

VMWARE, INC.
Form 10-Q
May 06, 2010
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2010

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)

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Delaware
(State or other jurisdiction of
incorporation or organization)

3401 Hillview Avenue
Palo Alto, CA
(Address of principal executive offices)

94-3292913
(I.R.S. Employer
Identification Number)

94304
(Zip Code)

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

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

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

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

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

As of April 30, 2010, the number of shares of common stock, par value \$.01 per share, of the registrant outstanding was 408,276,782, of which 108,276,782 shares were Class A common stock and 300,000,000 were Class B common stock.

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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.	

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PART I
FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

VMware, Inc.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(unaudited)

	For the Three Months Ended March 31,	
	2010	2009
Cash flows from operating activities:		
Net income	\$ 78,421	\$ 69,935
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	53,788	41,383
Stock-based compensation, excluding amounts capitalized	63,697	49,815
Excess tax benefits from stock-based compensation	(23,918)	(230)
Other	1,417	493
Changes in assets and liabilities, net of acquisitions:		
Accounts receivable	185,231	74,161
Other assets	(845)	10,209
Due to/from EMC, net	25,776	(15,384)
Accounts payable	(2,647)	(19,457)
Accrued expenses	(51,202)	(12,428)
Income taxes payable	14,365	20,377
Deferred income taxes, net	(4,221)	(6,844)
Deferred revenue	15,090	47,209
Net cash provided by operating activities	354,952	259,239
Cash flows from investing activities:		
Additions to property and equipment	(31,112)	(35,825)
Capitalized software development costs	(21,861)	(29,935)
Purchase of investments		(745)
Business acquisitions, net of cash acquired	(106,550)	
Increase in restricted cash	(16,848)	
Net cash used in investing activities	(176,371)	(66,505)
Cash flows from financing activities:		
Proceeds from issuance of common stock	109,775	4,503
Repurchase of common stock	(31,348)	
Excess tax benefits from stock-based compensation	23,918	230
Shares repurchased for tax withholdings on vesting of restricted stock	(10,906)	(6,797)

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Net cash provided by (used in) financing activities	91,439	(2,064)
Net increase in cash and cash equivalents	270,020	190,670
Cash and cash equivalents at beginning of the period	2,486,461	1,840,812
Cash and cash equivalents at end of the period	\$ 2,756,481	\$ 2,031,482

Non-cash items:

Changes in capital additions, accrued but not paid	\$ (2,067)	\$ (9,957)
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The accompanying notes are an integral part of the consolidated financial statements.

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

	For the Three Months Ended March 31,	
	2010	2009
Revenues:		
License	\$ 312,177	\$ 257,003
Services	321,356	213,307
	633,533	470,310
Operating expenses (1):		
Cost of license revenues	40,121	20,359
Cost of services revenues	68,529	54,644
Research and development	138,112	105,401
Sales and marketing	216,829	154,144
General and administrative	67,756	48,859
Operating income	102,186	86,903
Investment income	685	3,062
Interest expense with EMC, net	(901)	(2,674)
Other expense, net	(4,331)	(1,824)
Income before income taxes	97,639	85,467
Income tax provision	19,218	15,532
Net income	\$ 78,421	\$ 69,935
Net income per weighted-average share, basic for Class A and Class B	\$ 0.19	\$ 0.18
Net income per weighted-average share, diluted for Class A and Class B	\$ 0.19	\$ 0.18
Weighted-average shares, basic for Class A and Class B	404,480	389,857
Weighted-average shares, diluted for Class A and Class B	416,853	391,111

(1) Includes stock-based compensation as follows:

Cost of license revenues	\$ 385	\$ 330
Cost of services revenues	4,157	3,475
Research and development	34,723	23,904
Sales and marketing	16,047	13,834
General and administrative	8,385	8,272

