VMWARE, INC.
Form 10-Q
December 10, 2018
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
Form 10-Q
(Mark One)
þ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended November 2, 2018
OR
o 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 (Address of principal executive offices)	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 þ No o

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted 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 such files). Yes þ No o

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

Large accelerated filer þ	Accelerated filer o
Non-accelerated filer o	Smaller reporting company o
	Emerging growth company o

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No þ

As of November 30, 2018, the number of shares of common stock, par value $0.01 per share, of the registrant outstanding was 409,891,080, of which 109,891,080 shares were Class A common stock and 300,000,000 were Class B common stock.

TABLE OF CONTENTS

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Table of Contents

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		Nine Months Ended	
	November 2, 2018	November 3, 2017[1]	November 2, 2018	November 3, 2017[1]
Revenue[2]:				
License	$884	$ 758	$2,558	$ 2,182
Services	1,316	1,180	3,825	3,454
Total revenue	2,200	1,938	6,383	5,636
Operating expenses[3]:				
Cost of license revenue	49	38	139	116
Cost of services revenue	266	240	777	721
Research and development	499	449	1,433	1,298
Sales and marketing	707	624	2,110	1,818
General and administrative	178	175	529	486
Realignment and loss on disposition	6	2	9	101
Operating income	495	410	1,386	1,096
Investment income	63	33	168	82
Interest expense	(33)	(28)	(101)	(41)
Other income (expense), net	(180)	(2)	839	51
Income before income tax	345	413	2,292	1,188
Income tax provision	11	18	372	143
Net income	$334	$ 395	$1,920	$ 1,045
Net income per weighted-average share, basic for Classes A and B	$0.82	$ 0.97	$4.72	$ 2.56
Net income per weighted-average share, diluted for Classes A and B	$0.81	$ 0.96	$4.64	$ 2.53
Weighted-average shares, basic for Classes A and B	408,708	406,733	406,929	407,856
Weighted-average shares, diluted for Classes A and B	414,477	413,013	413,378	413,957

(1) Adjusted to reflect the retrospective adoption of Accounting Standards Codification 606, Revenue from Contracts with Customers (“Topic 606”).

(2) Includes related party revenue as follows (refer to Note C):

License	$290	$ 172	$765	$ 447
Services	260	163	694	451

(3) Includes stock-based compensation as follows:

Cost of license revenue	$—	$ —	$1	$ 1
Cost of services revenue	13	13	37	38
Research and development	98	96	272	266
Sales and marketing	53	52	147	150
General and administrative	28	21	74	58

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

Table of Contents

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

	Three Months Ended		Nine Months Ended	
	November 2, 2018	November 3, 2017[1]	November 2, 2018	November 3, 2017[1]
Net income	$334	$ 395	$1,920	$ 1,045
Other comprehensive income (loss):				
Changes in market value of available-for-sale securities:				
Unrealized gains (losses), net of tax provision (benefit) of ($1), ($3), ($4) and $5	(2)	(6)	(11)	9
Reclassification of (gains) losses realized during the period, net of tax (provision) benefit of $—, $—, $— and $2	—	—	—	3
Net change in market value of available-for-sale securities	(2)	(6)	(11)	12
Changes in market value of effective foreign currency forward contracts:				
Unrealized gains (losses), net of tax provision (benefit) of $— for all periods	(4)	(1)	(9)	3
Reclassification of (gains) losses realized during the period, net of tax (provision) benefit of $—, $3, $—, and $—	5	(1)	(1)	(2)
Net change in market value of effective foreign currency forward contracts	1	(2)	(10)	1
Total other comprehensive income (loss)	(1)	(8)	(21)	13
Total comprehensive income, net of taxes	$333	$ 387	$1,899	$ 1,058

[1] Adjusted to reflect the retrospective adoption of Topic 606.

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

Table of Contents

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

	November 2, 2018	February 2, 2018[1]
ASSETS		
Current assets:		
Cash and cash equivalents	$ 9,189	$ 5,971
Short-term investments	4,338	5,682
Accounts receivable, net of allowance for doubtful accounts of $5 and $2	1,101	1,394
Due from related parties, net	542	532
Other current assets	248	257
Total current assets	15,418	13,836
Property and equipment, net	1,128	1,074
Other assets	1,810	924
Deferred tax assets	59	227
Intangible assets, net	558	548
Goodwill	4,989	4,597
Total assets	$ 23,962	$ 21,206
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 158	$ 15
Accrued expenses and other	1,328	1,357
Unearned revenue	3,584	3,438
Total current liabilities	5,070	4,810
Notes payable to Dell	270	270
Long-term debt	3,970	3,964
Unearned revenue	2,617	2,401
Income tax payable	878	954
Other liabilities	246	183
Total liabilities	13,051	12,582
Contingencies (refer to Note K)		
Stockholders' equity:		
Class A common stock, par value $0.01; authorized 2,500,000 shares; issued and outstanding 109,843 and 103,776 shares	1	1
Class B convertible common stock, par value $0.01; authorized 1,000,000 shares; issued and outstanding 300,000 shares	3	3
Additional paid-in capital	1,268	844
Accumulated other comprehensive loss	(51)	(15)
Retained earnings	9,690	7,791
Total stockholders' equity	10,911	8,624
Total liabilities and stockholders' equity	$ 23,962	$ 21,206

(1) Adjusted to reflect the retrospective adoption of Topic 606.

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

Table of Contents

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

	Nine Months Ended November 2, 2018	Nine Months Ended November 3, 2017[(1)]
Operating activities:		
Net income	$1,920	$ 1,045
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	465	419
Stock-based compensation	531	513
Deferred income taxes, net	163	119
Unrealized (gain) loss on equity securities, net	(837)	—
Loss on disposition	6	94
(Gain) loss on disposition of assets, revaluation and impairment, net	1	(32)
Gain on extinguishment of debt	—	(6)
Loss on Dell stock purchase	—	2
Other	4	2
Changes in assets and liabilities, net of acquisitions:		
Accounts receivable	297	284
Other current assets and other assets	(264)	(240)
Due to/from related parties, net	(10)	(162)
Accounts payable	125	39
Accrued expenses and other liabilities	(117)	11
Income taxes payable	10	(63)
Unearned revenue	357	342
Net cash provided by operating activities	2,651	2,367
Investing activities:		
Additions to property and equipment	(178)	(164)
Purchases of available-for-sale securities	(781)	(3,339)
Sales of available-for-sale securities	186	1,745
Maturities of available-for-sale securities	1,905	1,207
Purchases of strategic investments	(3)	(33)
Proceeds from disposition of assets	35	6
Business combinations, net of cash acquired, and purchases of intangible assets	(519)	(236)
Net cash paid on disposition of a business	(11)	(47)
Net cash provided by (used in) investing activities	634	(861)
Financing activities:		
Proceeds from issuance of common stock	181	104
Net proceeds from issuance of long-term debt	—	3,961
Repayment of notes payable to Dell	—	(1,225)
Repurchase of common stock	—	(1,280)
Shares repurchased for tax withholdings on vesting of restricted stock	(228)	(271)
Payment for common control transaction with Dell	(8)	—
Net cash provided by (used in) financing activities	(55)	1,289
Net increase in cash, cash equivalents and restricted cash	3,230	2,795
Cash, cash equivalents and restricted cash at beginning of the period	6,003	3,239
Cash, cash equivalents and restricted cash at end of the period	$9,233	$ 6,034

Supplemental disclosures of cash flow information:		
Cash paid for interest	$126	$ 19
Cash paid for taxes, net	206	87
Non-cash items:		
Changes in capital additions, accrued but not paid	$16	$ 19

(1) Adjusted to reflect the retrospective adoption of Topic 606 and Accounting Standards Update ("ASU") 2016-18, Statement of Cash Flows (Topic 230): Restricted Cash. The adoption of Topic 606 had no impact to net cash provided by or used in operating, investing and financing activities.

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

6

Table of Contents

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

A. Overview and Basis of Presentation

Company and Background

VMware, Inc. (“VMware” or the “Company”) pioneered the development and application of virtualization technologies with x86 server-based computing, separating application software from the underlying hardware. Information technology driven innovation is disrupting markets and industries. Technologies emerge faster than organizations can absorb them, creating increasingly complex environments. To take on this challenge, businesses need a flexible and secure digital foundation. VMware provides compute, cloud, mobility, networking and security infrastructure software to businesses that provides a flexible digital foundation for the applications that empower businesses to serve their customers globally.

Accounting Principles

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

VMware adopted Accounting Standards Codification 606, Revenue from Contracts with Customers (“Topic 606”) and ASU 2016-18, Statement of Cash Flows: Restricted Cash (Topic 230), effective February 3, 2018 using retrospective application. As part of the adoption, certain prior period amounts have been adjusted or reclassified within the condensed consolidated financial statements.

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 fiscal year 2019. 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 Form 10-K filed on March 29, 2018.

Effective September 7, 2016, Dell Technologies Inc. (“Dell”) (formerly Denali Holding Inc.) acquired EMC Corporation (“EMC”), VMware’s parent company, including EMC’s majority control of VMware (the “Dell Acquisition”). As of November 2, 2018, Dell controlled 80.7% of VMware’s outstanding common stock and 97.5% of the combined voting power of VMware’s outstanding common stock, including 31 million shares of VMware’s Class A common stock and all of VMware’s Class B common stock.

As VMware is a majority-owned and controlled subsidiary of Dell, its results of operations and financial position are consolidated with Dell’s financial statements. Transactions prior to the effective date of the Dell Acquisition represent transactions only with EMC and its consolidated subsidiaries.

Management believes the assumptions underlying the condensed consolidated financial statements are reasonable. However, the amounts recorded for VMware’s intercompany transactions with Dell and its consolidated subsidiaries may not be considered arm’s length with an unrelated third party. Therefore, the condensed consolidated 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 products and services the Company receives from and provides to Dell.

Principles of Consolidation

The unaudited condensed consolidated financial statements include the accounts of VMware and subsidiaries in which VMware has a controlling financial interest. All intercompany transactions and account balances between VMware and its subsidiaries have been eliminated in consolidation. Transactions with Dell and its consolidated 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.

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 revenue and expenses during the reporting periods, and the disclosure of contingent liabilities at the date of the financial statements. Estimates are used for, but not limited to, trade receivable valuation, marketing development funds, expected period of benefit for deferred commissions, 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.

Significant Accounting Policies

During May 2014, the Financial Accounting Standards Board ("FASB") issued ASU 2014-09, Revenue from Contracts with Customers (Topic 606). In 2016, the FASB issued ASU 2016-08, ASU 2016-10 and ASU 2016-12, which provided interpretive clarifications on the guidance in Topic 606. The updated revenue standard replaced all existing revenue recognition guidance under GAAP and established common principles for recognizing revenue for all industries. It also provided guidance on the accounting for costs to fulfill or obtain a customer contract. The core principle underlying the updated standard is the recognition of revenue based on consideration expected to be entitled from the transfer of goods or services to a customer. VMware adopted Topic 606 on a full retrospective basis effective February 3, 2018; consequently, previously reported amounts were adjusted to reflect the adoption of Topic 606. Significant accounting policies applicable to revenue recognition and deferred commissions have been updated to reflect the adoption of Topic 606. There were no other changes to VMware's significant accounting policies described in the Form 10-K filed on March 29, 2018 that have had a material impact on the Company's condensed consolidated financial statements and the related notes.

