EMC CORP
Form 10-Q
November 07, 2013
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2013

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 1-9853

EMC CORPORATION
(Exact name of registrant as specified in its charter)

Massachusetts (State or other jurisdiction of incorporation or organization)	04-2680009 (I.R.S. Employer Identification Number)
176 South Street Hopkinton, Massachusetts (Address of principal executive offices)	01748 (Zip Code)

(508) 435-1000
(Registrant's telephone number, including area code)

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

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

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

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

The number of shares of common stock, par value $.01 per share, of the registrant outstanding as of September 30, 2013 was 2,057,846,730.

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EMC CORPORATION

FACTORS THAT MAY AFFECT FUTURE RESULTS

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

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PART I
FINANCIAL INFORMATION

Item 1. FINANCIAL STATEMENTS
EMC CORPORATION
CONSOLIDATED BALANCE SHEETS
(in millions, except per share amounts)

	September 30, 2013 (unaudited)	December 31, 2012
ASSETS		
Current assets:		
Cash and cash equivalents	$ 7,155	$ 4,714
Short-term investments	3,442	1,422
Accounts and notes receivable, less allowance for doubtful accounts of $63 and $68	2,934	3,433
Inventories	1,375	1,201
Deferred income taxes	986	942
Other current assets	555	465
Total current assets	16,447	12,177
Long-term investments	6,869	5,260
Property, plant and equipment, net	3,373	3,145
Intangible assets, net	1,831	2,035
Goodwill	14,306	13,840
Other assets, net	1,776	1,612
Total assets	$ 44,602	$ 38,069
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 1,108	$ 1,041
Accrued expenses	2,699	2,522
Income taxes payable	201	514
Convertible debt (See Note 4)	1,658	1,652
Deferred revenue	5,093	4,575
Total current liabilities	10,759	10,304
Income taxes payable	310	293
Deferred revenue	3,416	2,976
Deferred income taxes	505	575
Long-term debt (See Note 4)	5,493	—
Other liabilities	365	339
Total liabilities	20,848	14,487
Convertible debt (See Note 4)	9	58
Commitments and contingencies (See Note 14)		
Shareholders' equity:		
Preferred stock, par value $0.01; authorized 25 shares; none outstanding	—	—
Common stock, par value $0.01; authorized 6,000 shares; issued and outstanding 2,058 and 2,107 shares	21	21
Additional paid-in capital	2,289	3,691
Retained earnings	20,298	18,853
Accumulated other comprehensive loss, net	(291)	(208)

Total EMC Corporation’s shareholders’ equity	22,317	22,357
Non-controlling interests	1,428	1,167
Total shareholders’ equity	23,745	23,524
Total liabilities and shareholders’ equity	$ 44,602	$ 38,069

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

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EMC CORPORATION
CONSOLIDATED INCOME STATEMENTS
(in millions, except per share amounts)
(unaudited)

	For the Three Months Ended		For the Nine Months Ended	
	September 30, 2013	September 30, 2012	September 30, 2013	September 30, 2012
Revenues:				
Product sales	$3,165	$ 3,084	$9,535	$ 9,332
Services	2,374	2,194	7,005	6,352
	5,539	5,278	16,540	15,684
Costs and expenses:				
Cost of product sales	1,324	1,292	4,020	3,849
Cost of services	773	698	2,271	2,087
Research and development	686	653	2,056	1,896
Selling, general and administrative	1,809	1,709	5,308	5,076
Restructuring and acquisition-related charges	40	27	195	81
Operating income	907	899	2,690	2,695
Non-operating income (expense):				
Investment income	26	29	93	85
Interest expense	(58)	(21)	(109)	(58)
Other expense, net	(55)	(63)	(197)	(158)
Total non-operating income (expense)	(87)	(55)	(213)	(131)
Income before provision for income taxes	820	844	2,477	2,564
Income tax provision	181	185	474	590
Net income	639	659	2,003	1,974
Less: Net income attributable to the non-controlling interest in VMware, Inc.	(53)	(33)	(136)	(111)
Net income attributable to EMC Corporation	$586	$ 626	$1,867	$ 1,863
Net income per weighted average share, basic attributable to EMC Corporation common shareholders	$0.28	$ 0.30	$0.89	$ 0.89
Net income per weighted average share, diluted attributable to EMC Corporation common shareholders	$0.27	$ 0.28	$0.86	$ 0.84
Weighted average shares, basic	2,069	2,104	2,088	2,090
Weighted average shares, diluted	2,165	2,210	2,176	2,207
Cash dividends declared per common share	$0.10	$ —	$0.20	$ —

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

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EMC CORPORATION
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(in millions)
(unaudited)

	For the Three Months Ended		For the Nine Months Ended	
	September 30, 2013	September 30, 2012	September 30, 2013	September 30, 2012
Net income	$639	$ 659	$2,003	$ 1,974
Other comprehensive income (loss), net of taxes (benefits):				
Foreign currency translation adjustments	12	16	(44)	8
Changes in market value of investments:				
Changes in unrealized gains (losses), net of taxes (benefits) of $0, $25, $(16) and $53	(1)	44	(30)	86
Reclassification adjustment for net losses (gains) realized in net income, net of benefits (taxes) of $0, $(2), $(4) and $(4)	1	(3)	(7)	(2)
Net change in market value of investments	—	41	(37)	84
Changes in market value of derivatives:				
Changes in market value of derivatives, net of taxes (benefits) of $(1), $(6), $2 and $(20)	(1)	(14)	6	(38)
Reclassification adjustment for net losses (gains) included in net income, net of benefits (taxes) of $0, $1, $(2) and $15	(1)	7	(9)	27
Net change in the market value of derivatives	(2)	(7)	(3)	(11)
Other comprehensive income (loss)	10	50	(84)	81
Comprehensive income	649	709	1,919	2,055
Less: Net income attributable to the non-controlling interest in VMware, Inc.	(53)	(33)	(136)	(111)
Less: Other comprehensive income attributable to the non-controlling interest in VMware, Inc.	(1)	—	1	(1)
Comprehensive income attributable to EMC Corporation	$595	$ 676	$1,784	$ 1,943

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

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EMC CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
(in millions)
(unaudited)

