VMWARE, INC.
Form 10-K
March 01, 2010
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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, 2009

OR

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

For transition period from   to

Commission File Number 001-33622

VMWARE, INC.

(Exact name of registrant as specified in its charter)

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

(650) 427-5000

(Registrant s telephone number, including area code)

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 ¨   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. x

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

Large accelerated filer x   Accelerated filer ¨
Non-accelerated filer ¨   (Do not check if a smaller reporting company)   Smaller reporting company ¨
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).   Yes ¨   No x

At June 30, 2009, 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, 2009) was approximately $1,525,838,910. 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, 2009 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 18, 2010, the number of shares of common stock, par value $.01 per share, of the registrant outstanding was 405,960,429, of which 105,960,429 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 Shareholders to be held in 2010. 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, 2009.

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VMware, VMworld, VMware vSphere, VMware Fusion, VMmark, GSX Server, P2V, Multipleworlds, VMware vCloud, ESX, VMsafe, vMotion, Covalent, SpringSource, Hyperic and Hyperic HQ are registered trademarks or trademarks of VMware, Inc. in the United States and/or other jurisdictions. All other marks and names mentioned herein may be trademarks of their respective companies.

FACTORS THAT MAY AFFECT FUTURE RESULTS

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

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PART I

ITEM 1.   BUSINESS

VMware is the leading provider of virtualization solutions from the desktop to the data center and to the cloud. Our virtualization solutions represent a pioneering approach to computing that separates application software from the underlying hardware to achieve significant improvements in efficiency, availability, flexibility, and manageability. Our broad and proven suite of virtualization solutions addresses a range of complex information technology (IT) problems that include cost and operational inefficiencies, business continuity, software lifecycle management, and desktop management. The benefits to our customers include substantially lower IT costs, cost-effective high availability across a wide range of applications, and a more automated and resilient systems infrastructure capable of responding dynamically to variable business demands. Our customer base includes organizations of all sizes across numerous industries and includes 100% of the Fortune 100 and approximately 96% of the Fortune 1000. 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. In the eleven years since the introduction of our first virtualization platform, we have expanded our product offerings to address distributed and heterogeneous infrastructure challenges such as planned and unplanned downtime management, system recoverability and reliability, backup and recovery, resource provisioning and management, capacity and performance management, and security.

We work closely with more than 1,300 technology partners, including leading server, microprocessor, storage, networking and software 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 have further enhanced 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 large indirect sales channel that include distributors, resellers, x86 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 were incorporated as a Delaware corporation in 1998 and continued to operate in large measure as a stand-alone company following our acquisition by EMC Corporation (EMC) in 2004 and following our initial public offering of our Class A common stock in August 2007. EMC holds 81% of our outstanding common stock, including 27 million shares of our Class A common stock 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 2009 increased 8% to $2,023.9 million. This included license revenues of $1,029.4 million and services revenues of $994.5 million. In the years ended December 31, 2009, 2008 and 2007, nearly all of our license revenues were from our virtualization platforms (including data center and desktop solutions) with the balance from our other solutions (which is composed of Applications Middleware and Management). Of our total services revenues in 2009, 83% were software maintenance revenues and 17% were professional services revenues. For additional financial information on our business by product and geographic area, see Note M 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 78 offices worldwide.

We began shipping our first product in 1999, and today we offer multiple products from the desktop to the data center and to the cloud. Our business is organized around providing solutions for three major IT predicaments: reducing costs and increasing operational efficiency in data centers, providing easy access to cloud computing capacity and simplifying management and control of corporate client computing.

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Overview of Virtualization

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. Some of these challenges include a gross underutilization of hardware resources, 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.

Data Center Virtualization

Today, x86 hardware is becoming increasingly proficient with multi-core processors, growing memory capacity, and higher speed interconnects shipping in standard servers. Complexity of applications is on the rise with multi-element, mixed operating system (OS) applications becoming increasingly common, making it difficult to provide a uniform quality of service across all components. Virtualization is being overwhelmingly accepted as the standard way of computing in data centers for the most efficient utilization of hardware.