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

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

	March 31, 2010	December 31, 2009
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 2,756,481	\$ 2,486,461
Accounts receivable, less allowance for doubtful accounts	353,122	534,196
Due from EMC, net	626	26,402
Deferred tax asset, current portion	80,113	63,360
Income taxes receivable from EMC	2,967	2,967
Other current assets	87,316	69,094
Total current assets	3,280,625	3,182,480
Property and equipment, net	405,695	402,356
Capitalized software development costs, net and other	172,042	169,293
Deferred tax asset, net of current portion	103,756	102,529
Intangible assets, net	127,139	94,557
Goodwill	1,189,874	1,115,769
Total assets	\$ 5,279,131	\$ 5,066,984
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 46,113	\$ 50,566
Accrued expenses	272,466	324,061
Income taxes payable	1,831	10,462
Deferred revenue, current portion	934,099	908,953
Total current liabilities	1,254,509	1,294,042
Note payable to EMC	450,000	450,000
Deferred revenue, net of current portion	423,981	416,345
Deferred tax liability	62,036	60,300
Other liabilities	109,555	103,346
Total liabilities	2,300,081	2,324,033
Commitments and contingencies (see Note J)		
Stockholders' equity:		
Class A common stock, par value \$.01; authorized 2,500,000 shares; issued and outstanding 107,299 and 102,785 shares	1,073	1,028
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	2,538,538	2,339,079
Accumulated other comprehensive income	4,985	4,563
Retained earnings	431,454	395,281
Total stockholders' equity	2,979,050	2,742,951

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Total liabilities and stockholders' equity	\$ 5,279,131	\$ 5,066,984
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The accompanying notes are an integral part of the consolidated financial statements.

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VMWARE, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

A. Overview and Basis of Presentation

Company and Background

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

Accounting Principles

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

Unaudited Interim Financial Information

These accompanying unaudited consolidated financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (the "SEC") for interim financial reporting. In the opinion of management, these unaudited consolidated financial statements include all adjustments, consisting of normal recurring adjustments and accruals, for a fair statement of VMware's consolidated financial condition, results of operations and cash flows for the periods presented. Results of operations are not necessarily indicative of the results that may be expected for the full year 2010. Certain information and footnote disclosures typically included in annual consolidated financial statements have been condensed or omitted. Accordingly, these unaudited interim consolidated financial statements should be read in conjunction with the consolidated financial statements and related notes included in VMware's 2009 Annual Report on Form 10-K.

VMware historically has received, and continues to receive, certain administrative services from EMC Corporation ("EMC"), and VMware and EMC engage in certain intercompany transactions. Costs incurred by EMC for the direct benefit of VMware, such as rent, salaries and benefits, plus a mark-up intended to approximate third-party costs, are included in VMware's financial statements. Management believes the assumptions underlying the financial statements are reasonable. However, given that these intercompany transactions did not arise from transactions negotiated at arm's-length with an unrelated third party, the financial statements included herein may not necessarily reflect the results of operations, financial position, and cash flows had VMware engaged in such transactions with an unrelated third party during all periods presented. Accordingly, VMware's historical financial information is not necessarily indicative of what the Company's results of operations, financial position, or cash flows will be in the future if and when VMware contracts at arm's-length with independent third parties for services the Company has received and currently receives from EMC.

Principles of Consolidation

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

Use of Accounting Estimates

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

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VMWARE, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

(unaudited)

B. Significant Accounting Policies

Revenue Recognition

VMware derives revenues from the licensing of software and related services. VMware recognizes revenues when persuasive evidence of an arrangement exists, delivery has occurred, the sales price is fixed or determinable, and collectibility is probable.

The following summarizes the major terms of VMware's contractual relationships with customers and the manner in which VMware accounts for sales transactions.

License revenues

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

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

For all sales, VMware uses one of the following to constitute evidence of an arrangement:

a purchase order or equivalent;

a license agreement and a purchase order or equivalent;

a license agreement which includes language that the agreement also serves as the purchase order; or

a master agreement and a binding royalty report.

Sales through distributors and resellers are evidenced by a master distribution agreement, together with purchase orders or equivalent, on a transaction-by-transaction basis.

With the exception of one of VMware's desktop products, VMware's return policy does not allow end users to return products for a refund. Certain distributors and resellers may rotate stock when new versions of a product are released. VMware estimates future product returns at the time of sale. VMware's estimate is based on historical return rates, levels of inventory held by distributors and resellers, and other relevant factors. Returns have not been material to date and have been in line with the Company's expectations.

VMware offers rebates to certain channel partners. When rebates are based on a set percentage of actual sales, VMware recognizes the amount of the rebates as a reduction of revenues when the underlying revenue is recognized. When rebates are earned only if a cumulative level of sales

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is achieved, VMware recognizes the amount of the rebates as a reduction of revenues proportionally for each sale that is required to achieve the target.

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

Services revenues

Services revenues consist of software maintenance and professional services. VMware recognizes software maintenance revenues ratably over the contract period. Typically, our 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 VMware's products as these services do not alter the product capabilities and may be performed by customers or other vendors.