	For the Nine Months Ended	
	September 30, 2013	September 30, 2012
Cash flows from operating activities:		
Cash received from customers	$18,065	$16,557
Cash paid to suppliers and employees	(12,740)	(11,951)
Dividends and interest received	118	65
Interest paid	(19)	(17)
Income taxes paid	(691)	(291)
Net cash provided by operating activities	4,733	4,363
Cash flows from investing activities:		
Additions to property, plant and equipment	(673)	(523)
Capitalized software development costs	(342)	(316)
Purchases of short- and long-term available-for-sale securities	(8,630)	(5,012)
Sales of short- and long-term available-for-sale securities	3,540	4,154
Maturities of short- and long-term available-for-sale securities	1,386	844
Business acquisitions, net of cash acquired	(616)	(1,878)
Purchases of strategic and other related investments	(109)	(62)
Sales of strategic and other related investments	10	79
Joint venture funding	(268)	(218)
Proceeds from divestiture of businesses	38	—
Net cash used in investing activities	(5,664)	(2,932)
Cash flows from financing activities:		
Proceeds from the issuance of EMC's common stock	302	388
Proceeds from the issuance of VMware's common stock	185	214
EMC repurchase of EMC's common stock	(1,965)	(380)
EMC purchase of VMware's common stock	(160)	(132)
VMware repurchase of VMware's common stock	(392)	(307)
Excess tax benefits from stock-based compensation	102	212
Payment of long-term and short-term obligations	(14)	(1,714)
Proceeds from the issuance of long-term and short-term obligations	5,460	4
Interest rate contract settlement	—	(70)
Dividend payment	(209)	—
Third party contribution to Pivotal	105	—
Net cash provided by (used in) financing activities	3,414	(1,785)
Effect of exchange rate changes on cash and cash equivalents	(42)	(18)
Net increase (decrease) in cash and cash equivalents	2,441	(372)
Cash and cash equivalents at beginning of period	4,714	4,492
Cash and cash equivalents at end of period	$7,155	$4,120
Reconciliation of net income to net cash provided by operating activities:		
Net income	$2,003	$1,974
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	1,215	1,128
Non-cash interest expense on debt	82	34

Non-cash restructuring and other special charges	10	9
Stock-based compensation expense	700	659
Provision for (recovery of) doubtful accounts	(2)	21
Deferred income taxes, net	(31)	(73)
Excess tax benefits from stock-based compensation	(102)	(212)
Other, net	23	(20)
Changes in assets and liabilities, net of acquisitions:		
Accounts and notes receivable	521	(207)
Inventories	(382)	(337)
Other assets	122	63
Accounts payable	45	119
Accrued expenses	(321)	(226)
Income taxes payable	(176)	372
Deferred revenue	1,006	1,059
Other liabilities	20	—
Net cash provided by operating activities	$4,733	$4,363

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

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EMC CORPORATION
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
(in millions)
(unaudited)
For the nine months ended September 30, 2013:

	Common Stock Shares	Common Stock Par Value	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Non-controlling Interests	Shareholders' Equity
Balance, January 1, 2013	2,107	$21	$3,691	$18,853	$ (208)	$ 1,167	$ 23,524
Stock issued through stock option and stock purchase plans	21	—	302	—	—	—	302
Tax benefit from stock options exercised	—	—	115	—	—	—	115
Restricted stock grants, cancellations and withholdings, net	10	—	(115)	—	—	—	(115)
Repurchase of common stock	(80)	—	(2,000)	—	—	—	(2,000)
EMC purchase of VMware stock	—	—	(124)	—	—	(26)	(150)
Stock options issued in business acquisitions	—	—	1	—	—	—	1
Stock-based compensation	—	—	706	—	—	—	706
Cash dividends declared	—	—	—	(422)	—	—	(422)
Impact from equity transactions of non-controlling interests	—	—	(336)	—	—	152	(184)
Change in market value of investments	—	—	—	—	(36)	(1)	(37)
Change in market value of derivatives	—	—	—	—	(3)	—	(3)
Translation adjustment	—	—	—	—	(44)	—	(44)
Reclassification of convertible debt (to)/from mezzanine (Note 4)	—	—	49	—	—	—	49
Net income	—	—	—	1,867	—	136	2,003
Balance, September 30, 2013	2,058	$21	$2,289	$20,298	$ (291)	$ 1,428	$ 23,745

For the nine months ended September 30, 2012:

	Common Stock Shares	Common Stock Par Value	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Non-controlling Interests	Shareholders' Equity
Balance, January 1, 2012	2,050	$21	$3,405	$16,121	$ (235)	$ 968	$ 20,280
Stock issued through stock option and stock purchase plans	30	—	388	—	—	—	388
	—	—	257	—	—	—	257

Tax benefit from stock options exercised							
Restricted stock grants, cancellations and withholdings, net	10	—	(120)	—	—	—	(120)
Repurchase of common stock	(15)	—	(410)	—	—	—	(410)
EMC purchase of VMware stock	—	—	(114)	—	—	(18)	(132)
Stock options issued in business acquisitions	—	—	18	—	—	—	18
Stock-based compensation	—	—	661	—	—	—	661
Impact from equity transactions of VMware, Inc.	—	—	(275)	—	—	89	(186)
Change in market value of investments	—	—	—	—	83	1	84
Change in market value of derivatives	—	—	—	—	(11)	—	(11)
Translation adjustment	—	—	—	—	8	—	8
Convertible debt conversions and warrant settlement	32	(1)	(1)	—	—	—	(2)
Reclassification of convertible debt (to)/from mezzanine (Note 4)	—	—	46	—	—	—	46
Net income	—	—	—	1,863	—	111	1,974
Balance, September 30, 2012	2,107	$ 20	$ 3,855	$ 17,984	$ (155)	$ 1,151	$ 22,855

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

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EMC CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Basis of Presentation

Company

EMC Corporation (“EMC”) and its subsidiaries develop, deliver and support the Information Technology (“IT”) industry’s broadest range of information infrastructure and virtual infrastructure technologies, solutions and services.

EMC’s Information Infrastructure business provides a foundation for organizations to store, manage, protect, analyze and secure their vast and ever-increasing quantities of information, improve business agility, lower cost of ownership and enhance their competitive advantage within traditional data centers, virtual data centers and cloud-based IT infrastructures. EMC’s Information Infrastructure business comprises three segments – Information Storage, RSA Information Security and Information Intelligence Group.

EMC's GoPivotal, Inc. ("Pivotal") business was formed in the second quarter of 2013. Pivotal unites strategic technology, people and programs from EMC and VMware, Inc. ("VMware"), including Greenplum, Cloud Foundry, Spring, Cetas, Pivotal Labs, GemFire and other products from the VMware vFabric Suite. Pivotal is building a new platform comprising next-generation data fabrics, application fabrics and a cloud independent platform-as-a-service ("PaaS").