Revenue Recognition

VMware derives revenue primarily from licensing software under perpetual licenses or consumption-based contracts and related software maintenance and support, training, consulting services and hosted services. VMware accounts for a contract with a customer if all criteria defined by the guidance are met, including collectibility of consideration is probable. Revenue is recognized upon transfer of control of licenses or services to the customer in an amount that reflects the consideration VMware expects to receive in exchange for those licenses or services. Control of a promised good or service may be transferred to a customer either at a point in time or over time, which affects the timing of revenue recognition. VMware's contracts with customers may include a combination of licenses and services that are accounted for as distinct performance obligations. Certain contracts include third-party offerings and revenue that may be recognized net of the third-party costs, based upon an assessment as to whether VMware had control of the underlying third-party offering. Revenue is recognized net of any taxes invoiced to customers, which are subsequently remitted to governmental authorities.

From time to time, VMware may enter into revenue and purchase contracts with the same customer within a short period of time. VMware evaluates the underlying economics and fair value of the consideration payable to the customer to determine if any portion of the consideration payable to the customer exceeds the fair value of the goods and services received and should be accounted for as a reduction of the transaction price of the revenue contract.

License Revenue

VMware generally sells its license software through distributors, resellers, system vendors, systems integrators and its direct sales force. Performance obligations related to license revenue, including the license portion of term licenses, represent functional intellectual property under which a customer has the legal right to the on-premises license. The license provides significant standalone functionality and is a separate performance obligation from the maintenance and support and professional services sold by VMware. On-premises license revenue is recognized at a point in time, upon delivery and transfer of control of the underlying license to the customer.

License revenue from on-premises license software sold to original equipment manufacturers ("OEMs") is recognized when the sale occurs. Revenue is recognized upon reporting by the OEMs of their sales, and for the period where information of the underlying sales has not been made available, revenue is recognized based upon estimated sales. VMware Cloud Provider Program (“VCPP”) partners rent on-premises licenses from VMware, and the rental fee is recognized as license revenue upon consumption. Generally, contracts with VCPP partners include cancellation rights. License revenue is based upon reported consumption by VCPP partners and includes estimates for the period when consumption information has not been made available.

License revenue also includes an allocated portion of hosted services, which is recognized as revenue over time as the hosted services are consumed.

Services Revenue

VMware's services revenue generally consists of software maintenance and support, professional services and an allocated portion of hosted services. Software maintenance and support offerings entitle customers to receive major and minor product upgrades, on a when-and-if-available basis, and technical support. Maintenance and support services are comprised of multiple performance obligations including updates, upgrades to licenses and technical support. While separate performance obligations are identified within maintenance and support services, the underlying performance obligations generally have a consistent continuous pattern of transfer to a customer during the term of a contract. Maintenance and support services revenue is recognized over time on a ratable basis over the contract duration.

Professional services include design, implementation, training and consulting services. Professional services performed by VMware represent distinct performance obligations as they do not modify or customize licenses sold and such services are not highly interdependent or highly interrelated to licenses sold such that a customer would not be able to use the licenses without the professional services. Revenue from fixed fee professional services engagements is recognized based on progress made toward the total project effort, which can be reasonably estimated. As a practical expedient, VMware recognizes revenue from professional services engagements invoiced on a time and materials basis as the hours are incurred based on VMware's right to invoice amounts for performance completed to date.

VMware's hosted services consist of certain software offerings sold as a service-based technology without the customer's ability to take possession of the software over the subscription term. Currently, hosted services are recognized as revenue equally in both license and services over time as customers consume the services or ratably over the term of the subscription, commencing upon provisioning of the service.

Contracts with Multiple Performance Obligations

VMware enters into revenue contracts with multiple performance obligations in which a customer may purchase combinations of licenses, maintenance and support, training, consulting services, hosted services and rights to future products and services. For contracts with multiple performance obligations, VMware allocates total transaction value to the identified underlying performance obligations based on relative standalone selling price ("SSP"). VMware typically estimates SSP of services based on observable transactions when the services are sold on a standalone basis and those prices fall within a reasonable range. VMware utilizes the residual approach to estimate SSP of license as the licenses are not sold standalone and the same products are sold to different customers at a broad range of prices which are highly variable.

Rebates and Marketing Development Funds

Rebates, which are offered to certain channel partners and represent a form of variable consideration, are accounted for as a reduction to the transaction price on eligible contracts.

Rebates are determined based on eligible sales during the quarter or based on actual achievement to quarterly target sales. The reduction of the aggregate transaction price against eligible contracts is allocated to the applicable performance obligations. The difference between the estimated rebates recognized and the actual amounts paid has not been material to date.

Certain channel partners are also reimbursed for direct costs related to marketing or other services that are defined under the terms of the marketing development programs. Estimated reimbursements for marketing development funds are accounted for as consideration payable to a customer, reducing the transaction price of the underlying contracts. The most likely amount method is used to estimate the marketing fund reimbursements at the end of the quarter and the reduction of transaction price is allocated to the applicable performance obligations. The difference between the estimated reimbursement and the actual amount paid to channel partners has not been material to date.

Deferred Commissions

Sales commissions, including the employer portion of payroll taxes, earned by VMware's sales force are considered incremental and recoverable costs of obtaining a contract, and are deferred and generally amortized on a straight-line basis over the expected period of benefit. The expected period of benefit is determined using the contract term or underlying technology life, if renewals are expected and the renewal commissions are not commensurate with the initial commissions. Sales commissions related to software maintenance and support renewals are deferred and amortized on a straight-line basis over the contractual renewal period.

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

U.S. Tax Cuts and Jobs Act

The United States (“U.S.”) Tax Cuts and Jobs Act enacted on December 22, 2017 (the “2017 Tax Act”) introduced significant changes to U.S. income tax law, including a reduction of the U.S. statutory corporate income tax rate from 35% to 21%. During December 2017, the SEC staff issued Staff Accounting Bulletin No. 118, Income Tax Accounting Implications of the Tax Cuts and Jobs Act (“SAB 118”), which allows recognition of provisional tax amounts during a measurement period not to extend beyond one year of the enactment date. Due to the timing of the enactment and the complexity involved in applying the provisions of the 2017 Tax Act, VMware has made reasonable estimates for the related tax effects and recorded provisional amounts on its consolidated financial statements for fiscal 2018. The Company continues to evaluate the impact of the 2017 Tax Act on its consolidated financial statements and expects to complete its analysis within the measurement period permitted under SAB 118.

The Global Intangible Low-Taxed Income (“GILTI”) provisions of the 2017 Tax Act require VMware to include in its U.S. income tax return foreign subsidiary earnings in excess of an allowable return on the foreign subsidiary’s tangible assets. VMware has not elected its accounting policy as to the implementation of the GILTI provisions but plans to do so within the measurement period permitted under SAB 118. VMware recognized the tax impacts associated with GILTI as a current expense on its condensed consolidated statements of income during the three and nine months ended November 2, 2018.

New Accounting Pronouncements

ASU 2016-02, Leases

During February 2016, the FASB issued ASU 2016-02, Leases (Topic 842). The updated standard requires the recognition of a liability for lease obligations and a corresponding right-of-use asset on the balance sheet, and disclosures of key information regarding leasing arrangements. The standard may be early adopted and is effective for interim and annual periods beginning after December 15, 2018 and requires a modified retrospective adoption with the option of applying the requirements of the standard either (1) retrospectively to each prior comparative reporting period presented, or (2) retrospectively at the beginning of the period of adoption. VMware will adopt this standard beginning with its first quarter of fiscal 2020 and will apply it retrospectively at the beginning of the period of adoption through a cumulative-effect adjustment to retained earnings. VMware is currently evaluating the effect that the updated standard will have on its consolidated financial statements and related disclosures and expects that upon adoption most of its lease commitments will be recognized as lease liabilities and right-of-use assets.

B. Revenue

Full Retrospective Adoption

The adoption of Topic 606 impacted VMware’s previously reported results as follows (tables in millions):

	Three Months Ended November 3, 2017		
	As Reported	Topic 606 Adjustments	As Adjusted
Selected Captions from the Condensed Consolidated Statements of Income			
Revenue:			
License	$785	$ (27)	$ 758
Services	1,191	(11)	1,180
Total revenue	1,976	(38)	1,938
Operating expenses:			
Sales and marketing	607	17	624
Operating income	465	(55)	410
Income before income tax	468	(55)	413
Income tax provision	25	(7)	18
Net income	443	(48)	395

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

	Nine Months Ended November 3, 2017		
	As Reported	Topic 606 Adjustments	As Adjusted
Selected Captions from the Condensed Consolidated Statements of Income			
Revenue:			
License	$2,127	$ 55	$ 2,182
Services	3,485	(31)	3,454
Total revenue	5,612	24	5,636
Operating expenses:			
Sales and marketing	1,862	(44)	1,818
Realignment and loss on disposition	88	13	101
Operating income	1,041	55	1,096
Income before income tax	1,133	55	1,188
Income tax provision	124	19	143
Net income	1,009	36	1,045

	February 2, 2018		
	As Reported	Topic 606 Adjustments	As Adjusted
Selected Captions from the Condensed Consolidated Balance Sheets			
Accounts receivable, net of allowance for doubtful accounts	$1,312	$ 82	$ 1,394
Other current assets	237	20	257
Other assets	323	601	924
Deferred tax assets	346	(119)	227
Accrued expenses and other	1,241	116	1,357
Unearned revenue	6,250	(411)	5,839
Other liabilities	152	31	183
Retained earnings	6,943	848	7,791

The adoption of Topic 606 had no impact to net cash provided by or used in operating, investing and financing activities on VMware’s condensed consolidated statements of cash flows during the nine months ended November 3, 2017.

Receivables

VMware records a receivable when an unconditional right to consideration exists and transfer of control has occurred, such that only the passage of time is required before payment of consideration is due. Timing of revenue recognition may differ from the timing of invoicing to customers.

Payment terms vary based on license or service offerings and payment is generally required within 30 to 45 days from date of invoicing. Certain performance obligations may require payment before delivery of the license or service to the customer.

Contract Assets

A contract asset is recognized when a conditional right to consideration exists and transfer of control has occurred. Contract assets include fixed fee professional services where transfer of services has occurred in advance of the Company's right to invoice. Contract assets are classified as accounts receivables upon invoicing. Contract assets are included in other current assets on the condensed consolidated balance sheets. Contract assets were $21 million and $27 million as of November 2, 2018 and February 2, 2018, respectively. Contract asset balances will fluctuate based upon the timing of transfer of services, billings and customers’ acceptance of contractual milestones.

Contract Liabilities

Contract liabilities consist of unearned revenue, which is generally recorded when VMware has the right to invoice or payments have been received for undelivered products or services. Refer to Note L for further information.

