VMWARE, INC.
Form 10-Q
August 05, 2015
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
Form 10-Q
(Mark One)

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

For the quarterly period ended June 30, 2015
OR

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

For the 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	94304
(Address of principal executive offices)	(Zip Code)

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes 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 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

As of July 29, 2015, the number of shares of common stock, par value $0.01 per share, of the registrant outstanding was 422,071,688 of which 122,071,688 shares were Class A common stock and 300,000,000 were Class B common stock.

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PART I
FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS
VMware, Inc.
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(amounts in millions, except per share amounts, and shares in thousands)
(unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Revenues:				
License	$638	$614	$1,214	$1,175
Services	959	843	1,894	1,642
GSA settlement	(76)	—	(76)	—
Total revenues	1,521	1,457	3,032	2,817
Operating expenses (1):				
Cost of license revenues	46	46	96	96
Cost of services revenues	204	172	397	323
Research and development	322	317	627	610
Sales and marketing	565	544	1,100	1,018
General and administrative	180	179	367	330
Realignment charges	(2)	(1)	21	(1)
Operating income	206	200	424	441
Investment income	13	9	25	18
Interest expense with EMC	(7)	(7)	(13)	(12)
Other income, net	1	—	—	—
Income before income taxes	213	202	436	447
Income tax provision	41	35	68	81
Net income	$172	$167	$368	$366
Net income per weighted-average share, basic for Class A and Class B	$0.41	$0.39	$0.86	$0.85
Net income per weighted-average share, diluted for Class A and Class B	$0.40	$0.38	$0.86	$0.84
Weighted-average shares, basic for Class A and Class B	424,169	430,216	426,055	430,050
Weighted-average shares, diluted for Class A and Class B	426,797	434,199	428,772	434,218

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(1) Includes stock-based compensation as follows:				
Cost of license revenues	$—	$1	$1	$2
Cost of services revenues	10	11	22	20
Research and development	53	66	107	126
Sales and marketing	43	43	81	84
General and administrative	17	18	31	35

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

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Net income	$172	$167	$368	$366
Other comprehensive income (loss):				
Changes in market value of available-for-sale securities:				
Unrealized gains (losses), net of taxes of $(4), $2, $0 and $2	(5)	3	1	4
Changes in market value of effective foreign currency forward contracts:				
Unrealized gains (losses), net of taxes of $0 for all periods	5	—	(3)	—
Reclassification of (gains) realized during the period, net of taxes of $0 for all periods	(2)	—	—	—
Net change in market value of effective foreign currency forward contracts	3	—	(3)	—
Total other comprehensive income (loss)	(2)	3	(2)	4
Total comprehensive income, net of taxes	$170	$170	$366	$370

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

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

	June 30, 2015	December 31, 2014
ASSETS		
Current assets:		
Cash and cash equivalents	$1,791	$2,071
Short-term investments	5,205	5,004
Accounts receivable, net of allowance for doubtful accounts of $2 and $2	1,214	1,520
Due from related parties, net	—	49
Deferred tax assets	240	248
Other current assets	262	238
Total current assets	8,712	9,130
Property and equipment, net	1,112	1,035
Other assets	171	174
Deferred tax assets	195	165
Intangible assets, net	682	748
Goodwill	3,981	3,964
Total assets	$14,853	$15,216
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$163	$203
Accrued expenses and other	762	811
Due to related parties, net	8	—
Unearned revenues	3,022	2,982
Total current liabilities	3,955	3,996
Notes payable to EMC	1,500	1,500
Unearned revenues	1,791	1,851
Other liabilities	296	283
Total liabilities	7,542	7,630
Contingencies (refer to Note I)		
Stockholders' equity:		
Class A common stock, par value $.01; authorized 2,500,000 shares; issued and outstanding 122,920 and 129,359 shares	1	1
Class B convertible common stock, par value $.01; authorized 1,000,000 shares; issued and outstanding 300,000 shares	3	3
Additional paid-in capital	2,737	3,380
Accumulated other comprehensive loss	(3)	(1)
Retained earnings	4,566	4,198
Total VMware, Inc.'s stockholders' equity	7,304	7,581
Non-controlling interests	7	5
Total stockholders' equity	7,311	7,586
Total liabilities and stockholders' equity	$14,853	$15,216

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

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

	Six Months Ended June 30, 2015	2014
Operating activities:		
Net income	$368	$366
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	159	164
Stock-based compensation	242	267
Excess tax benefits from stock-based compensation	(26)	(26)
Deferred income taxes, net	(22)	(79)
Other	(1)	2
Changes in assets and liabilities, net of acquisitions:		
Accounts receivable	305	130
Other assets	(13)	(43)
Due to/from related parties, net	63	(33)
Accounts payable	(33)	(8)
Accrued expenses	27	56
Income taxes payable	(49)	112
Unearned revenues	(21)	251
Net cash provided by operating activities	999	1,159
Investing activities:		
Additions to property and equipment	(184)	(153)
Purchases of available-for-sale securities	(2,095)	(1,976)
Sales of available-for-sale securities	1,373	941
Maturities of available-for-sale securities	524	322
Purchases of strategic investments	(4)	(40)
Business acquisitions, net of cash acquired	(21)	(1,068)
Decrease (increase) in restricted cash	1	(76)
Other investing	2	(10)
Net cash used in investing activities	(404)	(2,060)
Financing activities:		
Proceeds from issuance of common stock	69	99
Proceeds from issuance of notes payable to EMC	—	1,050
Reduction in capital from EMC	—	(24)
Proceeds from non-controlling interests	4	—
Repurchase of common stock	(850)	(407)
Excess tax benefits from stock-based compensation	26	26
Shares repurchased for tax withholdings on vesting of restricted stock	(124)	(94)
Net cash provided by (used in) financing activities	(875)	650
Net decrease in cash and cash equivalents	(280)	(251)
Cash and cash equivalents at beginning of the period	2,071	2,305
Cash and cash equivalents at end of the period	$1,791	$2,054
Supplemental disclosures of cash flow information:		
Cash paid for interest	$14	$13
Cash paid for taxes, net	136	46

Non-cash items:		
Changes in capital additions, accrued but not paid	$(22)	$11
Fair value of stock-based awards assumed in acquisition	—	24

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

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

A. Overview and Basis of Presentation

Company and Background

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

Accounting Principles

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

Unaudited Interim Financial Information

The accompanying unaudited condensed 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 condensed consolidated financial statements include all adjustments, consisting of normal recurring adjustments and accruals, for a fair statement of VMware's condensed consolidated results of operations, financial position and cash flows for the periods presented. Results of operations are not necessarily indicative of the results that may be expected for the full year 2015. Certain information and footnote disclosures typically included in annual consolidated financial statements have been condensed or omitted. Accordingly, these unaudited interim condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and related notes included in VMware's 2014 Annual Report on Form 10-K.