EMC’s VMware Virtual Infrastructure business, which is represented by EMC’s majority equity stake in VMware, is the leader in virtualization infrastructure solutions utilized by organizations to help them transform the way they build, deliver and consume IT resources. VMware’s virtualization infrastructure solutions, which include a suite of products designed to deliver a software-defined data center, run on industry-standard desktop computers and servers and support a wide range of operating system and application environments, as well as networking and storage infrastructures.

General

The accompanying interim consolidated financial statements are unaudited and have been prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) for interim financial information. These consolidated financial statements include the accounts of EMC, its wholly owned subsidiaries, as well as Pivotal and VMware, companies majority-owned by EMC. All intercompany transactions have been eliminated. Certain information and footnote disclosures normally included in our annual consolidated financial statements have been condensed or omitted. Accordingly, these interim consolidated financial statements should be read in conjunction with the audited consolidated financial statements for the year ended December 31, 2012 which are contained in our Annual Report on Form 10-K filed with the Securities and Exchange Commission on February 27, 2013.

The results of operations for the interim periods are not necessarily indicative of the results of operations to be expected for any future period or the entire fiscal year. The interim consolidated financial statements, in the opinion of management, reflect all adjustments necessary to fairly state the results as of and for the three- and nine-month periods ended September 30, 2013 and 2012.

Net Income Per Share

Basic net income per weighted average share has been computed using the weighted average number of shares of common stock outstanding during the period. Diluted net income per weighted average share is computed using the weighted average number of common and dilutive common equivalent shares outstanding during the period. Common equivalent shares consist of stock options, restricted stock and restricted stock units, our $1.725 billion 1.75% convertible senior notes due 2013 ("2013 Notes") and associated warrants. Additionally, for purposes of calculating diluted net income per weighted average share, net income is adjusted for the difference between VMware’s reported diluted and basic net income per weighted average share, if any, multiplied by the number of shares of VMware held by EMC.

Reclassifications

Certain prior year amounts have been reclassified to conform with the current year's presentation. During the second quarter of 2013, EMC and VMware combined certain operations to form Pivotal, with a cash investment from General Electric Company ("GE"). Pivotal is considered a separate reportable segment. We recast the segment disclosures for the prior financial reporting periods to separately present the operations of the Pivotal segment. None of the segment reclassifications impact EMC's previously reported consolidated financial statements. See Note 15 for further discussion of the segment reclassifications.

EMC CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

Recent Accounting Pronouncements

In July 2013, the Financial Accounting Standards Board ("FASB") issued new accounting guidance on the presentation of unrecognized tax benefits. This new guidance requires an entity to present an unrecognized tax benefit, or a portion of an unrecognized tax benefit, as a reduction to a deferred tax asset when a net operating loss carryforward, a similar tax loss or a tax credit carryforward exists, with limited exceptions. This new guidance is effective for the periods beginning after December 15, 2013, and should be applied prospectively with retroactive application permitted. We are currently evaluating the impact of the new guidance, and do not expect it to have a material impact on our consolidated financial position, results of operations or cash flows.
In March 2013, the FASB issued guidance that requires a parent company to release any related cumulative translation adjustment into net income only if the sale or transfer results in the complete or substantially complete liquidation of the foreign entity in which the subsidiary or group of assets had resided. This new guidance is effective beginning after December 15, 2013. We do not anticipate that the adoption of this new guidance will have a material impact on our consolidated financial position, results of operations or cash flows.

2. Non-controlling Interests
The non-controlling interests' share of equity in VMware is reflected as non-controlling interests in the accompanying consolidated balance sheets and was $1,323 million and $1,167 million as of September 30, 2013 and December 31, 2012, respectively. At September 30, 2013, EMC held approximately 97% of the combined voting power of VMware's outstanding common stock and approximately 80% of the economic interest in VMware.
The effect of changes in our ownership interest in VMware on our equity was as follows (table in millions):

	For the Nine Months Ended	
	September 30, 2013	September 30, 2012
Net income attributable to EMC Corporation	$1,867	$1,863
Transfers (to) from the non-controlling interest in VMware, Inc.:		
Increase in EMC Corporation's additional paid-in-capital for VMware's equity issuances	90	117
Decrease in EMC Corporation's additional paid-in-capital for VMware's other equity activity	(426)	(392)
Net transfers (to) from non-controlling interest	(336)	(275)
Change from net income attributable to EMC Corporation and transfers from the non-controlling interest in VMware, Inc.	$1,531	$1,588

The non-controlling interests' share of equity in Pivotal is reflected as a component of the non-controlling interests in the accompanying consolidated balance sheets as $105 million and $0 million at September 30, 2013 and December 31, 2012, respectively. At September 30, 2013, EMC consolidated held approximately 84% of the economic interest in Pivotal. GE's interest in Pivotal is in the form of a preferred equity instrument. Consequently, there is no net income attributable to non-controlling interest related to Pivotal on the consolidated income statements. Additionally, due to the terms of the preferred instrument, GE's non-controlling interest on the consolidated balance sheets is generally not impacted by Pivotal's equity related activity. The preferred equity instrument is convertible into common shares at GE's election at any time.
3. Business Combinations, Intangibles and Goodwill

During the nine months ended September 30, 2013, EMC acquired five companies. We acquired substantially all of the outstanding capital stock of Adaptivity, Inc., a provider of software solutions that automate and accelerate enterprise IT migration to the Cloud and ScaleIO, a provider of server-side storage software. These acquisitions complement and expand our Information Storage segment. A member of our board of directors is an investor in a limited partnership which held an equity interest in ScaleIO. The director did not participate in any votes of the board of directors or any committee thereof approving the acquisition, and the terms of the acquisition were negotiated at arms' length.

We also acquired all of the outstanding capital stock of Sitrof Technologies, a document management consultancy provider which complements and expands our Information Intelligence Group segment. We acquired Aveksa, Inc., a provider of Cloud-based identity and access management solutions and PassBan Corporation, a developer of mobile and Cloud-based multi-factor authentication technology. These acquisitions complement and expand our RSA Information Security segment.

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EMC CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

Additionally, during the nine months ended September 30, 2013, VMware acquired Virsto Software, a provider of software that optimizes storage performance and utilization in virtual environments.

The aggregate consideration for these six acquisitions was $616 million, net of cash acquired. The consideration paid was allocated to the fair value of the assets acquired and liabilities assumed based on estimated fair values as of the respective acquisition dates. The aggregate allocation to goodwill, intangibles and net liabilities was approximately $490 million, $137 million and $11 million, respectively. The intangible assets are being amortized based upon the pattern in which the economic benefits of the intangible assets are being utilized. The results of these acquisitions have been included in the consolidated financial statements from the date of purchase. Pro forma results of operations have not been presented as the results of the acquired companies were not material to our consolidated results of operations for the three and nine months ended September 30, 2013 or 2012.