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

Customer Deposits
Customer deposits include prepayments from customers related to amounts received for contracts that include cancellation rights. Purchased credits eligible for redemption of VMware's hosted services ("cloud credits") are included in customer deposits until the cloud credit is consumed or is contractually committed to a specific hosted service. Cloud credits are redeemable by the customer for the gross value of the hosted offering. Upon contractual commitment for a hosted service, the net value of the cloud credits that are expected to be recognized as revenue when the obligation is fulfilled will be classified as unearned revenue.
As of November 2, 2018, customer deposits related to customer prepayments and cloud credits of $183 million were included in accrued expenses and other and $47 million were included in other long-term liabilities on the condensed consolidated balance sheets. As of February 2, 2018, customer deposits related to customer prepayments were $126 million and were included in accrued expenses and other on the condensed consolidated balance sheets.
Deferred Commissions
Deferred commissions are classified as current or non-current based on the duration of the expected period of benefit. Deferred commissions, including the employer portion of payroll taxes, included in other current assets as of November 2, 2018 and February 2, 2018 were not significant. Deferred commissions included in other assets were $697 million and $638 million as of November 2, 2018 and February 2, 2018, respectively.
Amortization expense for deferred commissions was included in sales and marketing on the condensed consolidated statements of income and was $64 million and $193 million during the three and nine months ended November 2, 2018, respectively, and $67 million and $172 million during the three and nine months ended November 3, 2017, respectively.
Upon adoption of Topic 606, VMware recognized an impairment on its deferred commissions of $13 million during the first quarter of fiscal 2018, relating to the sales of VMware vCloud Air offerings. The impairment was included in realignment and loss on disposition on the condensed consolidated statements of income. VMware completed the sale of its vCloud Air business ("vCloud Air") to OVH US LLC ("OVH") during the second quarter of fiscal 2018.
C. Related Parties
The information provided below includes a summary of the transactions entered into with Dell and Dell's consolidated subsidiaries, including EMC (collectively, "Dell").
Transactions with Dell
VMware and Dell engaged in the following ongoing intercompany transactions, which resulted in revenue and receipts, and unearned revenue for VMware:

- Pursuant to OEM and reseller arrangements, Dell integrates or bundles VMware's products and services with Dell's products and sells them to end users. Dell also acts as a distributor, purchasing VMware's standalone products and services for resale to end-user customers through VMware-authorized resellers. Revenue under these arrangements is presented net of related marketing development funds and rebates paid to Dell. In addition, VMware provides professional services to end users based upon contractual agreements with Dell.
- Dell purchases products and services from VMware for its internal use.
- From time to time, VMware and Dell enter into agreements to collaborate on technology projects, and Dell pays VMware for services that VMware provides to Dell 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 Dell, 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 agency fee.

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

Dell purchases VMware products and services directly from VMware, as well as through VMware's channel partners. Information about VMware's revenue and receipts, and unearned revenue from such arrangements, for the periods presented consisted of the following (table in millions):

	Revenue and Receipts				Unearned Revenue	
	Three Months Ended		Nine Months Ended		As of	
	November 2, 2018	November 3, 2017	November 2, 2018	November 3, 2017	November 2, 2018	February 2, 2018
Reseller revenue	$544	$ 313	$1,435	$ 867	$1,803	$ 1,236
Internal-use revenue	5	22	17	30	16	12
Collaborative technology project receipts	1	—	3	—	n/a	n/a
Agency fee revenue	—	—	4	1	—	—

Customer deposits resulting from transactions with Dell were $44 million and $37 million as of November 2, 2018 and February 2, 2018, respectively.

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

- VMware purchases and leases products and purchases services from Dell.
- From time to time, VMware and Dell enter into agreements to collaborate on technology projects, and VMware pays Dell for services provided to VMware by Dell related to such projects.
- In certain geographic regions where VMware does not have an established legal entity, VMware contracts with Dell subsidiaries for support services and support from Dell personnel who are managed by VMware. The costs incurred by Dell 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 occupancy expenses. Dell 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.
- In certain geographic regions, Dell files a consolidated indirect tax return, which includes value added taxes and other indirect taxes collected by VMware from its customers. VMware remits the indirect taxes to Dell and Dell remits the tax payment to the foreign governments on VMware's behalf.
- From time to time, VMware invoices end users on behalf of Dell for certain services rendered by Dell. Cash related to these services is collected from the end user by VMware and remitted to Dell.

Information about VMware's costs from such arrangements during the periods presented consisted of the following (table in millions):

	Three Months Ended		Nine Months Ended	
	November 2, 2018	November 3, 2017	November 2, 2018	November 3, 2017
Purchases and leases of products and purchases of services[(1)]	$ 38	$ 34	$ 129	$ 103
Dell subsidiary support and administrative costs	25	30	79	92

[(1)] Amount includes indirect taxes that were remitted to Dell during the periods presented.

VMware also purchases Dell products through Dell's channel partners. Purchases of Dell products through Dell's channel partners were not significant during the periods presented.

From time to time, VMware and Dell also enter into joint marketing and product development arrangements, for which both parties may incur costs.

During the third quarter of fiscal 2019, VMware acquired technology and employees related to the Dell EMC Service Assurance Suite, which provides root cause analysis management software for communications service providers, from Dell. The purchase of the Dell EMC Service Assurance Suite was accounted for as a transaction by entities under common control.

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

The amount of the purchase price in excess of the historical cost of the acquired assets was recognized as a reduction to retained earnings on the condensed consolidated balance sheets. Transition services are to be provided by Dell over a period of 18 months, starting from the date of the acquisition. Payments for transition services are not expected to be significant.

Dell Financial Services ("DFS")

DFS provided financing to certain of VMware's end users at the end users' discretion. Upon acceptance of the financing arrangement by both VMware's end user and DFS, amounts classified as trade accounts receivable are reclassified to due from related parties, net on the condensed consolidated balance sheets. Revenue recognized on transactions financed through DFS was recorded net of financing fees, which were $29 million and $15 million during the nine months ended November 2, 2018 and November 3, 2017, respectively. Financing fees during the three months ended November 2, 2018 and November 3, 2017 were not significant.

Tax Sharing Agreement with Dell

The following table summarizes the payments made to Dell pursuant to a tax sharing agreement during the periods presented (table in millions):

	Three Months Ended		Nine Months Ended	
	November 2, 2018	November 3, 2017	November 2, 2018	November 3, 2017
Payments from VMware to Dell, net	$ 100	$ —	$ 103	$ 12

Payments from VMware to Dell under the tax sharing agreement relate to VMware's portion of federal income taxes on Dell's consolidated tax return as well as state tax payments for combined states. The timing of the tax payments due to and from related parties is governed by the tax sharing agreement. The amounts that VMware pays to Dell for its portion of federal income taxes on Dell's consolidated tax return differ from the amounts VMware would owe on a separate tax return basis and the difference is recognized as a component of additional paid-in capital, generally in the period in which the consolidated tax return is filed. The difference between the amount of tax calculated on a separate tax return basis and the amount of tax calculated pursuant to the tax sharing agreement that was recorded in additional paid-in capital during the three and nine months ended November 2, 2018 was not significant, and was $14 million and $16 million during the three and nine months ended November 3, 2017, respectively.

Due To/From Related Parties, Net

Amounts due to and from related parties, net as of the periods presented consisted of the following (table in millions):

	November 2, 2018	February 2, 2018
Due to related parties	$ 129	$ 106
Due from related parties	671	638
Due from related parties, net	$ 542	$ 532
Income tax due to related parties	$ 787	$ 781

Amounts included in due from related parties, net, excluding DFS and tax obligations, are generally settled in cash within 60 days of each quarter-end.

Stock Purchase Arrangements with Dell

From time to time, VMware enters into stock purchase arrangements with Dell. The following table summarizes purchases of VMware's Class A common stock from Dell during the periods presented, pursuant to stock purchase agreements entered into on December 15, 2016 and March 29, 2017 (aggregate purchase price in millions, shares in thousands):

	Three Months Ended	Nine Months Ended
	November 3, 2017	November 3, 2017
Aggregate purchase price	$ 855	$ 1,280
Class A common shares repurchased[(1)]	7,771	12,598
Weighted-average price per share	$ 110.00	$ 101.59

[(1)] The aggregate number of shares purchased was determined based upon a volume-weighted average price during a defined period, less an agreed upon discount.

There were no purchases of VMware's Class A common stock from Dell during the three and nine months ended November 2, 2018.

Notes Payable to Dell

On January 21, 2014, VMware entered into a note exchange agreement with its parent company providing for the issuance of three promissory notes in the aggregate principal amount of $1,500 million, which consisted of outstanding principal due on the following dates: $680 million due May 1, 2018, $550 million due May 1, 2020 and $270 million due December 1, 2022.

On August 21, 2017, VMware repaid two of the notes payable to Dell in the aggregate principal amount of $1,230 million, representing repayment of the note due May 1, 2018 at par value and repayment of the note due May 1, 2020 at a discount. The remaining note payable of $270 million due December 1, 2022 may be prepaid without penalty or premium.

Interest is payable quarterly in arrears, at the annual rate of 1.75%. Interest expense on the notes payable to Dell was not significant during the three and nine months ended November 2, 2018 and the three months ended November 3, 2017. Interest expense recognized during the nine months ended November 3, 2017 was $15 million.

Pivotal

As of February 2, 2018, VMware had a 20% ownership interest in Pivotal, and the investment was accounted for using the cost method. The value of the investment was included in other assets on the condensed consolidated balance sheets and was $20 million as of February 2, 2018. Prior to Pivotal's initial public offering on April 20, 2018, VMware's previously held preferred shares were converted to shares of non-trading Class B common stock, resulting in VMware having a financial interest of 18% and a voting interest of 24% in Pivotal. VMware recognized an unrealized loss of $161 million during the three months ended November 2, 2018 and an unrealized gain of $851 million during the nine months ended November 2, 2018 in other income (expense), net on the condensed consolidated statements of income to adjust its investment in Pivotal to its fair value of $871 million as of November 2, 2018. A discrete tax benefit of $40 million and discrete tax expense of $196 million was recognized during the three and nine months ended November 2, 2018, respectively, related to its book and tax basis difference on the investment in Pivotal, net of the reversal of the previously recorded valuation allowance. Refer to Note I for further discussion.

D. Business Combinations, Definite-Lived Intangible Assets, Net and Goodwill

Business Combinations

During the third quarter of fiscal 2019, VMware completed the acquisition of CloudHealth Technologies, Inc. ("CloudHealth Technologies"). CloudHealth Technologies delivers a cloud operations platform that enables customers to analyze and manage cloud cost, usage, security, and performance centrally for native public clouds, which will expand VMware’s portfolio of multi-cloud management solutions. The total purchase price was $495 million, net of cash acquired of $26 million. The purchase price primarily included $101 million of identifiable intangible assets and $394 million of goodwill that is not expected to be deductible for tax purposes. The identifiable intangible assets included completed technology of $69 million and customer relationships of $18 million, with estimated useful lives of one to five years.