As of June 30, 2015, EMC Corporation ("EMC") held 81.1% of VMware's outstanding common stock and 97.4% of the combined voting power of VMware's outstanding common stock, including 43 million shares of VMware's Class A common stock and all of VMware's Class B common stock. VMware is a majority-owned and controlled subsidiary of EMC, and its results of operations and financial position are consolidated with EMC's financial statements.

Management believes the assumptions underlying the condensed consolidated financial statements are reasonable. However, the amounts recorded for VMware's intercompany transactions with EMC may not be considered arm's length with an unrelated third party. Therefore, 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 and cash flows will be in the future if and when VMware contracts at arm's length with unrelated third parties for the services the Company receives from and provides to EMC.

Principles of Consolidation

The condensed consolidated financial statements include the accounts of VMware and subsidiaries in which VMware has a controlling financial interest. Non-controlling interests are presented as a separate component within total stockholders' equity and represent the equity and cumulative pro-rata share of the results of operations attributable to the non-controlling interests. Net earnings attributable to the non-controlling interests are included in other income, net on the condensed consolidated statements of income and are not presented separately as the amounts were not material for the periods presented. All intercompany transactions and account balances between VMware and its subsidiaries have been eliminated in consolidation. Transactions with EMC and its subsidiaries are generally settled in cash and are classified on the condensed consolidated statements of cash flows based upon the nature of the underlying transaction.

Reclassification

Certain prior period amounts related to the notes payable to EMC have been reclassified within the financing activities section of the condensed consolidated statements of cash flows. The reclassifications had no effect on total cash flows used in or provided by operating, investing or financing activities as previously reported.

Use of Accounting Estimates

The preparation of financial statements in conformity with GAAP 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

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(unaudited)

not limited to trade receivable valuation, marketing development funds and rebates, useful lives assigned to fixed assets and intangible assets, valuation of goodwill and definite-lived intangibles, income taxes, stock-based compensation, and contingencies. Actual results could differ from those estimates.

New Accounting Pronouncement

During May 2014, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2014-09, Revenue from Contracts with Customers (Topic 606). The updated revenue standard establishes principles for recognizing revenue and develops a common revenue standard for all industries. Upon adoption, entities will be required to recognize the amount of revenue that they expect to be entitled to for the transfer of promised goods or services to their customers. The updated standard is effective for the Company in the first quarter of 2018 and permits the use of either the retrospective or cumulative effect transition method. Early adoption is permitted, but not earlier than the first quarter of 2017. The Company has not selected a transition method and is currently evaluating the effect that ASU 2014-09 will have on its consolidated financial statements and related disclosures.

B. Business Combination, Definite-Lived Intangible Assets, Net and Goodwill

Business Combination

On February 2, 2015, VMware acquired all of the outstanding shares of Immidio B.V. (“Immidio”) for approximately $21 million of cash, net of liabilities assumed. VMware acquired Immidio to expand VMware's Workspace Environment Management solutions within the End-User Computing product group. The preliminary purchase price primarily included $8 million of identifiable intangible assets and approximately $17 million of goodwill that is expected to be non-deductible for tax purposes. The impact of the acquisition was not material to VMware's condensed consolidated financial statements.

Definite-Lived Intangible Assets, Net

As of June 30, 2015 and December 31, 2014, definite-lived intangible assets consisted of the following (amounts in table in millions):

	June 30, 2015			
	Weighted-Average Useful Lives (in years)	Gross Carrying Amount	Accumulated Amortization	Net Book Value
Purchased technology	6.5	$698	$(299)	$399
Leasehold interest	34.9	149	(18)	131
Customer relationships and customer lists	8.2	157	(62)	95
Trademarks and tradenames	8.6	61	(13)	48
Other	2.9	20	(11)	9
Total definite-lived intangible assets		$1,085	$(403)	$682

	December 31, 2014			
	Weighted-Average Useful Lives (in years)	Gross Carrying Amount	Accumulated Amortization	Net Book Value
Purchased technology	6.5	$699	$(252)	$447
Leasehold interest	34.9	149	(15)	134
Customer relationships and customer lists	8.2	157	(53)	104
Trademarks and tradenames	8.6	61	(9)	52
Other	2.7	18	(7)	11
Total definite-lived intangible assets		$1,084	$(336)	$748

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(unaudited)

Amortization expense on definite-lived intangible assets was $37 million and $74 million during the three and six months ended June 30, 2015, respectively, and $36 million and $67 million during the three and six months ended June 30, 2014, respectively.

Based on intangible assets recorded as of June 30, 2015 and assuming no subsequent additions or impairment of underlying assets, the remaining estimated annual amortization expense is expected to be as follows (table in millions):

Remainder of 2015	$72
2016	128
2017	121
2018	108
2019	87
Thereafter	166
Total	$682

Goodwill

The following table summarizes the changes in the carrying amount of goodwill during the six months ended June 30, 2015 (table in millions):

Balance, January 1, 2015	$3,964
Increase in goodwill related to a business combination	17
Balance, June 30, 2015	$3,981

C. Realignment Charges

During the first quarter of 2015, VMware eliminated approximately 350 positions across all major functional groups and geographies to streamline its operations. As a result of this action, $21 million of realignment charges were recognized during the six months ended June 30, 2015, which consisted of severance-related costs. An immaterial credit was recognized during the three months ended June 30, 2015. As of June 30, 2015, $2 million remained in accrued expenses and other on the condensed consolidated balance sheets and is expected to be paid during 2015.

The following table summarizes the activity for the accrued realignment charges for the six months ended June 30, 2015 (table in millions):

	Six Months Ended June 30, 2015			
	Balance as of January 1, 2015	Realignment Charges	Utilization	Balance as of June 30, 2015
Severance-related costs	$8	$21	$(27)	$2

No realignment charges were recognized during the three and six months ended June 30, 2014.