Intangible Assets

Intangible assets, excluding goodwill, as of September 30, 2013 and December 31, 2012 consist of (tables in millions):

	September 30, 2013		
	Gross Carrying Amount	Accumulated Amortization	Net Book Value
Purchased technology	$2,327	$(1,373)	$954
Patents	225	(98)	127
Software licenses	100	(90)	10
Trademarks and tradenames	171	(114)	57
Customer relationships and customer lists	1,370	(822)	548
Leasehold interest	145	(10)	135
Other	27	(27)	—
Total intangible assets, excluding goodwill	$4,365	$(2,534)	$1,831

	December 31, 2012		
	Gross Carrying Amount	Accumulated Amortization	Net Book Value
Purchased technology	$2,233	$(1,207)	$1,026
Patents	225	(87)	138
Software licenses	96	(88)	8
Trademarks and tradenames	173	(102)	71
Customer relationships and customer lists	1,378	(724)	654
Leasehold interest	145	(7)	138
Other	26	(26)	—
Total intangible assets, excluding goodwill	$4,276	$(2,241)	$2,035

Goodwill

Changes in the carrying amount of goodwill, net, on a consolidated basis and by segment, for the nine months ended September 30, 2013 and the year ended December 31, 2012 consist of (tables in millions):

	Nine Months Ended September 30, 2013					
	Information Storage	Information Intelligence Group	RSA Information Security	Pivotal	VMware Virtual Infrastructure	Total

Balance, beginning of the period	$7,442	$1,484	$2,022	$—	$2,892	$13,840
Goodwill resulting from acquisitions	146	1	181	—	162	490
Finalization of purchase price allocations and other, net	(1)	2	(1)	—	(24)	(24)
Goodwill transferred in formation of Pivotal	(112)	—	—	140	(28)	—
Balance, end of the period	$7,475	$1,487	$2,202	$140	$3,002	$14,306

EMC CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

	Year Ended December 31, 2012					
	Information Storage	Information Intelligence Group	RSA Information Security	Pivotal	VMware Virtual Infrastructure	Total
Balance, beginning of the year	$7,034	$1,469	$1,849	$—	$1,803	$12,155
Goodwill resulting from acquisitions	438	15	179	—	1,092	1,724
Finalization of purchase price allocations	(1)	—	(6)	—	(3)	(10)
Goodwill de-recognized in divestiture of business	(29)	—	—	—	—	(29)
Balance, end of the year	$7,442	$1,484	$2,022	$—	$2,892	$13,840

During the second quarter of 2013, EMC and VMware formed Pivotal, with an investment from GE. As Pivotal is considered a separate reportable segment, the transfer of goodwill from the Information Storage and VMware Virtual Infrastructure segments to the newly formed Pivotal segment is shown in the current period rollforward. The amount of transferred goodwill was determined using the relative fair value method. See Note 15 for further discussion of the segment reclassifications.

4. Debt

Long-Term Debt

In June 2013, we issued $5.5 billion aggregate principal amount of senior notes (collectively, the "Notes"). The Notes pay a fixed rate of interest semi-annually in arrears with the first interest payment commencing on December 1, 2013. The proceeds from the Notes will be used to satisfy cash payment obligations at the maturity, or upon the conversion, of the outstanding 2013 Notes as well as for general corporate purposes including stock repurchases, dividend payments, working capital needs and other business opportunities. The Notes of each series are senior, unsecured obligations of EMC and are not convertible or exchangeable. Unless previously purchased and canceled, we will repay the Notes of each series at 100% of the principal amount, together with accrued and unpaid interest thereon, at maturity. However, EMC has the right to redeem any or all of the Notes at specified redemption prices. As of September 30, 2013, we were in compliance with all debt covenants, which are customary in nature.

Our long-term debt as of September 30, 2013 was as follows (dollars in millions):

Senior Notes	Issued at Discount to Par	Carrying Value
$2.5 billion 1.875% Notes due 2018	99.943 %	$2,499
$2.0 billion 2.650% Notes due 2020	99.760 %	$1,995
$1.0 billion 3.375% Notes due 2023	99.925 %	$999
		$5,493

The unamortized discount on the Notes consists of $7 million, which will be fully amortized by June 1, 2023. The effective interest rate on the Notes was 2.5% for the three and nine months ended September 30, 2013.

Convertible Debt

In November 2006, we issued our $1.725 billion 1.75% convertible senior notes due 2011 (the “2011 Notes”) and our 2013 Notes for total gross proceeds of $3.5 billion. The 2013 Notes are senior unsecured obligations and rank equally with all other existing and future senior unsecured debt.

The 2011 Notes matured and a majority of the noteholders exercised their right to convert the outstanding 2011 Notes at the end of 2011. Pursuant to the settlement terms, the majority of the converted 2011 Notes were not settled until January 9, 2012. At that time, we paid the noteholders $1.7 billion in cash for the outstanding principal and 30 million shares for the $661 million in excess of the conversion value over the principal amount, as prescribed by the terms of the 2011 Notes.

At September 30, 2013, the 2013 Notes were fully convertible until maturity. Accordingly, since the terms of the 2013 Notes require the principal to be settled in cash, we reclassified to the mezzanine from shareholders’ equity the portion of the 2013 Notes

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attributable to the conversion feature which had not yet been accreted to its face value, and the 2013 Notes are classified as a current liability. Approximately $58 million of the 2013 Notes have been converted as of September 30, 2013.

Upon conversion, we will pay cash up to the principal amount of the debt converted. With respect to any conversion value in excess of the principal amount of the 2013 Notes converted, we have the option to settle the excess with cash, shares of our common stock, or a combination of cash and shares of our common stock based on a daily conversion value, determined in accordance with the indenture, calculated on a proportionate basis for each day of the relevant 20-day observation period. The initial conversion rate for the 2013 Notes will be 62.1978 shares of our common stock per one thousand dollars of principal amount of 2013 Notes, which represents a 27.5% conversion premium from the date the 2013 Notes were issued and is equivalent to a conversion price of approximately $16.08 per share of our common stock. The conversion price is subject to adjustment in some events as set forth in the indenture. In addition, if a “fundamental change” (as defined in the indenture) occurs prior to the maturity date, we will in some cases increase the conversion rate for a holder of 2013 Notes that elects to convert its 2013 Notes in connection with such fundamental change.