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

The fair value of assumed unvested equity awards attributed to post-combination services was $39 million and will be expensed over the remaining requisite service periods on a straight-line basis. The estimated fair value of the stock options assumed by the Company was determined using the Black-Scholes option pricing model.
The initial allocation of the purchase price was based on a preliminary valuation and assumptions and is subject to change within the measurement period. VMware expects to finalize the allocation of the purchase price as soon as practicable and no later than one year from the acquisition date.
The pro forma financial information assuming the acquisition had occurred as of the beginning of the fiscal year prior to the fiscal year of acquisition, as well as the revenue and earnings generated during the current fiscal year, were not material for disclosure purposes.
In addition, during the first quarter of fiscal 2019, VMware completed four asset acquisitions, in which the Company acquired certain intangible assets classified as completed technology. The aggregate purchase price of the intangible assets acquired was $26 million.
Definite-Lived Intangible Assets, Net
As of the periods presented, definite-lived intangible assets consisted of the following (amounts in tables in millions):

	November 2, 2018			
	Weighted-Average Useful Lives (in years)	Gross Carrying Amount	Accumulated Amortization	Net Book Value
Purchased technology	6.3	$ 770	$ (479)	$ 291
Leasehold interest	34.9	149	(32)	117
Customer relationships and customer lists	7.6	192	(89)	103
Trademarks and tradenames	7.9	80	(38)	42
Other	3.9	7	(2)	5
Total definite-lived intangible assets		$ 1,198	$ (640)	$ 558

	February 2, 2018			
	Weighted-Average Useful Lives (in years)	Gross Carrying Amount	Accumulated Amortization	Net Book Value
Purchased technology	6.4	$ 750	$ (466)	$ 284
Leasehold interest	34.9	149	(29)	120
Customer relationships and customer lists	7.8	177	(74)	103
Trademarks and tradenames	8.4	70	(31)	39
Other	5.7	5	(3)	2
Total definite-lived intangible assets		$ 1,151	$ (603)	$ 548

Amortization expense on definite-lived intangible assets was $39 million and $117 million during the three and nine months ended November 2, 2018, respectively, and $34 million and $100 million during the three and nine months ended November 3, 2017, respectively.

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

Based on intangible assets recorded as of November 2, 2018 and assuming no subsequent additions, dispositions or impairment of underlying assets, the remaining estimated annual amortization expense over the next five fiscal years and thereafter is expected to be as follows (table in millions):

Remainder of 2019	$43
2020	150
2021	93
2022	78
2023	55
Thereafter	139
Total	$558

Goodwill

The following table summarizes the changes in the carrying amount of goodwill during the nine months ended November 2, 2018 (table in millions):

Balance, February 2, 2018	$4,597
Increase in goodwill related to business combinations	392
Balance, November 2, 2018	$4,989

E. Realignment and Loss on Disposition

Disposition of VMware vCloud Air Business

During the second quarter of fiscal 2018, VMware completed the sale of vCloud Air to OVH. The loss recognized in connection with this transaction was $101 million during the nine months ended November 3, 2017 and was recorded in realignment and loss on disposition on the condensed consolidated statements of income. The loss recognized during the three months ended November 3, 2017 was not significant. The losses recognized on the disposition of vCloud Air were deductible for tax purposes and resulted in a discrete tax benefit of $12 million during the second quarter of fiscal 2018.

F. 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, including performance stock units, and stock options, including purchase options under VMware's employee stock purchase plan. Securities are excluded from the computation 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.

The following table sets forth the computations of basic and diluted net income per share during the periods presented (table in millions, except per share amounts and shares in thousands):

	Three Months Ended		Nine Months Ended	
	November 2, 2018	November 3, 2017	November 2, 2018	November 3, 2017
Net income	$334	$ 395	$1,920	$ 1,045
Weighted-average shares, basic for Classes A and B	408,708	406,733	406,929	407,856
Effect of other dilutive securities	5,769	6,280	6,449	6,101
Weighted-average shares, diluted for Classes A and B	414,477	413,013	413,378	413,957
Net income per weighted-average share, basic for Classes A and B	$0.82	$ 0.97	$4.72	$ 2.56
Net income per weighted-average share, diluted for Classes A and B	$0.81	$ 0.96	$4.64	$ 2.53

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

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 periods presented because their effect would have been anti-dilutive (shares in thousands):

	Three Months Ended		Nine Months Ended	
	November 2, 2018	November 3, 2017	November 2, 2018	November 3, 2017
Anti-dilutive securities:				
Employee stock options	50	—	20	585
Restricted stock units	219	—	2,045	109
Total	269	—	2,065	694

There were no anti-dilutive shares during the three months ended November 3, 2017.

G. Cash, Cash Equivalents and Investments

Cash, cash equivalents and investments as of the periods presented consisted of the following (tables in millions):

	November 2, 2018			
	Cost or Amortized Cost	Unrealized Gains	Unrealized Losses	Aggregate Fair Value
Cash	$390	$ —	$ —	$ 390
Cash equivalents:				
Money-market funds	$8,766	$ —	$ —	$ 8,766
Demand deposits	33	—	—	33
Total cash equivalents	$8,799	$ —	$ —	$ 8,799
Short-term investments:				
U.S. Government and agency obligations	$634	$ —	$ (8)	$ 626
U.S. and foreign corporate debt securities	3,581	—	(45)	3,536
Foreign governments and multi-national agency obligations	75	—	(1)	74
Mortgage-backed securities	86	—	(3)	83
Total short-term investments[1]	$4,376	$ —	$ (57)	$ 4,319

[1] Short-term investments on the condensed consolidated balance sheets as of November 2, 2018 also includes the marketable equity investment carried at fair value. Refer to Note I for further information.

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

	February 2, 2018			
	Cost or Amortized Cost	Unrealized Gains	Unrealized Losses	Aggregate Fair Value
Cash	$423	$ —	$ —	$ 423
Cash equivalents:				
Money-market funds	$5,460	$ —	$ —	$ 5,460
U.S. and foreign corporate debt securities	88	—	—	88
Total cash equivalents	$5,548	$ —	$ —	$ 5,548
Short-term investments:				
U.S. Government and agency obligations	$965	$ —	$ (8)	$ 957
U.S. and foreign corporate debt securities	4,503	1	(31)	4,473
Foreign governments and multi-national agency obligations	99	—	(1)	98
Mortgage-backed securities	123	—	(2)	121
Marketable available-for-sale equity securities	15	18	—	33
Total short-term investments	$5,705	$ 19	$ (42)	$ 5,682

VMware evaluated its available-for-sale investments as of November 2, 2018 and February 2, 2018 for other-than-temporary declines in fair value and did not consider any to be other-than-temporarily impaired. The realized gains and losses on investments during the three and nine months ended November 2, 2018 and November 3, 2017 were not significant.

Unrealized losses on available-for-sale investments, which have been in a net loss position for less than twelve months as of the periods presented, were as follows (table in millions):

	November 2, 2018		February 2, 2018	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. and foreign corporate debt securities	$ 1,566	$ (21)	$ 3,100	$ (22)

As of the periods presented, unrealized losses on available-for-sale investments in the other investment categories, which have been in a net loss position for less than twelve months, were not significant.

Unrealized losses on available-for-sale investments, which have been in a net loss position twelve months or greater as of the periods presented, were as follows (table in millions):

	November 2, 2018		February 2, 2018	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. and foreign corporate debt securities	$ 1,594	$ (24)	$ 693	$ (9)

As of the periods presented, unrealized losses on available-for-sale investments in the other investment categories, which have been in a net loss position for twelve months or greater, were not significant.

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

Contractual Maturities

The contractual maturities of fixed income securities included in short-term investments on the condensed consolidated balance sheets and held as of November 2, 2018, consisted of the following (table in millions):

	Amortized Cost Basis	Aggregate Fair Value
Due within one year	$ 2,327	$ 2,315
Due after 1 year through 5 years	1,926	1,885
Due after 5 years through 10 years	65	63
Due after 10 years	58	56
Total fixed income securities	$ 4,376	$ 4,319

Restricted Cash

During November 2016, the FASB issued ASU 2016-18, for which restricted cash or restricted cash equivalents is included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on the statement of cash flows. The updated standard was effective for interim and annual periods beginning after December 15, 2017 and required a full retrospective transition method. VMware adopted ASU 2016-18 during the first quarter of fiscal 2019 and has applied the standard retrospectively to all periods presented. The adoption of ASU 2016-18 did not have a significant impact on the condensed consolidated statements of cash flows during the nine months ended November 3, 2017.

The following table provides a reconciliation of the Company’s cash and cash equivalents, current portion of restricted cash and non-current portion of restricted cash reported within the condensed consolidated balance sheets that sum to the total cash, cash equivalents and restricted cash shown in the Company’s condensed consolidated statements of cash flows for the periods presented (table in millions):

	November 2, 2018	February 2, 2018
Cash and cash equivalents	$ 9,189	$ 5,971
Restricted cash within other current assets	32	22
Restricted cash within other assets	12	10
Total cash, cash equivalents and restricted cash	$ 9,233	$ 6,003

Amounts included in restricted cash primarily relate to certain employee-related benefits, as well as amounts related to installment payments to certain employees as part of acquisitions, subject to the achievement of specified future employment conditions.

H. Debt

Long-term Debt

On August 21, 2017, VMware issued three series of unsecured senior notes (“Senior Notes”) pursuant to a public debt offering. The proceeds from the issuance were $3,961 million, net of debt discount of $9 million and debt issuance costs of $30 million.

Table of Contents

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

The carrying value of the Senior Notes as of the periods presented were as follows (amounts in millions):

	November 2, 2018	February 2, 2018	Effective Interest Rate
Long-term debt:			
2.30% Senior Note Due August 21, 2020	$ 1,250	$ 1,250	2.56%
2.95% Senior Note Due August 21, 2022	1,500	1,500	3.17%
3.90% Senior Note Due August 21, 2027	1,250	1,250	4.05%
Total principal amount	4,000	4,000	
Less: unamortized discount	(7)	(8)	
Less: unamortized debt issuance costs	(23)	(28)	
Net carrying amount	$ 3,970	$ 3,964	

Interest is payable semiannually in arrears, on February 21 and August 21 of each year. During the three and nine months ended November 2, 2018, interest expense of $32 million and $97 million, respectively, which included amortization of discount and issuance costs, was recognized on the condensed consolidated statements of income. During the three and nine months ended November 3, 2017, interest expense of $26 million was recognized. The discount and issuance costs are amortized over the term of the Senior Notes on a straight-line basis, which approximates the effective interest method.

The Senior Notes are redeemable in whole at any time or in part from time to time at VMware's option, subject to a make-whole premium. In addition, upon the occurrence of certain change-of-control triggering events and certain downgrades of the ratings on the Senior Notes, VMware may be required to repurchase the notes at a repurchase price equal to 101% of the aggregate principal plus any accrued and unpaid interest on the date of purchase. The Senior Notes rank equally in right of payment with VMware's other unsecured and unsubordinated indebtedness. The Senior Notes also include restrictive covenants that, in certain circumstances, limit VMware's ability to create certain liens, to enter into certain sale and leaseback transactions and to consolidate, merge, sell or otherwise dispose of all or substantially all of VMware's assets.

Refer to Note C for information regarding the notes payable to Dell.

Revolving Credit Facility

On September 12, 2017, VMware entered into an unsecured credit agreement establishing a revolving credit facility ("Credit Facility") with a syndicate of lenders that provides the Company with a borrowing capacity of up to $1,000 million, which may be used for general corporate purposes. Commitments under the Credit Facility are available for a period of five years, which may be extended, subject to the satisfaction of certain conditions, by up to two one-year periods. As of November 2, 2018, there were no outstanding borrowings under the Credit Facility. The credit agreement contains certain representations, warranties and covenants. Commitment fees, interest rates and other terms of borrowing under the Credit Facility may vary based on VMware's external credit ratings. The amount paid in connection with the ongoing commitment fee, which is payable quarterly in arrears, was not significant during the three and nine months ended November 2, 2018.