D. Net Income per Share

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

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(unaudited)

The following table sets forth the computations of basic and diluted net income per share during the three and six months ended June 30, 2015 and 2014 (net income in millions, shares in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Net income	$172	$167	$368	$366
Weighted-average shares, basic for Class A and Class B	424,169	430,216	426,055	430,050
Effect of dilutive securities	2,628	3,983	2,717	4,168
Weighted-average shares, diluted for Class A and Class B	426,797	434,199	428,772	434,218
Net income per weighted-average share, basic for Class A and Class B	$0.41	$0.39	$0.86	$0.85
Net income per weighted-average share, diluted for Class A and Class B	$0.40	$0.38	$0.86	$0.84

The following table sets forth the weighted-average common share equivalents of Class A common stock that were excluded from the diluted net income per share calculations during the three and six months ended June 30, 2015 and 2014, because their effect would have been anti-dilutive (shares in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Anti-dilutive securities:				
Employee stock options	2,100	1,085	2,206	1,007
Restricted stock units	90	2	399	4
Total	2,190	1,087	2,605	1,011

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(unaudited)

E. Cash, Cash Equivalents and Investments
Cash, cash equivalents and investments as of June 30, 2015 and December 31, 2014 consisted of the following (tables in millions):

	June 30, 2015			
	Cost or Amortized Cost	Unrealized Gains	Unrealized Losses	Aggregate Fair Value
Cash	$787	$—	$—	$787
Cash equivalents:				
Money-market funds	$990	$—	$—	$990
U.S. and foreign corporate debt securities	7	—	—	7
Municipal obligations	7	—	—	7
Total cash equivalents	$1,004	$—	$—	$1,004
Short-term investments:				
U.S. Government and agency obligations	$654	$1	$—	$655
U.S. and foreign corporate debt securities	3,293	4	(5)	3,292
Foreign governments and multi-national agency obligations	27	—	—	27
Municipal obligations	887	1	—	888
Asset-backed securities	36	—	—	36
Mortgage-backed securities	308	—	(1)	307
Total short-term investments	$5,205	$6	$(6)	$5,205
Other assets:				
Marketable available-for-sale equity securities	$15	$—	$—	$15

	December 31, 2014			
	Cost or Amortized Cost	Unrealized Gains	Unrealized Losses	Aggregate Fair Value
Cash	$885	$—	$—	$885
Cash equivalents:				
Money-market funds	$1,130	$—	$—	$1,130
U.S. and foreign corporate debt securities	54	—	—	54
Foreign governments and multi-national agency obligations	2	—	—	2
Total cash equivalents	$1,186	$—	$—	$1,186
Short-term investments:				
U.S. Government and agency obligations	$542	$—	$—	$542
U.S. and foreign corporate debt securities	3,236	3	(5)	3,234
Foreign governments and multi-national agency obligations	23	—	—	23
Municipal obligations	930	2	—	932
Asset-backed securities	53	—	—	53
Mortgage-backed securities	221	—	(1)	220
Total short-term investments	$5,005	$5	$(6)	$5,004

Refer to Note F for further information regarding the fair value of VMware’s cash equivalents and investments.

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

The realized gains and losses on investments during the three and six months ended June 30, 2015 and 2014 were not material.

Unrealized losses on cash equivalents and investments as of June 30, 2015 and December 31, 2014, which have been in a net loss position for less than twelve months, were classified by investment category as follows (table in millions):

	June 30, 2015		December 31, 2014	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. and foreign corporate debt securities	$1,718	$(5)	$1,964	$(5)
Mortgage-backed securities	169	(1)	107	(1)
Total	$1,887	$(6)	$2,071	$(6)

Unrealized losses on cash equivalents and available-for-sale investments, which have been in a net loss position for twelve months or greater, were not material as of June 30, 2015 and December 31, 2014.

Contractual Maturities

The contractual maturities of short-term investments held at June 30, 2015 consisted of the following (table in millions):

	Amortized Cost Basis	Aggregate Fair Value
Due within one year	$1,363	$1,363
Due after 1 year through 5 years	3,511	3,512
Due after 5 years through 10 years	107	107
Due after 10 years	224	223
Total short-term investments	$5,205	$5,205

F. Fair Value Measurements

Assets and Liabilities Measured and Recorded at Fair Value on a Recurring Basis

Certain financial assets and liabilities are measured at fair value on a recurring basis. VMware determines fair value using the following hierarchy:

- Level 1 - Quoted prices in active markets for identical assets or liabilities
- Level 2 - Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities; quoted prices in markets that are noted active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities
- Level 3 - Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities

VMware's fixed income securities are primarily classified as Level 2, with the exception of some of the U.S. Government and agency obligations which are classified as Level 1. Additionally, VMware's Level 2 classification includes foreign currency forward contracts and notes payable to EMC. At June 30, 2015 and December 31, 2014, VMware's Level 2 securities were generally priced using non-binding market consensus prices that are corroborated by observable market data, quoted market prices for similar instruments, or pricing models such as discounted cash flow techniques.

VMware does not have any material assets or liabilities that fall into Level 3 of the fair value hierarchy as of June 30, 2015 and December 31, 2014, and there have been no transfers between fair value measurement levels during the three and six months ended June 30, 2015 and 2014.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
(unaudited)

The following tables set forth the fair value hierarchy of VMware's money-market funds, available-for-sale securities, and foreign currency forward contracts, that were required to be measured at fair value as of June 30, 2015 and December 31, 2014 (tables in millions):

	June 30, 2015		
	Level 1	Level 2	Total
Cash equivalents:			
Money-market funds	$990	$—	$990
U.S. and foreign corporate debt securities	—	7	7
Municipal obligations	—	7	7
Total cash equivalents	$990	$14	$1,004
Short-term investments:			
U.S. Government and agency obligations	$443	$212	$655
U.S. and foreign corporate debt securities	—	3,292	3,292
Foreign governments and multi-national agency obligations	—	27	27
Municipal obligations	—	888	888
Asset-backed securities	—	36	36
Mortgage-backed securities	—	307	307
Total short-term investments	$443	$4,762	$5,205
Other assets:			
Marketable available-for-sale equity securities	$15	$—	$15
Accrued expenses and other:			
Foreign currency forward contracts	$—	$(3)	$(3)

	December 31, 2014		
	Level 1	Level 2	Total
Cash equivalents:			
Money-market funds	$1,130	$—	$1,130
U.S. and foreign corporate debt securities	—	54	54
Foreign governments and multi-national agency obligations	—	2	2
Total cash equivalents	$1,130	$56	$1,186
Short-term investments:			
U.S. Government and agency obligations	$353	$189	$542
U.S. and foreign corporate debt securities	—	3,234	3,234
Foreign governments and multi-national agency obligations	—	23	23
Municipal obligations	—	932	932
Asset-backed securities	—	53	53
Mortgage-backed securities	—	220	220
Total short-term investments	$353	$4,651	$5,004
Other current assets:			
Foreign currency forward contracts	$—	$1	$1
Accrued expenses and other:			
Foreign currency forward contracts	$—	$(1)	$(1)

VMware has elected not to record its notes payable to EMC at fair value, but has measured the notes at fair value for disclosure purposes. As of June 30, 2015 and December 31, 2014, the fair value of the notes payable to EMC was $1,510 million and $1,503 million, respectively. Fair value was estimated based on observable market interest rates (Level 2 inputs).