The carrying amount of the 2013 Notes reported in the consolidated balance sheets as of September 30, 2013 was $1,658 million and the fair value was $2,676 million. The carrying amount of the equity component of the 2013 Notes was $316 million at September 30, 2013. As of September 30, 2013, the unamortized discount on the 2013 Notes consists of $9 million, which will be fully amortized by December 1, 2013.

The 2013 Notes pay interest in cash at a rate of 1.75% semi-annually in arrears on December 1 and June 1 of each year. The effective interest rate on the 2011 Notes and 2013 Notes was 5.6% for both the three and nine months ended September 30, 2013 and 2012.

The following tables represent the key components of our interest expense on convertible debt (tables in millions):

	For the Three Months Ended	
	September 30, 2013	September 30, 2012
Contractual interest expense on the coupon	$7	$8
Amortization of the discount component recognized as interest expense	17	15
Total interest expense on the convertible debt	$24	$23

	For the Nine Months Ended	
	September 30, 2013	September 30, 2012
Contractual interest expense on the coupon	$22	$22
Amortization of the discount component recognized as interest expense	49	45
Total interest expense on the convertible debt	$71	$67

In connection with the issuance of the 2011 Notes and 2013 Notes, we entered into separate convertible note hedge transactions with respect to our common stock (the “Purchased Options”). The Purchased Options allow us to receive shares of our common stock and/or cash related to the excess conversion value that we would pay to the holders of the 2011 Notes and 2013 Notes upon conversion. The Purchased Options will cover, subject to customary anti-dilution adjustments, approximately 215 million shares of our common stock. We paid an aggregate amount of $669 million of the proceeds from the sale of the 2011 Notes and 2013 Notes for the Purchased Options that was recorded as additional paid-in-capital in shareholders’ equity. In the fourth quarter of 2011, we exercised 108 million of the Purchased Options in conjunction with the planned settlements of the 2011 Notes, and we received 30 million shares of net settlement on January 9, 2012, representing the excess conversion value of the options. The remaining 108 million of the Purchased Options expire on December 1, 2013.

We also entered into separate transactions in which we sold warrants to acquire, subject to customary anti-dilution adjustments, approximately 215 million shares of our common stock at an exercise price of approximately $19.55 per share of our common stock. We received aggregate proceeds of $391 million from the sale of the associated warrants. Upon exercise, the value of the warrants is required to be settled in shares. Half of the associated warrants were exercised between February 15, 2012 and March 14, 2012 and the remaining half of the associated warrants have expiration dates between February 18, 2014 and March 18, 2014. During the first quarter of 2012, the exercised warrants were settled with 32 million shares of our common stock.

The Purchased Options and associated warrants will generally have the effect of increasing the conversion price of the 2013 Notes to approximately $19.55 per share of our common stock, representing an approximate 55% conversion premium based on the closing price of $12.61 per share of our common stock on November 13, 2006, which was the issuance date of the 2013 Notes.

Interest Rate Swap Contracts

In 2010, EMC entered into interest rate swap contracts with an aggregate notional amount of approximately $900 million. These swaps were designated as cash flow hedges of the semi-annual interest payments of the forecasted issuance of ten year debt in 2011 when our 2011 Notes were scheduled to become due. As such, the unrealized loss on these hedges was recognized in other comprehensive loss. In November 2011, we settled the swaps and replaced them with new interest rate swap contracts for the forecasted issuance of debt in 2012. In April 2012, we settled the swaps and replaced them with new interest rate swap contracts for the forecasted issuance of debt in 2012. Each of these new swaps was deemed as an effective hedge as the notional amounts and other terms matched the underlying hedged item. Losses on the interest rate swap contracts at the time of settlement of $141 million in November 2011 and $23 million in April 2012 were deferred as they were expected to be realized over the life of the new debt issued under the related interest rate swap contracts and recognized as a component of interest expense in the consolidated income statements.

In June 2012, management changed its forecast date for the issuance of debt from December 31, 2012 to the first quarter of 2014. Consequently, hedge accounting effectively ceased as the terms of the swaps no longer matched the terms of the underlying hedged item resulting in changes in the fair value of the swaps being recorded in the consolidated income statement. The swaps were subsequently re-designated as cash flow hedges and achieved hedge accounting. The change in the forecasted timeframe for the issuance of debt resulted in certain previously-anticipated hedge interest payments no longer being expected to occur within the window covered by the hedge designation. As a result, $40 million of accumulated realized losses in other comprehensive income related to these previously-anticipated interest payments were reclassified from other comprehensive income and recognized in the 2012 consolidated income statements.

In July 2012, we settled the interest rate swap contracts and did not replace them. Losses on the interest rate swap contracts at the time of settlement of $46 million were deferred as they are expected to be realized over the life of the new debt issued under the related interest rate swap contracts and recognized as a component of interest expense in the consolidated income statements.

At September 30, 2013, we had $177 million of accumulated realized losses related to the settled swaps in accumulated other comprehensive income which will be realized during the life of our ten year Notes. These losses will be reclassified from other comprehensive income and recognized on a straight-line basis in the consolidated income statements as interest expense beginning in the third quarter of 2014.

5. Fair Value of Financial Assets and Liabilities

Our fixed income and equity investments are classified as available for sale and recorded at their fair market values. We determine 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 not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.
- Level 3 – Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

Most of our fixed income securities are classified as Level 2, with the exception of some of our U.S. government and agency obligations and our investments in publicly traded equity securities, which are classified as Level 1, and all of our auction rate securities, which are classified as Level 3. In addition, our strategic investments held at cost are classified as Level 3. At September 30, 2013, the vast majority of our Level 2 securities were priced by pricing vendors. These pricing vendors utilize the most recent observable market information in pricing these securities or, if specific prices are not available for these securities, use other observable inputs like market transactions involving identical or comparable securities. In the event observable inputs are not available, we assess other factors to determine the security’s market value, including broker quotes or model valuations. Each month, we perform independent price verifications of all of our fixed income holdings. In the event a price fails a pre-established tolerance check, it is researched so that we can assess the cause of the variance to determine what we believe is the appropriate fair market value.

In general, investments with remaining effective maturities of 12 months or less from the balance sheet date are classified as short-term investments. Investments with remaining effective maturities of more than 12 months from the balance sheet date are classified as long-term investments. Our publicly traded equity securities are classified as long-term investments and our strategic investments held at cost are classified as other assets. As a result of the lack of liquidity for auction rate securities, we have classified these as long-term investments as of September 30, 2013 and December 31, 2012. At September 30, 2013 and December 31, 2012, all of our short- and long-term investments, excluding auction rate securities, were recognized at fair value, which was determined based upon observable inputs from our pricing vendors for identical or similar assets. At September 30, 2013 and December 31, 2012, auction rate securities were valued using a discounted cash flow model.