VMware s infrastructure virtualization platform not only decouples the entire software environment from its underlying hardware infrastructure, but also enables the aggregation of multiple servers, storage infrastructure, 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 addition, the VMware virtualization platform is able to deliver services to applications running inside virtual machines, in an OS and application agnostic manner. This increases operational efficiency, since these services are built-in and easily enabled, and also allows mixed-element, multi-OS applications to get standard service levels delivered by the infrastructure, broadening customer deployment choices.

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. Virtual machine standardization also allows 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 platform available across the public and private clouds, applications can be easily moved between the two based on economics and organizational need.

To best leverage this cloud computing infrastructure, virtualization management products help streamline IT processes and reduce operating costs by automating critical workflows in the data center. VMware products for application management enable organizations to accelerate application development, automate application lifecycle processes, and manage to application performance service levels. Infrastructure management products help companies automate business continuity processes, manage capacity more efficiently, and provide financial cost information for internal chargeback.

In 2008, we announced our VMware vCloud (vCloud) initiative which leverages our platform to allow enterprises with internal clouds to easily access external cloud capacity on-demand without the need to customize or change their applications. The objective of the vCloud initiative is to enable hosting and cloud computing vendors to deliver enterprise-class cloud computing by federating on demand compute capacity between virtual data centers and cloud service providers on a common VMware platform. The initiative is aimed at providing users choice in where they deploy applications by providing a common set of cloud computing services for businesses and service providers, with support for any application or OS and the ability to choose where applications live, on or off premise.

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Data Center Products and Technology

VMware vSphere is our flagship data center platform. Users can choose to deploy the VMware ESX or VMware ESXi hypervisor when they purchase VMware vSphere. A hypervisor is a layer of software that resides between the operating system and system hardware to enable virtualization. VMware ESX is the industry s most mature hypervisor. VMware ESXi is a compact, small disk footprint version of VMware ESX with the same functionality and performance. Other components of VMware vSphere include capabilities such as the following:

VMware VMotion and Storage VMotion, the live migration of actively running virtual machines across servers or storage locations without disruption or downtime.

VMware High Availability, cost-effective high availability for all applications against hardware and operating system failures.

VMware Fault Tolerance, zero downtime, zero data loss, and continuous availability for applications.

VMware Distributed Resource Scheduler, continuous monitoring of virtual machines that ensure optimal placement on hardware based on resource requirements and priorities.

VMware vNetwork Distributed Switch, centralized point of control for cluster level networking.

VMware vShield Zones, maintains trust and network segmentation of users and sensitive data.

Virtualization management is provided by the vCenter family of products, which simplify and automate management tasks. Key vCenter products include the following:

vCenter Server, the central management and control point for VMware Infrastructure environments.

vCenter Site Recovery Manager, one-button disaster recovery for virtualized environments.

vCenter Lifecycle Manager, an automated process for managing the lifecycle of virtual machines in the data center.

vCenter Lab Manager, an automated process for software development environments.

vCenter CapacityIQ, use data center or desktop capacity efficiently and cost-effectively.

vCenter AppSpeed, measure application performance against business service level agreements.

vCenter Chargeback, map IT costs to business units, cost centers, or external customers.

We also offer free data center products such as VMware Server and a free version of VMware ESXi that encourage the trial, usage, and adoption of VMware virtualization in data centers of all sizes. VMware Server is a virtualization platform that runs on top of an OS (a hosted product) available for trial and download by customers so they can test virtualization before they move to the bare-metal products.

Desktop Virtualization

Personal computing and personal computing devices are undergoing change as users increasingly use multiple devices including desktop personal computers, laptop computers, thin clients, and mobile internet devices to access data and applications. In addition, users are employing various desktop operating systems including Windows, Apple OS X, and Linux to access applications that may run locally on a computer, centrally on a server, or accessed through a web page. This heterogeneity is becoming increasingly common, making it difficult to manage and secure customers desktop environments.

VMware desktop virtualization technology decouples the entire desktop environment from its underlying device, enabling customers to create user-centric instead of device-centric desktop environments. There are two main approaches to desktop virtualization: Virtual Desktop Infrastructure (VDI), where the desktop virtual machine runs on a server and is accessed remotely using a display protocol, and client-hosted virtual desktops,

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where a desktop virtual machine runs locally on a computer and is able to use the local hardware and peripherals. We have products in both of these categories, as well as offerings that combine both approaches. VDI enables customers to provide central management and control over their desktop environments by moving the entire desktop environments off the end-point device and into a virtual machine running on a virtual infrastructure. This enables customers to quickly provision new desktop environments to local and remote users while enabling centralized security, updating, and control over these environments. VDI can also take advantage of the other tools and technologies that surround a virtual infrastructure, including high availability and disaster recovery.