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VMware offers a deferred compensation plan for eligible employees that allows participants to defer payment for part or all of their compensation. VMware's results of operations are not significantly affected by this plan since changes in the fair value of the assets substantially offset changes in the fair value of the liabilities. As such, assets and liabilities associated with this plan have not been included in the above tables. Assets and liabilities associated with this plan were both approximately $14 million and $8 million as of June 30, 2015 and December 31, 2014, respectively, and are included in other assets and other liabilities on the condensed consolidated balance sheets.

Assets Measured and Recorded at Fair Value on a Non-Recurring Basis

VMware evaluated the strategic investments in its portfolio accounted for under the cost method to assess whether any of its strategic investments were other-than-temporarily impaired. VMware uses Level 3 inputs as part of its impairment analysis, including, pre- and post-money valuations of recent financing events and the impact of those on its fully diluted ownership percentages, as well as other available information regarding the issuer's historical and forecasted performance. The estimated fair value of these investments is considered in VMware's impairment review if any events or changes in circumstances occur that might have a significant adverse effect on their value. During the three and six months ended June 30, 2015 and 2014, VMware did not recognize an other-than-temporary impairment charge for a non-recoverable strategic investment.

During the three and six months ended June 30, 2015 and 2014, VMware did not have material realized gains or losses on strategic investments. Strategic investments are included in other assets on the condensed consolidated balance sheets. The carrying value of VMware's strategic investments was $98 million and $110 million as of June 30, 2015 and December 31, 2014, respectively.

G. Derivatives and Hedging Activities

VMware conducts business on a global basis in multiple foreign currencies, subjecting the Company to foreign currency risk. To mitigate this risk, VMware utilizes hedging contracts as described below, which potentially expose the Company to credit risk to the extent that the counterparties may be unable to meet the terms of the agreement. VMware manages counterparty risk by seeking counterparties of high credit quality, by monitoring credit ratings and credit spreads of, and other relevant public information about its counterparties. VMware does not, and does not intend to, use derivative instruments for trading or speculative purposes.

Cash Flow Hedges

To mitigate its exposure to foreign currency fluctuations resulting from operating expenses denominated in certain foreign currencies, VMware enters into foreign currency forward contracts. The Company designates these forward contracts as cash flow hedging instruments as the accounting criteria for such designation have been met. Therefore, the effective portion of gains or losses resulting from changes in the fair value of these hedges is initially reported in accumulated other comprehensive loss on the condensed consolidated balance sheets and is subsequently reclassified to the related operating expense line item on the condensed consolidated statements of income in the same period that the underlying expenses are incurred. During the three and six months ended June 30, 2015 and 2014, the effective portion of gains or losses reclassified to the condensed consolidated statements of income was not material. Interest charges or "forward points" on VMware's forward contracts are excluded from the assessment of hedge effectiveness and are recorded in other income, net on the condensed consolidated statements of income as incurred.

VMware enters into forward contracts annually, which have maturities of 12 months or less. As of June 30, 2015 and December 31, 2014, VMware had foreign currency forward contracts designated as cash flow hedges with a total notional value of $119 million and $240 million, respectively. The notional value represents the gross amount of foreign currency that will be bought or sold upon maturity of the forward contract.

During the three and six months ended June 30, 2015 and 2014, all cash flow hedges were considered effective.

Foreign Currency Forward Contracts Not Designated as Hedges

VMware has established a program that utilizes foreign currency forward contracts to offset the foreign currency risk associated with net outstanding monetary asset and liability positions. These forward contracts are not designated as hedging instruments under applicable accounting guidance, and therefore all changes in the fair value of the forward

contracts are reported in other income, net on the condensed consolidated statements of income.
VMware enters into foreign currency forward contracts on a monthly basis, which typically have a contractual term of one month. As of June 30, 2015 and December 31, 2014, VMware had outstanding forward contracts with a total notional value of $645 million and $697 million, respectively. The notional value represents the gross amount of foreign currency that will be bought or sold upon maturity of the forward contract.

During the three and six months ended June 30, 2015, VMware recognized a loss of $20 million and gain of $21 million, respectively, relating to the settlement of foreign currency forward contracts. During both the three and six months ended June 30, 2014, VMware recognized a loss of $5 million. Gains and losses are recorded in other income, net on the condensed consolidated statements of income.

The combined gains and losses derived from the settlement of foreign currency forward contracts and the underlying foreign currency denominated assets and liabilities resulted in a net loss of $3 million and $9 million during the three and six months ended June 30, 2015, respectively. The combined gains and losses derived from the settlement of foreign currency forward contracts and the underlying foreign currency denominated assets and liabilities were immaterial during the three and six months ended June 30, 2014. Net gains and losses are recorded in other income, net on the condensed consolidated statements of income.

H. Unearned Revenues

Unearned revenues as of June 30, 2015 and December 31, 2014 consisted of the following (table in millions):

	June 30, 2015	December 31, 2014
Unearned license revenues	$481	$488
Unearned software maintenance revenues	3,894	3,905
Unearned professional services revenues	438	440
Total unearned revenues	$4,813	$4,833

Unearned license revenues are generally recognized upon delivery of existing or future products or services, or are otherwise recognized ratably over the term of the arrangement. 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 the future product at no additional charge. To the extent the future product has 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. The amount of unearned revenues is impacted by timing of both product promotion offers and delivery of the future products offered as part of a product promotion. In the event the arrangement does not include professional services, unearned license revenues may also be recognized ratably, if the customer is granted the right to receive unspecified future products or VSOE of fair value on the software maintenance element of the arrangement does not exist. Total unearned license revenues may vary over periods for a variety of factors, including the type and level of promotions offered, and the timing of when the products are delivered upon general availability.

Unearned software maintenance revenues are attributable to VMware’s maintenance contracts and are generally recognized ratably over the contract period. The weighted-average remaining term at June 30, 2015 was approximately 2.0 years. Unearned professional services revenues result primarily from prepaid professional services, including training, and are generally recognized as the services are delivered.