I. 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 as being 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; and
- 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 were primarily classified as Level 2, with the exception of some of the U.S. Government and agency obligations that were classified as Level 1. Additionally, VMware's Level 2 classification included forward contracts, notes payable to Dell and the Senior Notes.

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

As of November 2, 2018 and February 2, 2018, VMware's Level 2 investment securities were generally priced using non-binding market consensus prices that were corroborated by observable market data, quoted market prices for similar instruments, or pricing models such as discounted cash flow techniques.
VMware did not have any significant assets or liabilities that were classified as Level 3 of the fair value hierarchy for the periods presented, and there have been no transfers between fair value measurement levels during the periods presented.
The following tables set forth the fair value hierarchy of VMware's cash equivalents and short-term investments that were required to be measured at fair value as of the periods presented (tables in millions):

	November 2, 2018		
	Level 1	Level 2	Total
Cash equivalents:			
Money-market funds	$8,766	$—	$8,766
Demand deposits	—	33	33
Total cash equivalents	$8,766	$33	$8,799
Short-term investments:			
U.S. Government and agency obligations	$436	$190	$626
U.S. and foreign corporate debt securities	—	3,536	3,536
Foreign governments and multi-national agency obligations	—	74	74
Mortgage-backed securities	—	83	83
Marketable equity securities	19	—	19
Total short-term investments	$455	$3,883	$4,338

	February 2, 2018		
	Level 1	Level 2	Total
Cash equivalents:			
Money-market funds	$5,460	$—	$5,460
U.S. and foreign corporate debt securities	—	88	88
Total cash equivalents	$5,460	$88	$5,548
Short-term investments:			
U.S. Government and agency obligations	$684	$273	$957
U.S. and foreign corporate debt securities	—	4,473	4,473
Foreign governments and multi-national agency obligations	—	98	98
Mortgage-backed securities	—	121	121
Marketable available-for-sale equity securities	33	—	33
Total short-term investments	$717	$4,965	$5,682

The notes payable to Dell and the Senior Notes were not adjusted to fair value. The fair value of the notes payable to Dell was approximately $245 million and $246 million as of November 2, 2018 and February 2, 2018, respectively. The fair value of the Senior Notes was approximately $3,795 million and $3,863 million as of November 2, 2018 and February 2, 2018, respectively. Fair value for both the notes payable to Dell and the Senior Notes was estimated primarily based on observable market interest rates (Level 2 inputs).
VMware offers a deferred compensation plan for eligible employees, which allows participants to defer payment for part or all of their compensation. The net impact to the condensed consolidated statements of income is not significant 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 associated with this plan were the same as the liabilities at approximately $74 million and $60 million as of November 2, 2018 and

February 2, 2018, respectively, and are included in other assets and other liabilities on the condensed consolidated balance sheets.

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

Equity securities
During January 2016, the FASB issued ASU 2016-01, Financial Instruments-Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities (“ASU 2016-01”), which requires equity investments with readily determinable fair values (other than those accounted for under the equity method or those that result in consolidation of the investee) to be measured at fair value with changes in fair value for certain equity investments recognized in other income (expenses), net on the condensed consolidated statements of income.
Securities Carried at Fair Value
VMware holds an equity security, which is publicly traded and measured at fair value using quoted prices for identical assets in an active market (Level 1). Prior to the adoption of ASU 2016-01, unrealized gains or losses on this equity security were recognized in accumulated other comprehensive loss on the condensed consolidated balance sheets. Effective February 3, 2018, VMware adopted ASU 2016-01 and reclassified the unrealized gain on this security of $11 million to retained earnings as a cumulative-effect adjustment on the condensed consolidated balance sheets. Unrealized gains and losses are now recognized in other income (expense), net on the condensed consolidated statements of income. As of November 2, 2018, the fair value of this equity security was $19 million and was included in short-term investments on the condensed consolidated balance sheets. The unrealized loss recognized was $14 million during the nine months ended November 2, 2018 and was not significant during the three months ended November 2, 2018.
Through its ownership in Class B Common Stock, VMware has a financial interest of 18% and a voting interest of 24% in Pivotal. VMware elected the fair value option of accounting because it believes that fair value is the most relevant measurement for this investment. The fair value of VMware’s investment in Pivotal was $871 million as of November 2, 2018 and was determined using the quoted market price of Pivotal’s Class A common stock as of each reporting period, adjusted for the impact of superior voting rights (Level 2).
Financial information of Pivotal is made publicly available. The following tables include summarized financial information for the second quarter of fiscal 2019 obtained from Pivotal’s most recent Form 10-Q filed with the SEC on September 13, 2018 (tables in millions):

	Three Months Ended August 3, 2018	Six Months Ended August 3, 2018
Results of Operations Data:		
Revenue	$ 164	$ 320
Gross profit	103	200
Loss from operations	(35)	(69)
Net loss	(36)	(68)
Net loss attributable to Pivotal	(36)	(68)

	August 3, 2018
Balance Sheet Data:	
Current assets	$ 857
Total assets	1,633
Current liabilities	328
Total liabilities	398
Non-controlling interest	1

Securities Without a Readily Determinable Fair Value

VMware's equity securities also include investments in privately held companies, which do not have a readily determinable fair value. Prior to the adoption of ASU 2016-01, VMware accounted for these equity securities at cost less impairment and recorded realized gains and losses on securities sold or impaired in other income (expense), net on the condensed consolidated

Table of Contents

statements of income. As of February 2, 2018, equity securities accounted for under the cost method had a carrying value of $146 million.

Upon adoption of ASU 2016-01, VMware elected to measure these equity securities at cost minus impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for the identical or a similar security of the same issuer. As of November 2, 2018, these equity securities had a carrying value of $96 million and were included in other assets on the condensed consolidated balance sheets. All gains and losses on these equity securities, whether realized or unrealized, are recognized in other income (expense), net on the condensed consolidated statements of income.

J. Derivatives and Hedging Activities

VMware conducts business on a global basis in multiple foreign currencies, subjecting the Company to foreign currency risk. To mitigate a portion of 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 agreements. 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 certain operating expenses denominated in certain foreign currencies, VMware enters into forward contracts that are designated as cash flow hedging instruments as the accounting criteria for such designation are met. Therefore, the effective portion of gains or losses resulting from changes in the fair value of these instruments 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 nine months ended November 2, 2018 and November 3, 2017, the effective portion of gains or losses reclassified to the condensed consolidated statements of income was not significant. Interest charges or “forward points” on VMware’s forward contracts are excluded from the assessment of hedge effectiveness and are recorded in other income (expense), net on the condensed consolidated statements of income as incurred.

These forward contracts have contractual maturities of twelve months or less, and as of November 2, 2018 and February 2, 2018, outstanding forward contracts had a total notional value of $88 million and $318 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 nine months ended November 2, 2018 and November 3, 2017, all cash flow hedges were considered effective.

Forward Contracts Not Designated as Hedges

VMware has established a program that utilizes 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 (expense), net on the condensed consolidated statements of income.

These forward contracts have a contractual maturity of one month, and as of November 2, 2018 and February 2, 2018, outstanding forward contracts had a total notional value of $976 million and $1,020 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 nine months ended November 2, 2018, VMware recognized gains of $16 million and $74 million, respectively, related to the settlement of forward contracts. The loss recognized during three months ended November 3, 2017 was not significant, and the loss recognized during the nine months ended November 3, 2017 was $33 million. Gains and losses are recorded in other income (expense), net on the condensed consolidated statements of income.

The combined gains and losses related to the settlement of forward contracts and the underlying foreign currency denominated assets and liabilities were not significant during the three and nine months ended November 2, 2018 and November 3, 2017. Net gains and losses are recorded in other income (expense), net on the condensed consolidated statements of income.

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

K. Contingencies
Litigation
On August 10, 2015, the Company received a subpoena from the California Attorney General's office ("California AG"), following the Company's settlement with the Department of Justice and the General Services Administration during June 2015. In this matter, the California AG is investigating the accuracy of the Company's sales practices with departments and agencies within the State of California. The Company held an initial meeting with the California AG's representatives on November 5, 2015, and thereafter provided certain requested documents to the California AG. The Company did not receive any further communications from the California AG until the fall of 2017. Since then, the California AG and the Company have exchanged communications regarding the legal bases for the allegations, and the Company has provided additional information requested by the California AG. The Company is unable at this time to reasonably assess whether or to what extent it may be found liable and believes a loss is not considered probable and is not estimable.
On March 4, 2015, Christoph Hellwig, a software developer who alleged that software code he wrote is used in a component of the Company's vSphere product, filed a lawsuit against VMware in the Hamburg Regional Court in Germany alleging copyright infringement for failing to comply with the terms of the open source General Public License v.2 ("GPL v.2"). On July 8, 2016, the German court issued a written decision dismissing Mr. Hellwig's lawsuit. Mr. Hellwig has appealed this decision, a hearing was held by the appellate court on November 28, 2018 and the appellate court has taken the matter under submission. The Company intends to continue vigorously defending itself against this lawsuit.
While VMware believes that it has valid defenses against each of the above legal matters, 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 accrues for a liability when a determination has been made that a loss is both probable and the amount of the loss can be reasonably estimated. If only a range can be estimated and no amount within the range is a better estimate than any other amount, an accrual is recorded for the minimum amount in the range. 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 is also subject to other legal, administrative and regulatory proceedings, claims, demands and investigations in the ordinary course of business or in connection with business mergers and acquisitions, including claims with respect to commercial, contracting and sales practices, product liability, intellectual property, employment, corporate and securities law, class action, whistleblower and other matters. From time to time, VMware also receives inquiries from and has discussions with government entities and stockholders on various matters. As of November 2, 2018, amounts accrued relating to these other matters arising as part of the ordinary course of business were considered not material. 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.
L. Unearned Revenue and Remaining Performance Obligations
Unearned Revenue
Unearned revenue as of the periods presented consisted of the following (table in millions):

	November 2, 2018	February 2, 2018
Unearned license revenue	$ 212	$ 184
Unearned software maintenance revenue	5,345	5,082
Unearned professional services revenue	644	573

Total unearned revenue	$ 6,201	$ 5,839

Unearned license revenue is primarily related to the allocated portion of VMware's software-as-a-service (“SaaS”) offerings and is generally recognized over time as customers consume the services or ratably over the term of the subscription, commencing upon provisioning of the service.

Unearned software maintenance revenue is attributable to VMware’s maintenance contracts and is generally recognized over time on a ratable basis over the contract duration. The weighted-average remaining term as of November 2, 2018 was

25

approximately two years. In addition, unearned software maintenance revenue also includes the allocated portion of VMware's SaaS offerings. Unearned professional services revenue results primarily from prepaid professional services and is generally recognized as the services are performed.

During the nine months ended November 2, 2018, unearned revenue on current period billings was $4,181 million. Revenue recognized during the nine months ended November 2, 2018, from amounts previously classified as unearned revenue, was $3,747 million and did not include revenue for performance obligations that were fully satisfied upon delivery, such as on-premises license.