Client-hosted desktop virtualization enables users to run one or more virtual machines on a single desktop or laptop computer. Technical professionals have been using our technology for testing and development because it allows them to run multiple operating systems on a single computer for securely testing new operating systems, patches, and applications. Client-hosted desktop virtualization also allows individual users to run applications that require a different operating system such as a Windows application on an Apple OS X. In addition, users can leverage desktop virtualization to run a virtual work desktop on an employee-owned home computer and use the isolation attribute of virtualization to create a secure barrier between the two environments.

In 2008, VMware announced its Desktop as a Managed Service initiative, which consists of both product and partnering efforts aimed at delivering universal clients, that is desktops that follow users to any end-point, that are secure, cost-effective, and easy for IT to manage. Our partnering efforts involve a network of hardware, systems, and software partners to deliver a complete universal client virtualization solution to customers.

Desktop Products and Technologies

Our desktop products leverage our virtualization technology to deliver desktop virtualization to both enterprise users and personal users.

VMware View is our enterprise desktop virtualization platform. VMware View incorporates and extends VMware vSphere into both a Virtual Desktop Infrastructure and a client-hosted virtualization solution that allows a desktop virtual machine to run centrally in the data center or locally. In November 2009, VMware introduced VMware View 4, the industry s first solution for delivering desktops as a managed service. Major components of VMware View include:

View Manager provides session management and security between a user connecting from a personal computer or a thin client to a virtual desktop running on VMware Infrastructure or to a terminal session running on Windows Terminal Services or to a physical PC.

View Composer provides desktop image provisioning, management, and storage reduction for desktop virtual machines running on VMware Infrastructure and managed by View Manager.

VMware ThinApp is an application virtualization solution that customers can purchase separately or with VMware View. Application virtualization packages individual applications into separate containers allowing quicker application delivery and reduced management costs.

VMware also sells a range of personal client-hosted desktop virtualization products including:

Workstation enables technical professionals to create multiple secure virtual sandboxes on a single computer for running and testing multiple operating systems and applications. In October 2009, VMware introduced VMware Workstation 7.

Fusion enables Apple users to seamlessly run Windows and Windows applications on an Intel processor-powered Apple OS X Macintosh computer. In October 2009, VMware also introduced VMware Fusion 3.

Other desktop products include VMware ACE, which provides a layer of management around client-hosted desktops, and VMware Player, a free client-hosted virtual desktop runtime that encourages trial of desktop virtualization.

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Applications Middleware and Management

VMware entered the Applications Middleware and Management market with the acquisition of SpringSource Global, Inc. (SpringSource) in the third quarter of 2009. SpringSource builds and supports solutions that help organizations build, run, and manage enterprise applications, particularly those written in the Java programming language. An application framework is a collection of software libraries that structures and simplifies the work of software developers building applications. SpringSource 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. SpringSource also offers a Java application server, tc Server, which is built around the open source Apache Tomcat project and offers integrated monitoring and management. Finally, SpringSource develops a monitoring solution for enterprise applications and infrastructure, Hyperic HQ. Both tc Server and Hyperic HQ combine open source and non-open source components. SpringSource revenues are generated from a combination of professional services, including training and consulting, and product subscriptions of primarily Hyperic HQ and tc Server solutions.

Support and Services

We believe that our strong services organization and frequent customer touch points help establish loyal customers who provide references and help promote our technology across various industries. We have implemented a broad services strategy that leverages the professional services organizations of our partners. We have also established our own services offerings to complement our partners services offerings and to ensure customer satisfaction, drive additional sales, and promote renewals and upgrades. Our services offerings include customized solutions and onsite support that enable us and our channel partners to provide a positive overall customer experience.

We have established our global customer support organization, VMware Global Support Services, to align with and support our expanding customer base.