The following tables summarize the composition of our short- and long-term investments at September 30, 2013 and December 31, 2012 (tables in millions):

	September 30, 2013			
	Amortized Cost	Unrealized Gains	Unrealized (Losses)	Aggregate Fair Value
U.S. government and agency obligations	$4,505	$6	$(3)	$4,508
U.S. corporate debt securities	2,106	6	(3)	2,109
High yield corporate debt securities	526	17	(7)	536
Asset-backed securities	5	—	—	5
Municipal obligations	939	3	(1)	941
Auction rate securities	72	—	(5)	67
Foreign debt securities	2,037	5	(3)	2,039
Total fixed income securities	10,190	37	(22)	10,205
Publicly traded equity securities	78	28	—	106
Total	$10,268	$65	$(22)	$10,311

We held approximately $2.0 billion in foreign debt securities at September 30, 2013. These securities have an average credit rating of A+, and approximately 4% of these securities are deemed sovereign debt with an average credit rating of AA+. None of the securities deemed sovereign debt are from Greece, Italy, Ireland, Portugal, Spain or Cyprus.

	December 31, 2012			
	Amortized Cost	Unrealized Gains	Unrealized (Losses)	Aggregate Fair Value
U.S. government and agency obligations	$2,191	$10	$(1)	$2,200
U.S. corporate debt securities	1,480	10	—	1,490
High yield corporate debt securities	486	34	(1)	519
Asset-backed securities	2	—	—	2
Municipal obligations	1,032	3	—	1,035
Auction rate securities	74	—	(4)	70
Foreign debt securities	1,270	9	—	1,279
Total fixed income securities	6,535	66	(6)	6,595
Publicly traded equity securities	47	41	(1)	87
Total	$6,582	$107	$(7)	$6,682

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The following tables represent our fair value hierarchy for our financial assets and liabilities measured at fair value as of September 30, 2013 and December 31, 2012 (tables in millions):

	September 30, 2013			
	Level 1	Level 2	Level 3	Total
Cash	$1,611	$—	$—	$1,611
Cash equivalents	4,942	602	—	5,544
U.S. government and agency obligations	2,201	2,307	—	4,508
U.S. corporate debt securities	—	2,109	—	2,109
High yield corporate debt securities	—	536	—	536
Asset-backed securities	—	5	—	5
Municipal obligations	—	941	—	941
Auction rate securities	—	—	67	67
Foreign debt securities	—	2,039	—	2,039
Publicly traded equity securities	106	—	—	106
Total cash and investments	$8,860	$8,539	$67	$17,466
Other items:				
Strategic investments held at cost	$—	$—	$378	$378
Investment in joint venture	—	—	34	34
Convertible debt carried at discounted cost	—	(2,676)	—	(2,676)
Long-term debt carried at discounted cost	—	(5,449)	—	(5,449)
Foreign exchange derivative assets	—	41	—	41
Foreign exchange derivative liabilities	—	(27)	—	(27)

	December 31, 2012			
	Level 1	Level 2	Level 3	Total
Cash	$1,454	$—	$—	$1,454
Cash equivalents	2,898	362	—	3,260
U.S. government and agency obligations	1,327	873	—	2,200
U.S. corporate debt securities	—	1,490	—	1,490
High yield corporate debt securities	—	519	—	519
Asset-backed securities	—	2	—	2
Municipal obligations	—	1,035	—	1,035
Auction rate securities	—	—	70	70
Foreign debt securities	—	1,279	—	1,279
Publicly traded equity securities	87	—	—	87
Total cash and investments	$5,766	$5,560	$70	$11,396
Other items:				
Strategic investments held at cost	$—	$—	$364	$364
Investment in joint venture	—	—	33	33
Convertible debt carried at discounted cost	—	(2,666)	—	(2,666)
Foreign exchange derivative assets	—	30	—	30
Foreign exchange derivative liabilities	—	(35)	—	(35)
Commodity derivative liabilities	—	(1)	—	(1)

Our auction rate securities are predominantly rated investment grade and are primarily collateralized by student loans. The underlying loans of all but two of our auction rate securities, with a market value of $16 million, have partial guarantees by the U.S. government as part of the Federal Family Education Loan Program (“FFELP”) through the U.S.

Department of Education. FFELP guarantees at least 95% of the loans which collateralize the auction rate securities. We believe the quality of the collateral underlying most of our auction rate securities will enable us to recover our principal balance.

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To determine the estimated fair value of our investment in auction rate securities, we used a discounted cash flow model using a five year time horizon. As of September 30, 2013, the coupon rates used ranged from 0% to 4% and the discount rate was 1%, which rate represents the rate at which similar FFELP backed securities with a five year time horizon outside of the auction rate securities market were trading at September 30, 2013. The assumptions used in preparing the discounted cash flow model include an incremental discount rate for the lack of liquidity in the market ("liquidity discount margin") for an estimated period of time. The discount rate we selected was based on AA-rated banks as the majority of our portfolio is invested in student loans where EMC acts as a financier to these lenders. The liquidity discount margin represents an estimate of the additional return an investor would require for the lack of liquidity of these securities over an estimated five year holding period. The rate used for the discount margin was 1% at September 30, 2013 and December 31, 2012 due to the narrowing of credit spreads on AA-rated banks during 2012 and into 2013.

The following table provides a summary of changes in fair value of our Level 3 auction rate securities for the three and nine months ended September 30, 2013 and 2012 (table in millions):

	For the Three Months Ended		For the Nine Months Ended	
	September 30, 2013	September 30, 2012	September 30, 2013	September 30, 2012
Balance, beginning of the period	$68	$74	$70	$75
Calls at par value	—	—	(1)	—
Other-than-temporary impairment loss	—	—	(1)	(2)
(Increase) decrease in previously recognized unrealized losses included in other comprehensive income	(1)	1	(1)	2
Balance, end of the period	$67	$75	$67	$75

Significant changes in the unobservable inputs discussed above could result in a significantly lower or higher fair value measurement. Generally, an increase in the discount rate, liquidity discount margin or coupon rate results in a decrease in our fair value measurement and a decrease in the discount rate, liquidity discount margin or coupon rate results in an increase in our fair value measurement.