I. Contingencies

Litigation

During June 2015, VMware reached an agreement with the Department of Justice (“DOJ”) and the General Services Administration (“GSA”) to pay $76 million to resolve allegations that VMware's government sales practices between 2006 and 2013 had violated the federal False Claims Act. The settlement was paid and recorded as a reduction of VMware's total revenues during the three months ended June 30, 2015.

On March 27, 2015, Phoenix Technologies (“Phoenix”) filed a complaint against VMware in the U.S. District Court for the Northern District of California asserting claims for copyright infringement and breach of contract relating to a version of Phoenix’s BIOS software that VMware licensed from Phoenix. In the lawsuit, Phoenix is seeking injunctive relief and monetary damages. VMware believes that it has meritorious defenses in connection with this lawsuit, and currently a reasonably possible loss or range of loss cannot be estimated.

On March 4, 2015, Christoph Hellwig, a software developer who alleges that software code he wrote is used in a component of the Company's vSphere product, filed a lawsuit against VMware in Germany alleging copyright infringement for failing to comply with the terms of an open source General Public License v.2 (“GPL v.2”) and seeking an order requiring VMware to comply with the GPL v.2 or cease distribution of any affected code within Germany. VMware believes that it has meritorious defenses in connection with this lawsuit, and currently a reasonably possible loss or range of loss cannot be estimated.

VMware accrues for a liability at the low end of the range of estimated losses when a determination has been made that a loss is both probable and the amount of the loss can be reasonably estimated. Significant judgment is required in both the determination that the occurrence of a loss is probable and is reasonably estimable. In making such judgments, VMware considers the impact of negotiations, settlements, rulings, advice of legal counsel and other information and events pertaining to a particular matter. Legal costs are generally recognized as expense when incurred.

VMware believes that it has valid defenses against each of the ongoing legal matters disclosed. However, given the unpredictable nature of legal proceedings, an unfavorable resolution of one or more legal proceedings, claims, or investigations could have a material adverse effect on VMware’s condensed consolidated financial statements.

VMware is also subject to other legal, administrative and regulatory proceedings, claims, demands and investigations in the ordinary course of business, including claims with respect to commercial, product liability, intellectual property, employment, class action, whistleblower and other matters. From time to time, VMware also receives inquiries from and has discussions with government entities on various matters. VMware does not believe that any liability from any reasonably foreseeable disposition of such claims and litigation, individually or in the aggregate, would have a material adverse effect on its condensed consolidated financial statements.

J. Stockholders’ Equity

VMware Stock Repurchases

On January 27, 2015, VMware’s Board of Directors authorized the repurchase of up to an additional one billion dollars of VMware’s Class A common stock through the end of 2017. Stock will be purchased from time to time, in the open market or through private transactions, subject to market conditions. The new stock repurchase authorization is in addition to VMware’s ongoing one-billion-dollar stock repurchase program, originally announced on August 6, 2014. 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. VMware is not obligated to purchase any shares under its stock repurchase programs. Purchases can be discontinued at any time VMware believes additional purchases are not warranted. All shares repurchased under VMware’s stock repurchase programs are retired.

The following table summarizes stock repurchase authorizations that remain open as of June 30, 2015 (amounts in table in millions):

Authorization Date	Amount Authorized	Expiration Date	Status
January 27, 2015	$1,000	December 31, 2017	Open
August 6, 2014	$1,000	December 31, 2016	Open

As of June 30, 2015, the cumulative authorized amount remaining for repurchase was $1,110 million.

The following table summarizes stock repurchase activity during the three and six months ended June 30, 2015 and 2014 (aggregate purchase price in millions, shares in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Aggregate purchase price	$412	$238	$850	$407
Class A common shares repurchased	4,750	2,488	10,116	4,255
Weighted-average price per share	$86.71	$95.73	$84.02	$95.67

The aggregate purchase price of repurchased shares includes commissions and is classified as a reduction to additional paid-in capital.

VMware Stock Options

The following table summarizes stock option activity since January 1, 2015 (shares in thousands):

	Number of Shares	Weighted-Average Exercise Price (per share)
Outstanding, January 1, 2015	5,869	$50.54
Granted	13	84.68
Forfeited	(130)	61.28
Exercised	(2,085)	30.67
Outstanding, June 30, 2015	3,667	61.60

The stock options outstanding as of June 30, 2015 had an aggregate intrinsic value of $99 million based on VMware's closing price as of June 30, 2015.

VMware Restricted Stock

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

VMware's restricted stock also includes performance stock unit ("PSU") awards, which have been granted to certain of VMware's executives and employees. The PSU awards include performance conditions and, in certain cases, a time-based vesting component. Upon vesting, each PSU award will convert into VMware's Class A common stock at various ratios ranging from 0.5 to 2.0 shares per PSU, depending upon the degree of achievement of the performance target designated by each individual award. If minimum performance thresholds are not achieved, then no shares will be issued. As of June 30, 2015, the number of PSUs outstanding includes certain PSUs for which performance conditions have concluded but that remain subject to certain service conditions.

The following table summarizes restricted stock activity since January 1, 2015 (units in thousands):

	Number of Units	Weighted-Average Grant Date Fair Value (per unit)
Outstanding, January 1, 2015	12,585	$88.88
Granted	5,170	87.04
Vested	(2,813)	85.20
Forfeited	(872)	86.89
Outstanding, June 30, 2015	14,070	87.70

The total fair value of VMware restricted stock that vested during the six months ended June 30, 2015 was $240 million. As of June 30, 2015, restricted stock representing 14.1 million shares of VMware's Class A common stock were outstanding, with an aggregate intrinsic value of $1,206 million based on VMware's closing price as of June 30, 2015.

As of June 30, 2015, the total unrecognized compensation cost for stock options and restricted stock was $1,009 million and will be recognized through 2019 with a weighted-average remaining period of 1.6 years.

Accumulated Other Comprehensive Income (Loss)

The changes in components of accumulated other comprehensive income (loss) during the six months ended June 30, 2015 and 2014 were as follows (tables in millions):

	Unrealized Gain on Available-for-Sale Securities	Unrealized Loss on Cash Flow Hedges	Total
Balance, January 1, 2015	$—	$(1)	$(1)
Unrealized gain (loss), net of taxes of $0	1	(3)	(2)
Balance, June 30, 2015	$1	$(4)	$(3)

	Unrealized Gain on Available-for-Sale Securities	Total
Balance, January 1, 2014	$4	$4
Unrealized gain, net of taxes of $2	4	4
Balance, June 30, 2014	$8	$8

Unrealized gains on VMware's available-for-sale securities are reclassified to investment income on the condensed consolidated statements of income in the period that such gains are realized.