VMware Global Support Services. We offer a suite of support packages backed by industry-leading expertise. We offer three support and subscription programs (Platinum, Gold, and Silver) on an annual or multi-year subscription basis, that include VMware support along with access to periodic updates, bug fixes, and enhancements to our products. Complementing our Platinum support and subscription program, we offer Business Critical Support which provides customers personalized technical support delivered by a designated team of experts familiar with a customer s specific system configuration, past support experience, and business needs. Of our customers who purchase support, the majority purchase Platinum support. We sell and market our support and service agreements through the same network of channel partners who also sell our products. We also have a renewal sales team and utilize a third party vendor to sell renewals directly to end user customers. In addition, the renewal sales team and the third party vendor assist and complement our channel partners efforts by providing quotation and sales support to our channel partners.

The core support and subscription offerings provide live phone support, and our customers have access to an online product knowledge database for help with troubleshooting and operational questions. Our support teams provide first response and manage the resolution of customer issues. In addition, we have authorized certain systems vendors and independent service providers to provide support for our products on our behalf.

We also offer a range of professional services under our VMware Professional Services offering, which includes the following:

VMware Consulting Services. VMware Certified Professionals (VCPs) provide on-site assistance throughout the virtualization adoption lifecycle to accelerate the implementation of our virtualization solutions. VCPs conduct initial assessments and upgrade workshops and prepare detailed implementation project plans. Once customers are ready for standardization across their enterprise,

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VCPs help integrate virtual infrastructure into enterprise systems and processes. VCPs include VMware employees, partners, and customers who have completed training and have successfully passed our VCP exam.

VMware Education Services. Our courses provide extensive hands-on labs, case study examples, and course materials. Customers work in teams of two on servers located offsite using a variety of remote access technologies.

VMware Technical Account Manager (TAM). TAM service provides our customers with a dedicated VMware expert, which enables customers to accelerate standardization of VMware products by assessing their unique environment, proactively recommending solutions, and identifying unforeseen circumstances that may cause delays in deployment.

Technology Alliances

Consistent with our partner-centric strategy, we have engaged a broad group of hardware and software 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 1,300 technology partners with whom we bring joint offerings to the marketplace. We classify our partners as follows:

Independent Hardware Vendors (IHVs). We have established strong 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 to enable them to deliver value-added products that integrate with our VMware vSphere and vCenter suite of products.

The VMware Technology Alliance Partner program facilitates joint solution creation and coordinated go-to-market activities with our partners. Nearly 1,000 of the most widely used applications from ISVs support the VMware vSphere platform. Each month, dozens of additional applications are added to the supported list. 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 Management program to allow middleware and application software to qualify for the VMware Ready logo. The VMware Ready Management program validates the integrations of partner solutions that simplify comprehensive management of VMware virtual datacenter operating system environments.

Our ISVs and other alliance partners, open source contributors, and other VMware community members have distributed more than 1,300 software applications as virtual appliances. In addition to developing open APIs, formats, and protocols at multiple levels in our products, we provide source code access to select partners in our Community Source program to facilitate joint development and partner differentiation. We provide access to our ESX source code to approximately 700 developers from more than 40 partners for joint development projects. We also work with our industry partners to promote and foster the adoption of industry standards.

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 3,300 server, storage, I/O, and thin- client devices from more than 150 companies that are VMware Ready. We have successfully tested more than 450 operating system versions for use with our solutions. We believe that the scale and scope of this effort is a significant competitive advantage.

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Research and Development

We have made, and expect to continue to make, significant investments in research and development (R&D). We have assembled a strong group of developers with system level, systems management, desktop, security, application development, and open source software expertise. We also have strong ties to leading academic institutions around the world, and we support academic programs that range from shared source code for research to sabbatical programs for visiting professors.

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. We currently participate in numerous standards groups, and VMware employees hold a variety of standards organization leadership positions, including the Distributed Management Task Force, the Standard Performance Evaluation Corporation, and the OSGi Alliance. We believe that the strength of our R&D organization is a competitive differentiator.

Our R&D expenses totaled $496.6 million, $429.2 million and $285.9 million in 2009, 2008 and 2007, respectively.