In the fourth quarter of 2012, EMC and Lenovo formed a joint venture, LenovoEMC Limited, to provide NAS systems to small- and medium-sized businesses and distributed enterprise sites. EMC has a 49% ownership percentage of the joint venture. We account for our LenovoEMC joint venture using the fair value method of accounting. To determine the estimated fair value of our investment, we use a discounted cash flow model using a three year time horizon. The discount rate used was 6%, which represents the incremental borrowing rate for a market participant. The assumptions used in preparing the discounted cash flow model include an analysis of estimated Lenovo NAS revenue against a prescribed target as well as consideration of the purchase price put and call features included in the joint venture agreement. The put and call features create a floor and a cap on the fair value of the investment. As such, there is a limit to the impact on the fair value that would result from significant changes in the unobservable inputs.

The following table provides a summary of changes in fair value of our LenovoEMC joint venture for the three and nine months ended September 30, 2013 (table in millions):

	September 30, 2013	
	Three Months Ended	Nine Months Ended
Balance, beginning of the period	$34	$33
Realized gain included in other income (expense)	—	1
Balance, end of period	$34	$34

The carrying value of the strategic investments held at cost were accounted for under the cost method. As part of our impairment review, we perform a fair value calculation of our strategic investments held at cost on a quarterly basis using the most currently available information. To determine the estimated fair value of private strategic investments held at cost, we use a combination of several valuation techniques including discounted cash flow models, acquisition comparables and trading comparables. In addition, we evaluate the impact of pre- and post-money valuations of recent financing events and the impact of those on our fully diluted ownership percentages, and we consider any available information regarding the issuer's historical and forecasted performance as well as market comparables and conditions. The fair value of these investments is considered in our review for impairment if any events and changes in circumstances occur that might have a significant adverse effect on their value.

Investment Losses

Unrealized losses on investments at September 30, 2013 by investment category and length of time the investment has been in a continuous unrealized loss position are as follows (table in millions):

	Less Than 12 Months		12 Months or Greater		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
U.S. government and agency obligations	$787	$(3)	$—	$—	$787	$(3)
U.S. corporate debt securities	823	(3)	—	—	823	(3)
High yield corporate debt securities	190	(7)	—	—	190	(7)
Municipal obligations	139	(1)	—	—	139	(1)
Auction rate securities	—	—	67	(5)	67	(5)
Foreign debt securities	805	(3)	—	—	805	(3)
Total	$2,744	$(17)	$67	$(5)	$2,811	$(22)

For all of our securities for which the amortized cost basis was greater than the fair value at September 30, 2013, we have concluded that currently we neither plan to sell the security nor is it more likely than not that we would be required to sell the security before its anticipated recovery. In making the determination as to whether the unrealized loss is other-than-temporary, we considered the length of time and extent the investment has been in an unrealized loss position, the financial condition and near-term prospects of the issuers, the issuers' credit rating, third party guarantees and the time to maturity.

Contractual Maturities

The contractual maturities of fixed income securities held at September 30, 2013 are as follows (table in millions):

	September 30, 2013	
	Amortized Cost Basis	Aggregate Fair Value
Due within one year	$3,439	$3,442
Due after 1 year through 5 years	5,707	5,718
Due after 5 years through 10 years	539	546
Due after 10 years	505	499
Total	$10,190	$10,205

6. Inventories

Inventories consist of (table in millions):

	September 30, 2013	December 31, 2012
Work-in-process	$691	$606
Finished goods	684	595
	$1,375	$1,201

7. Accounts and Notes Receivable and Allowance for Credit Losses

Accounts and notes receivable are recorded at cost. The portion of our notes receivable due in one year or less are included in accounts and notes receivable and the long-term portion is included in other assets, net on the consolidated balance sheets. Lease receivables arise from sales-type leases of products. We typically sell, without recourse, the contractual right to the lease payment stream and assets under lease to third parties. For certain customers, we retain the lease.

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The contractual amounts due under the leases we retained as of September 30, 2013 were as follows (table in millions):

Year	Contractual Amounts Due Under Leases
Due within one year	$123
Due within two years	81
Due within three years	70
Thereafter	2
Total	276
Less amounts representing interest	(5)
Present value	271
Current portion (included in accounts and notes receivable)	130
Long-term portion (included in other assets, net)	$141

Subsequent to September 30, 2013, we sold $56 million of these notes to third parties without recourse.

We maintain an allowance for credit losses on our accounts and notes receivable. The allowance is based on the credit worthiness of our customers, including an assessment of the customer’s financial position, operating performance and their ability to meet their contractual obligation. We assess the credit scores for our customers each quarter. In addition, we consider our historical experience, the age of the receivable and current market and economic conditions. Uncollectible amounts are charged against the allowance account.

In the event we determine that a lease may not be paid, we include in our allowance an amount for the outstanding balance related to the lease receivable. As of September 30, 2013, amounts from lease receivables past due for more than 90 days were not significant.

The following table presents the activity of our allowance for credit losses related to lease receivables for the nine months ended September 30, 2013 and 2012 (table in millions):

	For the Nine Months Ended	
	September 30, 2013	September 30, 2012
Balance, beginning of the period	$17	$24
Recoveries	(12)	(16)
Provisions	3	9
Balance, end of the period	$8	$17

Gross lease receivables totaled $276 million and $329 million as of September 30, 2013 and December 31, 2012, respectively, before the allowance. The components of these balances were individually evaluated for impairment and included in our allowance determination as necessary.

8. Property, Plant and Equipment

Property, plant and equipment consist of (table in millions):

	September 30, 2013	December 31, 2012
Furniture and fixtures	$215	$197
Equipment and software	5,804	5,345
Buildings and improvements	1,991	1,873
Land	121	121
Building construction in progress	286	197
	8,417	7,733
Accumulated depreciation	(5,044)	(4,588)

	$3,373	$3,145

Building construction in progress at September 30, 2013 includes $74 million for facilities not yet placed in service that we are holding for future use.

9. Joint Ventures

We make investments in joint ventures. For each joint venture investment, we consider the facts and circumstances in order to determine whether it qualifies for cost accounting, equity accounting, fair value method accounting or whether it should be consolidated.

In 2009, Cisco and EMC formed VCE Company LLC (“VCE”), with investments from VMware and Intel. VCE, through Vblock infrastructure platforms, delivers an integrated IT offering that combines network, computing, storage, management, security and virtualization technologies for converged infrastructures and cloud based computing models. As of September 30, 2013, we have contributed $976 million in funding and $16 million in stock-based compensation to VCE since inception and own approximately 58% of VCE’s outstanding equity.

We consider VCE a variable interest entity. Authoritative guidance related to variable interest entities states that the primary beneficiary of a variable interest entity must have both of the following characteristics: (a) the power to direct the activities of a variable interest entity that most significantly will impact the entity’s economic performance; and (b) the obligation to absorb losses that could be potentially significant to the variable interest entity or the right to receive benefits from the entity that could potentially be significant to the variable interest entity. Since the power to direct the activities of VCE which most significantly impact its economic performance are determined by its board of directors, which is comprised of equal representation of EMC and Cisco, and all significant decisions require the approval of the minority shareholders, we have determined we are not the primary beneficiary, and as such we account for the investment under the equity method.

