available-for-sale securities	1,880,545	816,351	389,251
Maturities of available-for-sale securities	901,743	974,413	127,054
Sale of strategic investments	—	78,513	2,648
Business acquisitions, net of cash acquired	(1,344,214)	(303,610)	(292,970)
Transfer of net assets under common control	—	(22,393)	(185,580)
Other investing	(49,552)	(31,187)	(4,594)
Net cash used in investing activities	(2,034,620)	(1,610,973)	(2,261,942)
Financing activities:			
Proceeds from issuance of common stock	253,159	337,618	431,306
Repurchase of common stock	(467,534)	(526,203)	(338,527)
Excess tax benefits from stock-based compensation	138,139	224,503	223,457
Shares repurchased for tax withholdings on vesting of restricted stock	(133,102)	(123,787)	(86,179)
Net cash provided by (used in) financing activities	(209,338)	(87,869)	230,057
Net increase (decrease) in cash and cash equivalents	(346,434)	326,791	(857,496)
Cash and cash equivalents at beginning of the period	1,955,756	1,628,965	2,486,461
Cash and cash equivalents at end of the period	$1,609,322	$1,955,756	$1,628,965
Supplemental disclosures of cash flow information:			
Cash paid for interest	$6,772	$5,806	$6,194
Cash paid (refunded) for taxes, net	55,766	(268,954)	23,428

Non-cash items:			
Changes in capital additions, accrued but not paid	$36,562	$11,736	$(1,338)
Changes in tax withholdings on vesting of restricted stock, accrued but not paid	2,346	(1,870)	—
Fair value of stock options assumed in acquisition	16,625	—	—

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

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VMware, Inc.
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(in thousands)

	Class A Common Stock		Class B Convertible Common Stock		Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income	Stockholders' Equity
	Shares	Par Value	Shares	Par Value				
Balance, January 1, 2010	102,785	$ 1,028	300,000	$ 3,000	$ 2,263,129	$ 471,231	$ 4,563	$ 2,742,951
Proceeds from issuance of common stock	17,084	171	—	—	432,074	—	—	432,245
Repurchase and retirement of common stock	(4,909)	(49)	—	—	(338,478)	—	—	(338,527)
Issuance of restricted stock, net of cancellations	2,998	30	—	—	(30)	—		