Sales and Marketing

We sell and market our products largely through a network of channel partners, which includes distributors, resellers, x86 system vendors, and systems integrators, with over 75% of our revenue in 2009 derived from this network. The remainder is primarily derived from direct sales.

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. The majority of these resellers are part of our VIP Partner Program, which offers these resellers sales and product training and pricing incentives and rebates and access to the worldwide network of VMware distributors and access to the VMware Partner Central Web portal.

We offer several levels of membership in our VIP reseller network 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 VIP network 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 direct sales force that complements our channel partners efforts. Our sales force works with our channel partners to introduce them to end user customer accounts and new sales opportunities. Our channel partners also introduce our sales force to their end user customers.

In addition, our channel partner network includes certain system 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, x86 system vendors, 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. Software maintenance is sold both directly to end user customers and via our network of channel partners and the majority of professional services are sold directly,

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with some professional services sold via our channel partners. 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.

The competitive landscape in which we operate includes not only other software virtualization vendors, but also traditional hardware solutions. 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. We believe the significant number of customers who also purchase our software services reflects a clear customer perception as to the value of our software services.

Our marketing efforts focus on communicating the benefits of our solutions and educating our customers, distributors, resellers, x86 system vendors, systems integrators, the media, and analysts about the advantages of our innovative virtualization technology.

We raise the awareness of our company, market our products, and generate sales leads through industry events, public relations efforts, marketing materials, free downloads, and our website. On average, our website receives approximately 1.2 million cumulative, unique visits to www.vmware.com each week, as measured by a third-party tracking system. We also have created an online community called VMware Technology Network (VMTN) that enables customers and partners to share and discuss sales and development resources, implementation best practices, and industry trends among other topics. Attendance at VMworld in the U.S. has grown from approximately 1,400 attendees in 2004 to nearly 13,000 attendees in 2009. We also offer management presentations, seminars, and webinars on our products and topics of virtualization. We believe a combination of these efforts 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. Additionally, 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.

Customers

Our customers include 100% of the Fortune 100 and approximately 96% of the Fortune 1000. Our customer deployments range in size from a single virtualized server for small businesses to up to thousands of virtual machines for our largest enterprise customers. In periodic third-party surveys commissioned by us, our customers indicate very high satisfaction rates with our products and many have indicated a strong preference for repeat purchases.

During 2009, two distributors, who purchase software licenses and software support from us for resale to end user customers directly or via resellers, each accounted for over 10% each of our worldwide revenues. Arrow Electronics, Inc. and Ingram Micro, Inc. accounted for 16% and 15%, respectively, of our worldwide revenues in 2009. 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 2009.

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Competition

The virtualization market is rapidly evolving, and as such, we experienced increased competition during 2009, and we expect competition to significantly intensify in the future. We compete with both large and small vendors in different segments of the virtualization market, and we expect that new entrants will continue to enter the market and develop technologies that, if commercialized, may compete with our products.

We believe that the key competitive factors in the virtualization market include:

the level of reliability and new functionality of product offerings;

the ability to provide full virtual infrastructure solutions;

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

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

pricing of products, individually and in bundles;

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

the ability to create and maintain partnering opportunities with hardware and infrastructure software vendors and development of robust indirect sales channels; and

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

Microsoft is the primary competitor for our data center virtualization solutions. In 2009, Microsoft released the second generation of its Hyper-V virtualization offering and continues to develop virtual management products. Microsoft also continues to articulate a cloud-based computing initiative. Microsoft s offerings are positioned to compete with our virtual infrastructure, virtualization management, and some of our free data center product offerings. Microsoft s cloud initiative may eventually compete with our cloud offerings and with cloud service providers who standardize on our solutions. We believe our approach to both server virtualization and cloud computing is differentiated from Microsoft s and our solutions deliver significant flexibility, functionality, reliability, and superior economic value to customers.

We also compete with Citrix for desktop virtualization 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 suite competes with products that provide high availability clustering, workload management, and resource management.

We also expect to compete with new entrants to the virtualization market, which may include parties currently selling our products and/or 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 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 a more comprehensive virtualization solution than they individually had offered. Some 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. A number of companies have recently announced initiatives in these areas.

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 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

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additional charge. Many of our current and future 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 leadership, large customer base, strong partner network, broad and innovative solutions suite, and platform-agnostic approach position us to compete effectively for the foreseeable future.