The effective portion of gains (losses) resulting from changes in the fair value of forward contracts designated as cash flow hedging instruments are reclassified to its related operating expense line item on the condensed consolidated statements of income in the same period that the underlying expenses are incurred. The amounts recorded to their related operating expense line items on the condensed consolidated statements of income during the three and six months ended June 30, 2015 and 2014, were not material.

K. Related Parties

The information provided below includes a summary of the transactions entered into with EMC and EMC's consolidated subsidiaries (collectively "EMC"). EMC acquired VCE Company LLC ("VCE") during the fourth quarter of 2014. Transactions with VCE from the date EMC acquired the controlling interest in VCE have been included in the tables below.

Transactions with EMC

VMware and EMC engaged in the following ongoing intercompany transactions, which resulted in revenues and receipts and unearned revenues for VMware:

- Pursuant to an ongoing reseller arrangement with EMC, EMC bundles VMware's products and services with EMC's products and sells them to end users.
- EMC purchases products and services from VMware for internal use.
- VMware provides professional services to end users based upon contractual agreements with EMC.
- From time to time, VMware and EMC enter into agreements to collaborate on technology projects, and EMC pays VMware for services that VMware provides to EMC in connection with such projects.
- Pursuant to an ongoing distribution agreement, VMware acts as the selling agent for certain products and services of Pivotal Software, Inc. ("Pivotal"), a subsidiary of EMC, in exchange for an agency fee. Under this agreement, cash is collected from the end user by VMware and remitted to Pivotal, net of the contractual fee.
- VMware provides various transition services to Pivotal. Support costs incurred by VMware are reimbursed to VMware and are recorded as a reduction to the costs incurred by VMware.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
(unaudited)

Information about VMware’s revenues and receipts from such arrangements with EMC during the three and six months ended June 30, 2015 and 2014 and unearned revenues as of June 30, 2015 and December 31, 2014 consisted of the following (table in millions):

	Revenues and Receipts from EMC				Unearned Revenues from EMC	
	Three Months Ended June 30,		Six Months Ended June 30,		June 30,	December 31,
	2015	2014	2015	2014	2015	2014
Reseller revenues	$69	$43	$131	$89	$261	$290
Internal-use revenues	6	5	9	13	14	18
Professional services revenues	24	18	48	40	3	9
Agency fee revenues	3	1	4	2	—	—
Reimbursement for transition services	1	—	2	2	n/a	n/a

VMware and EMC engaged in the following ongoing intercompany transactions, which resulted in costs to VMware:

- VMware purchases and leases products and purchases services from EMC.
- From time to time, VMware and EMC enter into agreements to collaborate on technology projects, and VMware pays EMC for services provided to VMware by EMC related to such projects.
- In certain geographic regions where VMware does not have an established legal entity, VMware contracts with EMC subsidiaries for support services and EMC personnel who are managed by VMware. The costs incurred by EMC on VMware’s behalf related to these employees are charged to VMware with a mark-up intended to approximate costs that would have been incurred had VMware contracted for such services with an unrelated third party. These costs are included as expenses on VMware’s condensed consolidated statements of income and primarily include salaries, benefits, travel and rent expenses. EMC also incurs certain administrative costs on VMware’s behalf in the U.S. that are recorded as expenses on VMware’s condensed consolidated statements of income.

Information about VMware’s costs from such arrangements with EMC for the three and six months ended June 30, 2015 and 2014 consisted of the following (table in millions):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Purchases and leases of products and purchases of services	$12	$12	$31	$33
Collaborative technology project costs	1	3	3	7
EMC subsidiary support and administrative costs	26	35	54	76

VMware also purchases EMC products through EMC's channel partners. Purchases of EMC products through EMC's channel partners were $18 million and $26 million during the three and six months ended June 30, 2015, respectively, and $8 million and $11 million during the three and six months ended June 30, 2014, respectively.

Certain Stock-Based Compensation

Effective September 1, 2012, Pat Gelsinger was appointed Chief Executive Officer of VMware. Prior to joining VMware, Mr. Gelsinger was the President and Chief Operating Officer of EMC Information Infrastructure Products. Mr. Gelsinger retains certain of his EMC equity awards that were held as of September 1, 2012 and he continues to vest in such awards. Stock-based compensation related to Mr. Gelsinger’s EMC awards are being recognized on VMware’s condensed consolidated statements of income over the awards’ remaining requisite service periods.

VMware, Inc.
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Tax Sharing Agreement with EMC

Pursuant to a tax sharing agreement between VMware and EMC, payments are made between VMware and EMC related to VMware's portion of federal income taxes on EMC's consolidated tax return as well as income taxes for states in which combined state income tax returns are filed. The following table summarizes these payments made between VMware and EMC during the three and six months ended June 30, 2015 and 2014 (table in millions):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Payments from VMware to EMC	$43	$—	$92	$20

Payments made by VMware to EMC result from VMware having a tax liability. The amount that VMware pays to EMC for its portion of federal income taxes on EMC’s consolidated tax return differs from the amount VMware would owe on a separate return basis, and the difference is presented as a component of stockholders’ equity. During the three and six months ended June 30, 2015 and 2014, the difference between the amount of tax calculated on a stand-alone basis and the amount of tax calculated per the tax sharing agreement was not material.

Due To/From Related Parties, Net

As a result of the related party transactions with EMC described above, amounts due to and from related parties, net as of June 30, 2015 and December 31, 2014 consisted of the following (table in millions):

	June 30, 2015	December 31, 2014
Due to related parties	$(85)	$(76)
Due from related parties	77	125
Due (to) from related parties, net	$(8)	$49
Income tax due (to) from related parties	$6	$(40)

Balances due to or from related parties, 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 related parties is governed by the tax sharing agreement with EMC.

Notes Payable to EMC

VMware and EMC entered into a note exchange agreement on January 21, 2014 providing for the issuance of three promissory notes in the aggregate principal amount of $1,500 million. The total debt of $1,500 million includes $450 million that was exchanged for the $450 million promissory note issued to EMC in April 2007, as amended and restated in June 2011.

The three notes issued may be prepaid without penalty or premium, and outstanding principal is due on the following dates: $680 million due May 1, 2018, $550 million due May 1, 2020 and $270 million due December 1, 2022. The notes bear interest, payable quarterly in arrears, at the annual rate of 1.75%. During the three and six months ended June 30, 2015, $7 million and $13 million, respectively, of interest expense was recognized. During the three and six months ended June 30, 2014, $7 million and $12 million, respectively, of interest expense was recognized.