During the nine months ended November 2, 2018, cloud credits totaling $77 million were reclassified from unearned revenue to customer deposits due to the addition of third-party offerings that would be recognized net of associated cost upon redemption of cloud credits.

Revenue recognized during the nine months ended November 3, 2017, from amounts previously classified as unearned revenue, was $3,434 million and did not include revenue for performance obligations that were fully satisfied upon delivery, such as on-premises license.

Remaining Performance Obligations

Remaining performance obligations represent the aggregate amount of the transaction price in contracts allocated to performance obligations not delivered, or partially undelivered, as of the end of the reporting period. Remaining performance obligations include unearned revenue, multi-year contracts with future installment payments and certain unfulfilled orders against accepted customer contracts at the end of any given period.

As of November 2, 2018, the aggregate transaction price allocated to remaining performance obligations was $6,711 million. Approximately 57% is expected to be recognized as revenue over the next 12 months and the remainder thereafter. VMware applied the practical expedient to not disclose the amount of transaction price allocated to remaining performance obligations for periods prior to adoption of Topic 606.

M. Stockholders' Equity

Special Dividend

On July 1, 2018, VMware's board of directors declared a conditional $11 billion one-time special cash dividend (the "Special Dividend"), payable pro-rata to VMware stockholders as of the record date. The Special Dividend is payable in connection with the closing of a proposed transaction by Dell (the "Dell Class V Transaction") pursuant to which holders of Dell Class V common stock, which is designed to track the economic performance of VMware, will exchange the Dell Class V common stock for Dell Class C common stock or cash or both, resulting in the elimination of the Dell Class V common stock. Payment of the Special Dividend is conditioned upon approval of the Dell Class V Transaction and the satisfaction of certain other conditions set forth in current reports on Form 8-K filed by VMware on July 2, 2018 and November 15, 2018. The record date for the Special Dividend will follow approval of the Dell Class V Transaction by Dell's stockholders, and the Special Dividend will be paid in connection with the consummation of the Dell Class V Transaction. The conditions for payment of the Special Dividend must be met no later than January 31, 2019 or the Special Dividend will not be paid. Dell's stockholders are scheduled to vote on the Dell Class V Transaction on December 11, 2018.

Stock awards that are outstanding at the time of the Special Dividend will be adjusted pursuant to anti-dilution provisions in the Company's stock plan documents that provide for equitable adjustments to be determined by the Company's Compensation and Corporation Governance Committee in the event of an extraordinary cash dividend.

VMware Stock Repurchases

VMware purchases stock from time to time in open market transactions, subject to market conditions. 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, legal 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. From time to time, VMware also purchases stock in private transactions, such as those with Dell. All shares repurchased

under VMware's stock repurchase programs are retired.
During August 2017, VMware's board of directors authorized the repurchase of up to $1,000 million of Class A common stock through August 31, 2018. On July 1, 2018, VMware's board of directors extended authorization of the existing stock repurchase program through August 31, 2019. As of November 2, 2018, the cumulative authorized amount remaining for stock repurchases was $876 million.

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

The following table summarizes stock repurchase activity, including shares purchased from Dell, during the periods presented (aggregate purchase price in millions, shares in thousands):

	Three Months Ended	Nine Months Ended
	November 3, 2017	November 3, 2017
Aggregate purchase price[1]	$ 855	$ 1,280
Class A common shares repurchased	7,771	12,598
Weighted-average price per share	$ 110.00	$ 101.59

[1] The aggregate purchase price of repurchased shares is classified as a reduction to additional paid-in capital.

There were no repurchases of VMware's Class A common stock during the three and nine months ended November 2, 2018.

VMware Restricted Stock

VMware's restricted stock primarily consists of restricted stock unit ("RSU") awards, which have been granted to employees. The value of an RSU grant is 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's Class A common stock.

VMware's restricted stock also includes performance stock unit ("PSU") awards, which have been granted to certain VMware executives and employees. The PSU awards include performance conditions and, in certain cases, a time-based or market-based vesting component. Upon vesting, PSU awards 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 or market-based target designated by each award. If minimum performance thresholds are not achieved, then no shares are issued.

The following table summarizes restricted stock activity since February 3, 2018 (units in thousands):

	Number of Units	Weighted-Average Grant Date Fair Value (per unit)
Outstanding, February 3, 2018	17,360	$ 78.62
Granted	5,658	145.19
Vested	(5,814)	75.90
Forfeited	(1,291)	84.95
Outstanding, November 2, 2018	15,913	102.89

The aggregate vesting date fair value of VMware's restricted stock that vested during the nine months ended November 2, 2018 was $819 million. As of November 2, 2018, restricted stock representing 15.9 million shares of VMware's Class A common stock were outstanding, with an aggregate intrinsic value of $2,249 million based on VMware's closing stock price as of November 2, 2018.

Net excess tax benefits

Net excess tax benefits recognized in connection with stock-based awards are included in income tax provision on the condensed consolidated statements of income. Net excess tax benefits recognized during the three and nine months ended November 2, 2018 were $23 million and $76 million, respectively, and were $32 million and $76 million during the three and nine months ended November 3, 2017, respectively.

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

Accumulated Other Comprehensive Income (Loss)
The changes in components of accumulated other comprehensive income (loss) during the periods presented were as follows (tables in millions):

	Unrealized Gain (Loss) on Available-for-Sale Securities	Unrealized Gain (Loss) on Forward Contracts	Total
Balance, February 2, 2018	$ (15)	$ —	$ (15)
Adjustments related to adoption of ASU 2016-01 and 2018-02	(15)	—	(15)
Unrealized gains (losses), net of tax (benefit) of ($4), $—, and ($4)	(11)	(9)	(20)
Amounts reclassified from accumulated other comprehensive income (loss) to the condensed consolidated statements of income, net of tax benefit of $—, $— and $—	—	(1)	(1)
Other comprehensive income (loss), net	(11)	(10)	(21)
Balance, November 2, 2018	$ (41)	$ (10)	$ (51)

	Unrealized Gain (Loss) on Available-for-Sale Securities	Unrealized Gain (Loss) on Forward Contracts	Total
Balance, February 3, 2017	$ (6)	$ 2	$ (4)
Unrealized gains (losses), net of tax provision of $5, $— and $5	9	3	12
Amounts reclassified from accumulated other comprehensive income (loss) to the condensed consolidated statements of income, net of tax benefit of $2, $— and $2	3	(2)	1
Other comprehensive income (loss), net	12	1	13
Balance, November 3, 2017	$ 6	$ 3	$ 9

Unrealized gains and losses 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 and losses are realized.
The effective portion of gains or losses resulting from changes in the fair value of forward contracts designated as cash flow hedging instruments is reclassified to its related operating expense line item on the condensed consolidated statements of income in the same period that the underlying expenses are incurred. The amounts recorded to their related operating expense functional line items on the condensed consolidated statements of income were not significant to the individual functional line items during the periods presented.
Effective February 3, 2018, VMware adopted ASU 2016-16, Income Taxes: Intra-Entity Transfers of Assets Other Than Inventory (Topic 740), on a modified retrospective basis. The standard requires entities to recognize at the transaction date the income tax consequences of intra-entity asset transfers. VMware recorded a cumulative-effect adjustment of $27 million to retained earnings on the condensed consolidated balance sheets as of the beginning of the period of adoption. Subsequent to the adoption, any transfers of intellectual property between VMware's legal entities will be recorded on the condensed consolidated statements of income in the period that the transfer occurs.
Effective February 3, 2018, VMware early adopted ASU 2018-02, Income Statement-Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income, which allows companies to reclassify stranded tax effects resulting from the 2017 Tax Act from accumulated other comprehensive income to retained earnings. VMware elected to reclassify income tax effects due to the 2017 Tax Act from accumulated other comprehensive loss to retained earnings on the condensed consolidated balance sheets in the period of adoption. The impact of the reclassification of stranded tax effects was not significant.
N. Segment Information

VMware operates in one reportable operating segment, thus all required financial segment information is included in the condensed consolidated financial statements. Operating segments are defined as components of an enterprise for 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.

Revenue by type during the periods presented was as follows (table in millions):

	Three Months Ended		Nine Months Ended	
	November 2, 2018	November 3, 2017	November 2, 2018	November 3, 2017
Revenue:				
License	$884	$ 758	$2,558	$ 2,182
Services:				
Software maintenance	1,138	1,016	3,324	2,989
Professional services	178	164	501	465
Total services	1,316	1,180	3,825	3,454
Total revenue[1]	$2,200	$ 1,938	$6,383	$ 5,636

[1] Includes revenue derived from VMware's Hybrid Cloud Computing subscription and SaaS offerings, which was $237 million and $665 million during the three and nine months ended November 2, 2018, respectively, and $175 million and $514 million during the three and nine months ended November 3, 2017, respectively. Revenue from Hybrid Cloud Computing offerings consisted primarily of VCPP revenue.

Revenue by geographic area during the periods presented was as follows (table in millions):

	Three Months Ended		Nine Months Ended	
	November 2, 2018	November 3, 2017	November 2, 2018	November 3, 2017
United States	$1,052	$ 970	$3,053	$ 2,825
International	1,148	968	3,330	2,811
Total	$2,200	$ 1,938	$6,383	$ 5,636

Revenue by geographic area is based on the ship-to addresses of VMware's customers. No individual country other than the U.S. accounted for 10% or more of revenue during the three and nine months ended November 2, 2018 and November 3, 2017.

Long-lived assets by geographic area, which primarily include property and equipment, net, as of the periods presented were as follows (table in millions):

	November 2, 2018	February 2, 2018
United States	$ 825	$ 784
International	105	117
Total	$ 930	$ 901

No individual country other than the U.S. accounted for 10% or more of these assets as of November 2, 2018 and February 2, 2018.

O. Subsequent Event

During November 2018, VMware entered into a definitive agreement to acquire Heptio Inc. ("Heptio"). Total consideration for the acquisition, subject to purchase price adjustments, will consist of approximately $550 million in cash and assumed unvested equity awards of the acquiree. Heptio provides products and services that help enterprises deploy and operationalize Kubernetes. The transaction is expected to close during the fourth quarter of fiscal 2019 and is subject to regulatory approvals and customary closing conditions.

Table of Contents

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

The following management's discussion and analysis 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 November 2, 2018 should be read in conjunction with our consolidated financial statements for the year ended February 2, 2018 contained in our Form 10-K filed on March 29, 2018. Multiple accounting standards were adopted during the three months ended May 4, 2018, which resulted in adjustments or reclassifications of amounts previously reported. Refer to the Notes to the condensed consolidated financial statements in Part I, Item 1 of this Quarterly Report on Form 10-Q for further discussion.