Intellectual Property

As of December 31, 2009, the United States Patent and Trademark Office has issued us 63 patents covering 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 2028. 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 been issued trademark registrations in the United States, the European Community and Japan covering the trademarks VMWARE for use in connection with computer software, clothing and reference materials, and VMWORLD for use in connection with educational seminars. VMWARE also is our registered trademark in Australia, Canada, China, India, Israel, the Republic of Korea, Mexico, Singapore and Taiwan. VMWARE FUSION is registered in Australia, Canada, China, the European Community, New Zealand, the Russian Federation, the Republic of Korea, the United States, Hong Kong and Japan. VMMARK is registered in the European Community, Israel, the Russian Federation and Japan. We also have trademark applications pending to register the VMMARK mark in the United States, China, and India. In addition, we have registered trademarks for GSX SERVER and P2V in the United States and for MULTIPLEWORLDS in Japan. VMWARE VSPHERE is registered in Austria, Australia and the European Community and pending to register in Canada, China, India, Japan and the United States. We also have trademark applications pending to register the VMWARE VCLOUD mark in the United States and European Community, a trademark registration for the mark ESX in the United States, a trademark registration for the mark VMSAFE in the United States, a trademark registration for the mark VMOTION in the United States and a trademark registration for the mark COVALENT in the United States.

Trademark registrations have been granted for the SPRINGSOURCE mark in Australia, the United States and the European Community and for the SPRINGSOURCE mark and logo in the United States and European Community. Trademark registrations have been granted for the HYPERIC mark and design in the European Community, Norway, Switzerland and the United States and for the HYPERIC HQ mark and design in the United States.

We also rely on intellectual property protections such as copyrights and trade secrets.

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, selling, or importing in the United States the inventions 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.

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Employees

As of December 31, 2009, we had approximately 7,100 employees in offices worldwide, including employees contracted through EMC as discussed below. 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 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 Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and amendments to reports filed pursuant to Sections 13(a) and 15(d) of the Securities Exchange Act of 1934, as amended (the Exchange Act), are made available free of charge on or through our website at www.vmware.com as soon as reasonably practicable after such reports are filed with, or furnished to, the Securities and Exchange Commission (the SEC). Copies of the (i) charters for our Audit Committee, Compensation and Corporate Governance Committee, and Mergers and Acquisitions Committee, (ii) our Business Conduct Guidelines (code of business conduct and ethics), and (iii) our Corporate Governance Guidelines are available on the Investor Relations page of our website at www.vmware.com. None of the information posted on or accessible through our website is incorporated by reference into this Annual Report.

ITEM 1A.   RISK FACTORS

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

Risks Related to Our Business

The virtualization products and services we sell are based on a technology with emerging applications and therefore the potential market for our products remains uncertain.

The virtualization products and services we develop and sell are based on a technology platform with established applications in virtualizing on-premises data centers and emerging applications for desktop interface and as a platform for cloud computing. Our success depends on organizations and customers perceiving technological and operational benefits and cost savings associated with the increasing adoption of virtual infrastructure solutions for on-premises data centers as well as for desktop interface and cloud computing. Although the use of virtualization technologies on servers and in on-premises data centers has gained acceptance on computer servers for enterprise-level applications, the extent of adoption of virtualization for desktop interface as a platform for cloud computing and by small and medium-size businesses remains uncertain. As the markets for our products mature and the scale of our business increases, the rate of growth in our product sales will likely be lower than those we have experienced in earlier periods. In addition, to the extent that rates of adoption of virtualization infrastructure solutions occur more slowly or less comprehensively than we expect, our revenue growth rates may slow materially or our revenue may decline substantially.

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

The market for our products is competitive and we expect competition to significantly intensify in the future. For example, Microsoft provides products that compete with some of our offerings, has released virtual infrastructure and virtual management products, and recently added higher-end features to those products. Microsoft has also announced a cloud-based computing initiative. Microsoft s offerings are positioned to

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compete with our virtual infrastructure and other virtualization product offerings. We also face competition from other companies and there have been a number of announcements of new product initiatives, alliances and consolidation efforts by our competitors. For example, Citrix Systems continues to enhance its server virtualization offerings and its virtual desktop offering and has also announced plans for a cloud computing offering. During 2009, Oracle completed its acquisition of Virtual Iron and in early 2010 completed its acquisition of Sun Microsystems which has its own hypervisor-based virtualization technology, Microsoft recently released the second version of its hypervisor-based server virtualization product and IBM, Google and Amazon have announced new cloud computing initiatives. Other companies have also indicated their intention to expand offerings of virtual management solutions.