L. Segment Information

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

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

Revenues by geographic area for the three and six months ended June 30, 2015 and 2014 were as follows (table in millions):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
United States	$742	$683	$1,504	$1,332
International	779	774	1,528	1,485
Total	$1,521	$1,457	$3,032	$2,817

Revenues by geographic area are based on the ship-to addresses of VMware's customers. No individual country other than the United States accounted for 10% or more of revenues for the three and six months ended June 30, 2015 and 2014.

Long-lived assets by geographic area, which primarily include property and equipment, net, as of June 30, 2015 and December 31, 2014 were as follows (table in millions):

	June 30, 2015	December 31, 2014
United States	$834	$801
International	146	117
Total	$980	$918

No individual country other than the United States accounted for 10% or more of these assets as of June 30, 2015 and December 31, 2014, respectively.

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

The following management's discussion and analysis ("MD&A") is provided in addition to the accompanying condensed consolidated financial statements and notes to assist in understanding our results of operations and financial condition. Financial information as of June 30, 2015 should be read in conjunction with our consolidated financial statements for the year ended December 31, 2014 contained in our Form 10-K filed February 26, 2015.

All dollar amounts expressed as numbers in this MD&A (except share and per share amounts) are in millions. Period-over-period changes are calculated based upon the respective underlying, non-rounded data. Unless the context requires otherwise, we are referring to VMware, Inc. and its consolidated subsidiaries when we use the terms "VMware," the "Company," "we," "our" or "us."

Overview

The information technology ("IT") industry is transforming, moving from a hardware-based traditional model to one of a software-defined infrastructure. We are the leader in virtualization infrastructure solutions utilized by organizations to help transform the way they build, deliver and consume IT resources. We develop and market our product and service offerings within three main product groups and we also leverage synergies across these three product and service areas:

- SDDC or Software-Defined Data Center
- Hybrid Cloud Computing
- End-User Computing

Historically, the majority of our license sales have been from our standalone vSphere product, which is included in our compute product category within our SDDC architecture. However, over the last two years, standalone vSphere product license sales are slowing, while the growth rate of license sales beyond our standalone vSphere product are continuing to increase as we transition to offering a wider range of products and services to enable the entire SDDC.

As the transformation of the IT industry continues, we expect that our growth rates will be increasingly derived from sales of our newer products, suites and services solutions across our SDDC portfolio, beyond standalone vSphere. For example, we have experienced continued growth in sales volumes, production use and number of customers who have purchased VMware NSX, our network virtualization solution, throughout 2014 and during the six months ended June 30, 2015. We also continue to see traction of our Virtual SAN product and other newer offerings.

Hybrid cloud computing, comprised of VMware vCloud Air ("vCloud Air") and VMware vCloud Air Network ("vCAN") Service Providers Program offerings, continued to experience growth during the three and six months ended June 30, 2015. We plan to continue to expand our hybrid cloud global footprint as well as our service offerings. Due to the nature of these offerings, revenues are recognized over a period of time.

Our end-user computing solutions include our Horizon workplace suites and enterprise mobile management offerings, led by our AirWatch mobile solutions. Currently, our AirWatch business models include an on-premise solution that we offer through the sale of perpetual licenses and an off-premise solution that we offer as software-as-a-service ("SaaS"). AirWatch products and services continued to contribute to the growth of our end-user computing products during the three and six months ended June 30, 2015. Our investments in AirWatch resulted in increased operating expenses during the six months ended June 30, 2015, primarily driven by employee-related costs, including expenses we recognized in connection with installment payments to certain key employees as part of the acquisition, as well as amortization of purchased intangible assets.

Approximately 70% of our sales are denominated in the U.S. dollar, however, we also invoice and collect in the euro, the British pound, the Japanese yen, the Australian dollar and the Chinese renminbi in their respective regions. As a result, our financial statements, including our revenues, operating expenses, unearned revenues, and the resulting cash flows derived from the U.S. dollar equivalent of foreign currency transactions are impacted by foreign exchange fluctuations. Foreign currency fluctuations have had a negative impact on the growth rate of our revenues during 2015, the amount of unearned revenues recognized derived from sales denominated in foreign currencies, and the U.S. dollar equivalent of foreign currency cash collections. We have also benefited from operating expenses incurred and paid in currencies other than the U.S. dollar.

We generally sell our solutions using enterprise agreements (“EAs”) or as part of our non-EA, or transactional, business. EAs are comprehensive volume license offerings, offered both directly by us and through certain channel partners, that also provide for multi-year maintenance and support.

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Results of Operations

Revenues

Our revenues during the three and six months ended June 30, 2015 and 2014 were as follows:

	Three Months Ended					Six Months Ended				
	June 30,		$ Change	% Change		June 30,		$ Change	% Change	
	2015	2014	Actual	Actual	Constant Currency	2015	2014	Actual	Actual	Constant Currency
Revenues:										
License	$638	$614	$24	4 %	9 %	$1,214	$1,175	$39	3 %	8 %
Services:										
Software maintenance	829	737	91	12		1,641	1,438	203	14	
Professional services	130	106	24	23		253	204	48	24	
Total services	959	843	115	14		1,894	1,642	251	15	
GSA settlement	(76)	—	(76)	n/a		(76)	—	(76)	n/a	
Total revenues	$1,521	$1,457	$64	4	8	$3,032	$2,817	$215	8	10
Revenues:										
United States	$742	$683	$59	9 %		$1,504	$1,332	$172	13 %	
International	779	774	5	1		1,528	1,485	43	3	
Total revenues	$1,521	$1,457	$64	4	8	$3,032	$2,817	$215	8	10

In order to provide a comparable framework for assessing how our business performed, adjusted for the impact of foreign currency fluctuations, management analyzes year-over-year license and total revenues growth on a constant currency basis. License and total revenues recognized during the current period derived from non-U.S. dollar based transactions were converted into U.S. dollars using the exchange rates that were effective in the comparable prior year period. The calculated current period license and total revenues, adjusted for foreign currency fluctuations, is compared to the license and total revenues of the comparable prior year period, as reported, in calculating license and total revenue growth in constant currency.

Hybrid cloud, including vCAN and vCloud Air, and our SaaS offerings, including our AirWatch mobile solutions, increased to greater than 6% of our total revenues during the three and six months ended June 30, 2015. We expect our hybrid cloud and SaaS offerings will continue to grow and represent an increasing percentage of total revenues in future periods. vCAN revenues are generally included in license revenues and our SaaS revenues, including vCloud Air and our AirWatch mobile solutions, are included in both license and services revenues.