Period-over-period changes are calculated based upon the respective underlying, non-rounded data. We refer to our fiscal years ended February 1, 2019 and February 2, 2018 as "fiscal 2019" and "fiscal 2018," respectively. 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

We pioneered the development and application of virtualization technologies with x86 server-based computing, separating application software from the underlying hardware. Information technology ("IT") driven innovation is disrupting markets and industries. Technologies emerge faster than organizations can absorb them, creating increasingly complex environments. To take on this challenge, businesses need a flexible and secure digital foundation. We provide compute, cloud, mobility, networking and security infrastructure software to businesses that provides a flexible digital foundation for the applications that empower businesses to serve their customers globally. Over the years, we have increased our product and solution offerings beyond compute virtualization to include offerings that allow organizations to manage IT resources across private clouds and complex multi-cloud, multi-device environments by leveraging synergies across three product categories: Software-Defined Data Center ("SDDC"), Hybrid Cloud Computing and End-User Computing ("EUC"). Our portfolio supports and addresses the four key IT priorities of our customers: modernizing data centers, integrating public clouds, empowering digital workspaces and transforming security.

We 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. We continue to experience strong renewals, including renewals of our EAs, resulting in additional license sales of both our existing and newer products and solutions.

SDDC or Software-Defined Data Center

Our SDDC technologies form the foundation of our customers' private cloud environments and provide the capabilities for our customers to extend their private cloud to the public cloud and to help them run, manage, secure and connect all their applications across all clouds and devices. During the three and nine months ended November 2, 2018, we continued to see broad-based strength of our SDDC solutions. Future sales growth rates may fluctuate period to period, depending largely upon the extent to which SDDC technologies are included in our particular larger EAs. For example, sales from our management products were positively impacted during the three and nine months ended November 2, 2018 as a result of being included in some of the larger strategic deals.

Hybrid Cloud Computing

Our overarching cloud strategy contains three key components: (i) continue to expand beyond compute virtualization in the private cloud; (ii) extend the private cloud into the public cloud; and (iii) connect and secure endpoints across a range of public clouds. During the nine months ended November 2, 2018, Hybrid Cloud Computing was primarily comprised of VMware Cloud Provider Program ("VCPP") and also included VMware Cloud Services, which enable customers to run, manage, connect and secure their applications across private and public clouds.

During the nine months ended November 2, 2018, revenue growth in our Hybrid Cloud Computing offerings was primarily driven by our VCPP offerings. We expect VMware Cloud on AWS and other cloud services offerings such as CloudHealth to drive revenue growth in this product category in fiscal 2020.

End-User Computing

Our EUC solution consists of VMware Workspace ONE ("Workspace ONE"), our digital workspace platform, which includes VMware AirWatch ("AirWatch") and VMware Horizon. Our AirWatch business model includes an on-premises solution that we offer through the sale of perpetual licenses, subscription and software-as-a-service ("SaaS") solutions. Workspace ONE continued to be our primary growth driver within our EUC product group during the nine months ended November 2, 2018.

Table of Contents

Dell Synergies

We continue joint marketing, sales, branding and product development efforts with Dell Technologies Inc. ("Dell") and other Dell Technologies companies to enhance the collective value we deliver to our mutual customers. Our collective business built with Dell continued to create synergies that benefit our sales during the nine months ended November 2, 2018.

Special Dividend

On July 1, 2018, our board of directors declared a conditional $11 billion one-time special cash dividend (the "Special Dividend"), payable pro-rata to our stockholders as of the record date. The Special Dividend is payable in connection with the closing of a proposed transaction by Dell (the "Dell Class V Transaction") pursuant to which holders of Dell Class V common stock, which is designed to track our economic performance, will exchange the Dell Class V common stock for Dell Class C common stock or cash or both, resulting in the elimination of the Dell Class V common stock. Payment of the Special Dividend is conditioned upon approval of the Dell Class V Transaction and the satisfaction of certain other conditions set forth in current reports on Form 8-K we filed on July 2, 2018 and November 15, 2018. The record date for the Special Dividend will follow approval of the Dell Class V Transaction by Dell's stockholders, and the Special Dividend will be paid in connection with the consummation of the Dell Class V Transaction. The conditions for payment of the Special Dividend must be met no later than January 31, 2019 or the Special Dividend will not be paid. Dell's stockholders are scheduled to vote on the Dell Class V Transaction on December 11, 2018.

In the event that the Special Dividend is paid, our cash, cash equivalents and short-term investment balances will decline significantly. This will result in significantly lower investment income, which will also reduce cash provided by operating activities, net income and net income per share in future periods.

Results of Operations

Approximately 70% of our sales are denominated in the United States ("U.S.") dollar, however, in certain countries we also invoice and collect in the following currencies: euro; British pound; Japanese yen; Australian dollar; and Chinese renminbi. In addition, we incur and pay operating expenses in currencies other than the U.S. dollar. As a result, our financial statements, including our revenue, operating expenses, unearned revenue and the resulting cash flows derived from the U.S. dollar equivalent of foreign currency transactions, are affected by foreign exchange fluctuations.

Revenue

Our revenue during the periods presented was as follows (dollars in millions):

	Three Months Ended				Nine Months Ended			
	November 2,	November 3,			November 2,	November 3,		
	2018	2017[1]	$ Change	% Change	2018	2017[1]	$ Change	% Change
Revenue:								
License	$884	$ 758	$ 126	17 %	$2,558	$ 2,182	$ 376	17 %
Services:								
Software maintenance	1,138	1,016	122	12	3,324	2,989	335	11
Professional services	178	164	14	9	501	465	36	8
Total services	1,316	1,180	136	12	3,825	3,454	371	11
Total revenue	$2,200	$ 1,938	$ 262	14	$6,383	$ 5,636	$ 747	13
Revenue:								
United States	$1,052	$ 970	$ 82	8 %	$3,053	$ 2,825	$ 228	8 %
International	1,148	968	180	19	3,330	2,811	519	18
Total revenue	$2,200	$ 1,938	$ 262	14	$6,383	$ 5,636	$ 747	13

[1] Fiscal 2018 amounts have been adjusted to reflect the impact of our retrospective adoption of Accounting Standards Codification 606, Revenue from Contracts with Customers ("Topic 606"), effective February 3, 2018.

Revenue from our Hybrid Cloud Computing offerings consisted primarily of VCPP, and revenue from our SaaS offerings consisted primarily of our AirWatch mobile solution within Workspace ONE. VCPP revenue is included in license revenue and SaaS revenue is allocated equally between license and services revenue. Hybrid Cloud Computing, together with our SaaS

31

Table of Contents

offerings, increased to greater than 10% of our total revenue during the three and nine months ended November 2, 2018 from approximately 9% of our total revenue during the three and nine months ended November 3, 2017.

License revenue relating to the sale of perpetual licenses that are part of a multi-year contract is generally recognized upon delivery of the underlying license, whereas revenue derived from our Hybrid Cloud Computing and SaaS offerings is recognized on a consumption basis or over a period of time.

License Revenue

License revenue during the three and nine months ended November 2, 2018 compared to the three and nine months ended November 3, 2017 benefited from broad-based growth across our diverse product portfolio and across our U.S. and international geographies. Revenue growth from our VCPP offerings continued to contribute to license growth during the three and nine months ended November 2, 2018. Strength in our EA renewal business and product offerings acquired in recent acquisitions such as VeloCloud, also contributed to license revenue growth during the three and nine months ended November 2, 2018 compared to the three and nine months ended November 3, 2017.

Services Revenue

During the three and nine months ended November 2, 2018, software maintenance revenue continued to benefit from strong renewals of our EAs, maintenance contracts sold in previous periods and additional maintenance contracts sold in conjunction with new software license sales. In each period presented, customers purchased, on a weighted-average basis, approximately three years of support and maintenance with each new license purchased.

Professional services revenue increased during the three and nine months ended November 2, 2018, respectively, as compared to the three and nine months ended November 3, 2017. Services we provide through our technical account managers and our continued focus on solution deployments, including our VMware NSX (“NSX”) products, contributed to the increase in professional services revenue. We continue to also focus on enabling our partners to deliver professional services for our solutions and as such, our professional services revenue may vary as we continue to leverage our partners. Timing of service engagements will also impact the amount of professional services revenue we recognize during a period.

Unearned Revenue

Unearned revenue as of the periods presented consisted of the following (table in millions):

	November 2, 2018	February 2, 2018[1]
Unearned license revenue	$ 212	$ 184
Unearned software maintenance revenue	5,345	5,082
Unearned professional services revenue	644	573
Total unearned revenue	$ 6,201	$ 5,839

[1] Fiscal 2018 amounts have been adjusted to reflect the impact of our retrospective adoption of Topic 606, effective February 3, 2018.

Unearned license revenue is primarily related to the allocated portion of our SaaS offerings and is generally recognized over time as customers consume the services or ratably over the term of the subscription, commencing upon provisioning of the service.

Unearned software maintenance revenue is attributable to our maintenance contracts and is generally recognized over time on a ratable basis over the contract duration. The weighted-average remaining term as of November 2, 2018 was approximately two years. In addition, unearned software maintenance revenue also includes the allocated portion of our SaaS offerings. Unearned professional services revenue results primarily from prepaid professional services and is generally recognized as the services are performed.

Remaining Performance Obligations and Backlog

Remaining Performance Obligations

Remaining performance obligations represent the aggregate amount of the transaction price in contracts allocated to performance obligations not delivered, or partially undelivered, as of the end of the reporting period. Remaining performance obligations include unearned revenue, multi-year contracts with future installment payments and certain unfulfilled orders against accepted customer contracts at the end of any given period.

As of November 2, 2018, the aggregate transaction price allocated to remaining performance obligations was $6,711 million. Approximately 57% is expected to be recognized as revenue over the next 12 months and the remainder thereafter.

Table of Contents

Backlog

Backlog is comprised of unfulfilled purchase orders or unfulfilled executed agreements at the end of a given period and is net of related estimated rebates and marketing development funds. As of November 2, 2018, our total backlog was $324 million and included a large strategic deal that is effective in the fourth quarter of fiscal 2019. Backlog primarily consists of licenses, maintenance and services. Our backlog related to licenses was $144 million, which we generally expect to deliver and recognize as revenue during the following quarter. Backlog totaling $58 million as of November 2, 2018 is excluded from the remaining performance obligations because such contracts are subject to cancellation until fulfillment of the performance obligation occurs. As of February 2, 2018, our total backlog was $285 million, generally consisting of licenses, maintenance and services, and our backlog related to licenses was $99 million.

The amount and composition of backlog will fluctuate period to period, and backlog is managed based upon multiple considerations, including product and geography. We do not believe the amount of backlog is indicative of future sales or revenue or that the mix of backlog at the end of any given period correlates with actual sales performance of a particular geography or particular products and services.

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

Our cost of services revenue and operating expenses primarily reflected increasing cash-based employee-related expenses, driven by incremental growth in salaries and headcount across most of our income statement expense categories during the three and nine months ended November 2, 2018. We expect increases in cash-based employee-related expenses to continue.

Cost of License Revenue

Cost of license revenue primarily consists of the cost of fulfillment of our software and SD-WAN offerings, royalty costs in connection with technology licensed from third-party providers and amortization of intangible assets. The cost of fulfillment of our software and SD-WAN offerings includes personnel costs and related overhead associated with the physical and electronic delivery of our products.