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

the level of reliability and new functionality of product offerings;

the ability to provide full virtual infrastructure solutions;

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

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

pricing of products, individually and in bundles;

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

the ability to create and maintain partnering opportunities with hardware and infrastructure software vendors and development of robust indirect sales channels; and

the ability to attract and retain 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 products similar to features that presently differentiate our product offerings from theirs. Many of our current or potential competitors also have longer operating histories, greater name recognition, larger customer bases and significantly greater financial, technical, sales, marketing and other resources than we do. This competition could result in increased pricing pressure and sales and marketing expenses, thereby materially reducing our operating margins, and could harm our ability to increase, or cause us to lose, market share. Increased competition also may prevent us from entering into or renewing service contracts on terms similar to those that we currently offer and may cause the length of our sales cycle to increase. Some of our competitors and potential competitors supply a wide variety of products to, and have well-established relationships with, our current and prospective end users. Some of these competitors have in the past and may in the future take advantage of their existing relationships to engage in business practices that make our products less attractive to our end users. For example, Microsoft has implemented distribution arrangements with x86 system vendors and ISVs, related to certain of their operating systems that only permit the use of Microsoft s virtualization format and do not allow the use of our corresponding format. Microsoft has in the past also implemented pricing policies that require customers to pay additional license fees based on certain uses of virtualization technology and other competitors have limited or denied support for their applications running in VMware virtualization environments. These distribution and licensing restrictions, as well as other business practices that may be adopted in the future by our competitors, could materially impact our prospects regardless of the merits of our products. In addition, competitors with existing relationships with our current or prospective end users could in the future integrate competitive capabilities into their existing products and make them available without additional charge. For example, Oracle provides free server virtualization software intended to support Oracle and non-Oracle applications and Microsoft offers its own server virtualization software packaged with the 2008 release of its Windows server product. By engaging in such business practices, our

competitors can diminish competitive advantages we may possess by incentivizing end users to choose products that lack some of the technical advantages of our own offerings.

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

Ongoing uncertainty regarding the duration and extent of the recovery from the recent economic downturn and in global economic conditions generally 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 recovery from the recent economic downturn could adversely impact our business, financial condition and results of operations in a number of ways, including by lengthening sales cycles (for example, ELAs), lowering prices for our products and services, reducing unit sales, decreasing or reversing quarterly growth in our revenues, 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 recent global economic disruption also resulted in general and ongoing tightening in the credit markets, lower levels of liquidity and increases in the rates of default and bankruptcy, while the potential for extreme volatility in credit, equity and fixed income markets continues. 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 deferred 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.

Additionally, while we plan to continue making strategic investments in our business, many of our competitors have significantly greater financial, technical and other resources than us, and if the economic recovery is not durable, they may be better positioned to sustain investment in competitive technologies.

Industry alliances or consolidation may result in increased competition.

Some of our competitors have made acquisitions or entered into partnerships or other strategic relationships to offer a more comprehensive virtualization solution than they individually had offered. For example, in 2008, Red Hat acquired Qumranet, a developer of virtual infrastructure solutions, and Citrix and Intel announced a desktop virtualization collaboration. During 2009, Oracle completed its acquisition of Virtual Iron and Microsoft announced an additional expansion of its alliance with Citrix. Additionally, information technology companies are increasingly seeking to deliver top-to-bottom IT solutions to end users that combine enterprise-level hardware and software solutions to provide an alternative to our virtualization platform. For example, in early 2010, Oracle completed its acquisition of Sun Microsystems which is both a hardware vendor and has its own virtualization technology and Microsoft and Hewlett-Packard announced a collaboration based on Microsoft s cloud computing and virtualization platforms. 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. These pressures could result in a substantial loss of customers or a reduction in our revenues.

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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;