Our portion of VCE’s gains and losses is recognized in other expense, net, in the consolidated income statements. Our consolidated share of VCE’s losses, based upon our portion of the overall funding, was approximately 63% for the three and nine months ended September 30, 2013 and 2012. As of September 30, 2013, we have recorded net accumulated losses from VCE of $713 million since inception, of which $75 million and $215 million were recorded in the three and nine months ending September 30, 2013, respectively, and $62 million and $177 million were recorded in the three and nine months ended September 30, 2012, respectively.

We recognized $131 million and $307 million in revenue from sales of product and services to VCE during the three and nine months ended September 30, 2013, respectively, and $65 million and $211 million for the three and nine months ended September 30, 2012, respectively. We perform certain administrative services, pursuant to an administrative services agreement, on behalf of VCE and we pay certain operating expenses on behalf of VCE. Accordingly, we had a receivable from VCE related to the administrative services agreement of $47 million and $44 million as of September 30, 2013 and December 31, 2012, respectively, included in other current assets in the consolidated balance sheets.

10. Accrued Expenses

Accrued expenses consist of (table in millions):

	September 30, 2013	December 31, 2012
Salaries and benefits	$961	$1,018
Product warranties	285	278
Dividends payable (see Note 12)	208	—
Partner rebates	174	187

Restructuring, current (See Note 13)	87	76
Derivatives	38	40
Other	946	923
	$2,699	$2,522

Product Warranties

Systems sales include a standard product warranty. At the time of the sale, we accrue for systems’ warranty costs. The initial systems’ warranty accrual is based upon our historical experience, expected future costs and specific identification of systems’ requirements. Upon sale or expiration of the initial warranty, we may sell additional maintenance contracts to our customers. Revenue from these additional maintenance contracts is included in deferred revenue and recognized ratably over the service period. The following represents the activity in our warranty accrual for the three and nine months ended September 30, 2013 and 2012 (table in millions):

	For the Three Months Ended		For the Nine Months Ended	
	September 30, 2013	September 30, 2012	September 30, 2013	September 30, 2012
Balance, beginning of the period	$291	$ 262	$278	$ 255
Provision	39	41	135	129
Amounts charged to the accrual	(45)	(38)	(128)	(119)
Balance, end of the period	$285	$ 265	$285	$ 265

The provision includes amounts accrued for systems at the time of shipment, adjustments for changes in estimated costs for warranties on systems shipped in the period and changes in estimated costs for warranties on systems shipped in prior periods. It is not practicable to determine the amounts applicable to each of the components.

11. Income Taxes

Our effective income tax rates were 22.1% and 19.1% for the three and nine months ended September 30, 2013, respectively. Our effective income tax rates were 22.0% and 23.0% for the three and nine months ended September 30, 2012, respectively. Our effective income tax rate is based upon estimated income before provision for income taxes for the year, composition of the income in different countries, and adjustments, if any, in the applicable quarterly periods for potential tax consequences, benefits and/or resolutions of tax audits or other tax contingencies. For the three and nine months ended September 30, 2013, the effective income tax rate varied from the statutory income tax rate principally as a result of the mix of income attributable to foreign versus domestic jurisdictions, state taxes and the federal tax credit for increasing research activities. Our aggregate income tax rate in foreign jurisdictions is lower than our income tax rate in the United States; substantially all of our income before provision for income taxes from foreign operations has been earned by our Irish subsidiaries. We do not believe that any recent or currently expected developments in non-U.S. tax jurisdictions are reasonably likely to have a material impact on our effective income rate. On January 2, 2013, the American Taxpayer Relief Act of 2012 was signed into law. Some of the provisions were retroactive to January 1, 2012 including an extension of the U.S. federal tax credit for increasing research activities through December 31, 2013. Because the extension was enacted after December 31, 2012, our income tax provision for the nine months ended September 30, 2013 included the federal tax credit for increasing research activities for the full year 2012 as well as the nine months ended September 30, 2013, which reduced our effective tax rate for the nine month period. For the three and nine months ended September 30, 2012, the effective income tax rate varied from the statutory income tax rate principally as a result of the mix of income attributable to foreign versus domestic jurisdictions.

Our effective income tax rate decreased in the nine months ended September 30, 2013 from the nine months ended September 30, 2012 due primarily to the retroactive renewal of the U.S. federal tax credit for increasing research activities on January 2, 2013 as discussed above. The U.S. federal tax credit for increasing research activities reduced our effective income tax rate by approximately 4.4% for the nine months ended September 30, 2013. There were also differences in the mix of income attributable to foreign versus domestic jurisdictions, state taxes, change in tax contingency reserves and discrete items, the net impact of which is immaterial. Our effective income tax rate for the three months ended September 30, 2013 is consistent with our effective income tax rate for the three months ended September 30, 2012 as a 3.0% favorable impact of U.S. federal tax credit for increasing research activities on our effective income tax rate is offset by a lower estimated Section 199 deduction and other differences between the two three-month periods.

We are routinely under audit by the Internal Revenue Service (the "IRS"). We have concluded all U.S. federal income tax matters for years through 2008. The IRS commenced a federal income tax audit for the tax years 2009 and 2010 in the third quarter of 2012. The current federal income tax audit is still in the early stage for information gathering and it is not expected to be completed until 2015. We also have income tax audits in process in numerous state, local and international jurisdictions. In our international jurisdictions that comprise a significant portion of our operations, the years that may be examined vary, with the earliest year being 2003. Based on the timing and outcome of examinations of EMC, the result of the expiration of statutes of limitations for specific jurisdictions or the timing and result of ruling requests from taxing authorities, it is reasonably possible that the related unrecognized tax benefits could change from those recorded in our statement of financial position. We anticipate that several of these audits may be finalized within the next twelve months. While we expect the amount of unrecognized tax

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

benefits to change in the next twelve months, we do not expect the change to have a significant impact on our results of operations or financial position.

12. Shareholders' Equity

The reconciliation from basic to diluted earnings per share for both the numerators and denominators is as follows (table in millions):

	For the Three Months Ended		For the Nine Months Ended	
	September 30, 2013	September 30, 2012	September 30, 2013	September 30, 2012
Numerator:				
Net income attributable to EMC Corporation	$586	$ 626	$1,867	$ 1,863
Incremental dilution from VMware	(2)			