Cost of license revenue during the periods presented was as follows (dollars in millions):

	Three Months Ended				Nine Months Ended			
	November 2, 2018	November 3, 2017	$ Change	% Change	November 2, 2018	November 3, 2017	$ Change	% Change
Cost of license revenue	$49	$ 38	$ 11	30 %	$138	$ 115	$ 24	21 %
Stock-based compensation	—	—	—	(44)	1	1	(1)	(56)
Total expenses	$49	$ 38	$ 11	29	$139	$ 116	$ 23	20
% of License revenue	5 %	5 %			5 %	5 %		

Cost of license revenue increased during the three and nine months ended November 2, 2018 compared to the three and nine months ended November 3, 2017, primarily driven by fulfillment-related costs for our SD-WAN offerings as well as an increase in amortization of intangible assets during the nine months ended November 2, 2018.

Cost of Services Revenue

Cost of services revenue primarily includes the costs of personnel and related overhead to physically and electronically deliver technical support for our products, hosted services supporting our SaaS offerings, and costs to deliver professional services. Additionally, cost of services revenue includes depreciation of equipment supporting our service offerings.

Table of Contents

Cost of services revenue during the periods presented was as follows (dollars in millions):

	Three Months Ended				Nine Months Ended			
	November 2,	November 3,			November 2,	November 3,		
	2018	2017	$ Change	% Change	2018	2017	$ Change	% Change
Cost of services revenue	$253	$ 227	$ 26	12 %	$740	$ 683	$ 58	8 %
Stock-based compensation	13	13	—	(1)	37	38	(2)	(5)
Total expenses	$266	$ 240	$ 26	11	$777	$ 721	$ 56	8
% of Services revenue	20 %	20 %			20 %	21 %		

Cost of services revenue increased during the three and nine months ended November 2, 2018 compared to the three and nine months ended November 3, 2017. The increase was primarily due to an increase in costs associated with third-party hosting services to support our SaaS offerings of $13 million and $27 million during the three and nine months ended November 2, 2018, respectively, as well as growth in cash-based employee-related expenses of $21 million during the nine months ended November 2, 2018, driven by incremental growth in headcount and salaries.

Research and Development Expenses

Research and development expenses include the personnel and related overhead associated with the development of our product software and service offerings. We continue to invest in our key growth areas, including NSX and VMware vSAN, while also investing in areas that we expect to be significant growth drivers in future periods, such as VMware Cloud on AWS.

Research and development expenses during the periods presented were as follows (dollars in millions):

	Three Months Ended				Nine Months Ended			
	November 2,	November 3,			November 2,	November 3,		
	2018	2017	$ Change	% Change	2018	2017	$ Change	% Change
Research and development	$401	$ 353	$ 48	14 %	$1,161	$ 1,032	$ 129	13 %
Stock-based compensation	98	96	2	2	272	266	6	2
Total expenses	$499	$ 449	$ 50	11	$1,433	$ 1,298	$ 135	10
% of Total revenue	23 %	23 %			22 %	23 %		

Research and development expenses increased during the three and nine months ended November 2, 2018 compared to the three and nine months ended November 3, 2017. The increase was primarily due to growth in cash-based employee-related expenses of $36 million and $87 million during the three and nine months ended November 2, 2018, respectively, driven by incremental growth in headcount and salaries. The increase was also driven by increased equipment, depreciation and facilities-related costs, including costs associated with third-party hosting services related to research and development, of $37 million and a decrease in capitalized internal-use software development costs of $22 million during the nine months ended November 2, 2018 as compared to the nine months ended November 3, 2017.

Sales and Marketing Expenses

Sales and marketing expenses include personnel costs, sales commissions and related overhead associated with the sale and marketing of our license and services offerings, as well as the cost of product launches and marketing initiatives. A significant portion of our sales commissions are deferred and recognized over the expected period of benefit.

Table of Contents

Sales and marketing expenses during the periods presented were as follows (dollars in millions):

	Three Months Ended				Nine Months Ended			
	November 2,	November 3,			November 2,	November 3,		
	2018	2017[1]	$ Change	% Change	2018	2017[1]	$ Change	% Change
Sales and marketing	$654	$ 572	$ 82	14 %	$1,963	$ 1,668	$ 294	18 %
Stock-based compensation	53	52	2	4	147	150	(1)	(1)
Total expenses	$707	$ 624	$ 83	13	$2,110	$ 1,818	$ 293	16
% of Total revenue	32 %	32 %			33 %	32 %		

[1] Fiscal 2018 amounts have been adjusted to reflect the impact of our retrospective adoption of Topic 606, effective February 3, 2018.

Sales and marketing expenses increased during the three and nine months ended November 2, 2018 compared to the three and nine months ended November 3, 2017. The increase was primarily due to growth in cash-based employee-related expenses of $65 million and $207 million during the three and nine months ended November 2, 2018, respectively, driven by incremental growth in headcount and salaries, as well as higher commission costs, resulting from increased sales volume and headcount. The increase during the nine months ended November 2, 2018 was also driven by an increase in costs incurred for sales enablement-based initiatives of $52 million and fluctuations in the exchange rates for foreign currencies in which we incur expenses. Equipment, depreciation and facilities-related costs also contributed to the increase during the three and nine months ended November 2, 2018.

General and Administrative Expenses

General and administrative expenses include personnel and related overhead costs to support the business. These expenses include the costs associated with finance, human resources, IT infrastructure and legal, as well as expenses related to corporate costs and initiatives, including certain charitable donations to the VMware Foundation.

General and administrative expenses during the periods presented were as follows (dollars in millions):

	Three Months Ended				Nine Months Ended			
	November 2,	November 3,			November 2,	November 3,		
	2018	2017	$ Change	% Change	2018	2017	$ Change	% Change
General and administrative	$150	$ 154	$ (4)	(3)%	$455	$ 428	$ 28	7 %
Stock-based compensation	28	21	7	32	74	58	15	26
Total expenses	$178	$ 175	$ 3	2	$529	$ 486	$ 43	9
% of Total revenue	8 %	9 %			8 %	9 %		

General and administrative expenses increased during the three and nine months ended November 2, 2018 compared to the three and nine months ended November 3, 2017. Overall, general and administrative expenses remained relatively consistent as a percentage of total revenue.

Realignment and Loss on Disposition

Realignment expenses and loss on disposition during the periods presented were as follows (dollars in millions):

	Three Months Ended				Nine Months Ended			
	November 2,	November 3,			November 2,	November 3,		
	2018	2017[1]	$ Change	% Change	2018	2017[1]	$ Change	% Change
Realignment and loss on disposition	$ 6	$ 2	$ 4	191 %	$9	$ 101	$ (93)	(92)%
% of Total revenue	— %	— %			— %	2 %		

[1] Fiscal 2018 amounts have been adjusted to reflect the impact of our retrospective adoption of Topic 606, effective February 3, 2018.

During the second quarter of fiscal 2018, we completed the sale of our VMware vCloud Air business to OVH US LLC. Losses recognized in connection with this transaction were $2 million and $101 million during the three and nine months ended

35

Table of Contents

November 3, 2017, respectively. The loss recognized during the nine months ended November 3, 2017 included the $13 million impairment of deferred commissions resulting from the retrospective adoption of Topic 606.

Investment Income

Investment income during the periods presented was as follows (dollars in millions):

	Three Months Ended				Nine Months Ended			
	November 2,	November 3,			November 2,	November 3,		
	2018	2017	$ Change	% Change	2018	2017	$ Change	% Change
Investment income	$63	$ 33	$ 29	87 %	$168	$ 82	$ 86	106 %
% of Total revenue	3 %	2 %			3 %	1 %		

Investment income increased during the three and nine months ended November 2, 2018 compared to the three and nine months ended November 3, 2017, primarily driven by increased interest income earned on our cash equivalents and short-term investments resulting from higher yields and from higher balances.

In the event that the conditional Special Dividend is paid, our cash, cash equivalent and short-term investment balances will decline significantly, which will result in significantly lower investment income in the future.

Interest expense

Interest expense during the periods presented was as follows (dollars in millions):

	Three Months Ended				Nine Months Ended			
	November 2,	November 3,			November 2,	November 3,		
	2018	2017	$ Change	% Change	2018	2017	$ Change	% Change
Interest expense	$33	$ 28	$ 5	18 %	$101	$ 41	$ 59	144 %
% of Total revenue	2 %	1 %			2 %	1 %		

On August 21, 2017, we issued three series of unsecured senior notes ("Senior Notes") pursuant to a public debt offering in the aggregate amount of $4,000 million. Upon closing, a portion of the net proceeds from the offering was used to repay two of the notes payable to Dell in the aggregate principal amount of $1,230 million. Interest expense increased by $5 million and $59 million during the three and nine months ended November 2, 2018 compared to the three and nine months ended November 3, 2017, due to the issuance of the Senior Notes, offset in part by a reduction in interest expense on the notes payable to Dell.

Other Income (Expense), net

Other income (expense), net during the periods presented was as follows (dollars in millions):

	Three Months Ended				Nine Months Ended			
	November 2,	November 3,			November 2,	November 3,		
	2018	2017	$ Change	% Change	2018	2017	$ Change	% Change
Other income (expense), net	$(180)	$ (2)	$(178)	(8,900)%	$839	$ 51	$ 786	1,541 %
% of Total revenue	8 %	— %			13 %	1 %		

Upon adoption of Accounting Standards Update ("ASU") 2016-01, Financial Instruments-Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities, the carrying value of our non-marketable equity securities is adjusted to fair value based upon observable transactions for identical or similar investments of the same issuer or impairment (referred to as the measurement alternative). All gains and losses on non-marketable equity securities, realized and unrealized, are recognized in other income (expense), net on the condensed consolidated statements of income. To adjust our investment in Pivotal Software Inc. ("Pivotal") to its fair value of $871 million as of November 2, 2018, we recognized an unrealized loss of $161 million and an unrealized gain of $851 million during the three and nine months ended November 2, 2018, respectively.

The fair value of our investment is determined primarily using the quoted market price of Pivotal's Class A common stock. As a result, any volatility in Pivotal's publicly traded Class A common stock introduces variability to our condensed consolidated statements of income.

Table of Contents

The unrealized gains related to our investment in Pivotal were partially offset by the absence of a gain recognized on a step acquisition, specifically related to the Wavefront, Inc. acquisition during the second quarter of fiscal 2018, when comparing the nine months ended November 2, 2018 to the nine months ended November 3, 2017, and an unrealized loss recognized for an equity security during the nine months ended November 2, 2018.

Income Tax Provision

Our quarterly effective income tax rate is based on our estimated annual income tax rate forecast and discrete tax items recognized in the period. Our quarterly effective income tax rate was 3.2% and 16.2% during the three and nine months ended November 2, 2018, respectively. For the three and nine months ended November 3, 2017, our quarterly effective income tax rate was 4.4% and 12.0%, respectively. Our effective income tax rate for the three months ended November 2, 2018 decreased primarily due to the lower estimated annual effective income tax rate for fiscal 2019 when compared to the annual effective income tax rate for fiscal 2018 as a result of the reduction in the U.S. statutory corporate tax rate from 35% to 21% for fiscal 2019 partially offset by the expected increase due to Global Intangible Low-Taxed Income provisions of the U.S. Tax Cuts and Jobs Act enacted on December 22, 2017 (the “2017 Tax Act”). Our effective income tax rate for the nine months ended November 2, 2018 increased primarily due to the discrete tax expense of $196 million related to our book and tax basis difference on the investment in Pivotal, net of the reversal of the previously recorded valuation allowance.

Due to the timing of the enactment and the compl