License Revenues

License revenues during the three and six months ended June 30, 2015 were up 4% and 3%, respectively, compared to the same periods in the prior year. Our license revenues increased primarily as a result of increased sales of our emerging product offerings, including AirWatch mobile solutions, as well as revenues from our hybrid cloud offerings. Sales of products beyond standalone vSphere, including vSphere with Operations Management, also contribute to license revenues growth, partially offset by a decline in our standalone vSphere product license sales. Our license revenues growth rate also continues to be negatively impacted by changes in the value of the U.S. dollar against foreign currencies in which we invoice.

The anticipated continued revenue growth of our hybrid cloud and SaaS offerings are expected to adversely impact the growth rate of our license revenues during the remainder of 2015 as we will recognize less revenue up-front than we would otherwise recognize as part of a multi-year license arrangement. Additionally, we expect changes in foreign currency to continue to have an impact on our license revenues growth rate.

Services Revenues

During the three and six months ended June 30, 2015, software maintenance revenues benefited from renewals, multi-year software maintenance contracts sold in previous periods and additional maintenance contracts sold in conjunction with new software license sales. In each period presented, customers bought, on average, more than 24 months of support and maintenance with each new license purchased, which we believe demonstrates our customers' commitment to our SDDC strategy.

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Professional services revenues increased during the three and six months ended June 30, 2015 compared to the same periods in 2014, which is attributable to growth in our license sales and an increase in our solution-based selling. 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, our professional services revenues will vary based on the delivery channels used in any given period as well as the timing of engagements.

GSA settlement

During June 2015, we reached an agreement with the Department of Justice ("DOJ") and the General Services Administration ("GSA") to pay $76 to resolve allegations that our government sales practices between 2006 and 2013 had violated the federal False Claims Act. The settlement was paid and recorded as a reduction of our total revenues during the three months ended June 30, 2015.

Unearned Revenues

Our unearned revenues as of June 30, 2015 and December 31, 2014 were as follows:

	June 30, 2015	December 31, 2014
Unearned license revenues	$481	$488
Unearned software maintenance revenues	3,894	3,905
Unearned professional services revenues	438	440
Total unearned revenues	$4,813	$4,833

Unearned license revenues are generally recognized upon delivery of existing or future products or services, or they are otherwise recognized ratably over the term of the arrangement. 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 the future product at no additional charge. To the extent the future product has 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. The amount of unearned revenues is impacted by timing of both product promotion offers and delivery of the future products offered as part of a product promotion. In the event the arrangement does not include professional services, unearned license revenues may also be recognized ratably, if the customer is granted the right to receive unspecified future products or VSOE of fair value on the software maintenance element of the arrangement does not exist. Total unearned license revenues may vary over periods for a variety of factors, including the type and level of promotions offered, and the timing of when the products are delivered upon general availability.

Unearned software maintenance revenues are primarily attributable to our maintenance contracts and are generally recognized ratably over the contract period. The weighted-average remaining term at June 30, 2015 was approximately 2.0 years. Unearned professional services revenues result primarily from prepaid professional services, including training, and are generally recognized as the services are delivered. Our total unearned revenues are impacted by the amount and timing of sales as well as fluctuations in the foreign currencies in which we invoice.

Cost of License Revenues, Cost of Services Revenues and Operating Expenses

Our cost of services revenues and operating expenses were primarily impacted by increasing headcount, net of realignment activities discussed below. Headcount during the three and six months ended June 30, 2015 continued to increase due to organic growth. The increased headcount has resulted in higher cash-based employee-related expenses across most of our income statement expense categories when compared to the same period in 2014, and we expect this trend to continue.

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Cost of License Revenues

Our cost of license revenues principally consists of the cost of fulfillment of our software, royalty costs in connection with technology licensed from third-party providers and amortization of intangible assets. The cost of fulfillment of our software includes IT development efforts, personnel costs and related overhead associated with the physical and electronic delivery of our software products.

	Three Months Ended June 30,				Six Months Ended June 30,			
	2015	2014	$ Change	% Change	2015	2014	$ Change	% Change
Cost of license revenues	$46	$45	$—	— %	$95	$94	$—	— %
Stock-based compensation	—	1	—	(20)	1	2	—	(17)
Total expenses	$46	$46	$—	—	$96	$96	$—	—
% of License revenues	7 %	8 %			8 %	8 %		

Cost of license revenues was relatively flat when comparing three and six months ended June 30, 2015 and 2014.

Cost of Services Revenues

Our cost of services revenues primarily includes the costs of personnel and related overhead to deliver technical support for our products and to provide our professional services. Additionally, our costs of services revenues include costs related to our IT development efforts and depreciation on equipment supporting our service offerings. As we continue to invest in and grow business from our hybrid cloud, SaaS and professional services offerings, we expect our total costs of services revenues to continue to increase.

	Three Months Ended June 30,				Six Months Ended June 30,			
	2015	2014	$ Change	% Change	2015	2014	$ Change	% Change
Cost of services revenues	$194	$161	$32	20 %	$375	$303	$72	24 %
Stock-based compensation	10	11	(1)	(5)	22	20	1	6
Total expenses	$204	$172	$31	18	$397	$323	$74	23
% of Services revenues	21 %	20 %			21 %	20 %		

Cost of services revenues increased during the three and six months ended June 30, 2015 compared to the same periods in 2014 primarily driven by the growth in cash-based employee-related expenses of $26 and $56, respectively, due to organic growth in headcount for the three and six months ended June 30, 2015. Our acquisition of AirWatch, which occurred during the three months ended March 31, 2014, also contributed to the growth in cash-based employee-related expenses during the six months ended June 30, 2015. In addition, the growth of our hybrid cloud and SaaS offerings led to an increase in our professional services costs of $15 during the six months ended June 30, 2015. Additionally, increases in equipment, depreciation and facilities-related costs of $13 and $21 during the three and six months ended June 30, 2015, respectively, contributed to the increase in cost of services revenues. These increases were partially offset by the positive impact of $13 and $22 during the three and six months ended June 30, 2015, respectively, from fluctuations in the exchange rate between the U.S. dollar and the foreign currencies in which we incur expenses.

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Research and Development Expenses

Our research and development expenses include the personnel and related overhead associated with the development of our product software and service offerings.

	Three Months Ended June 30,	Six Months Ended