EMC CORP
Form 10-Q
August 08, 2016
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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 June 30, 2016
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	04-2680009
(State or other jurisdiction of incorporation or organization)	(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 June 30, 2016 was 1,956,842,060.

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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)
(unaudited)

	June 30, 2016	December 31, 2015
ASSETS		
Current assets:		
Cash and cash equivalents	$9,354	$ 6,549
Short-term investments	2,407	2,726
Accounts and notes receivable, less allowance for doubtful accounts of $89 and $90	2,896	3,977
Inventories	1,243	1,245
Other current assets	650	566
Total current assets	16,550	15,063
Long-term investments	4,387	5,508
Property, plant and equipment, net	3,725	3,850
Intangible assets, net	1,998	2,149
Goodwill	17,137	17,090
Deferred income taxes	1,169	1,164
Other assets, net	1,779	1,788
Total assets	$46,745	$ 46,612
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$1,158	$ 1,644
Accrued expenses	2,739	3,123
Income taxes payable	285	609
Short-term debt (See Note 4)	800	1,299
Deferred revenue	6,421	6,210
Total current liabilities	11,403	12,885
Income taxes payable	487	461
Deferred revenue	4,750	4,592
Long-term debt (See Note 4)	5,479	5,475
Other liabilities	471	480
Total liabilities	22,590	23,893
Commitments and contingencies (See Note 13)		
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 1,957 and 1,943 shares	20	19
Additional paid-in capital	—	—
Retained earnings	22,679	21,700
Accumulated other comprehensive loss, net	(561)	(579)
Total EMC Corporation's shareholders' equity	22,138	21,140
Non-controlling interests	2,017	1,579

Total shareholders' equity	24,155	22,719
Total liabilities and shareholders' equity	$46,745	$ 46,612

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 Six Months Ended	
	June 30, 2016	June 30, 2015	June 30, 2016	June 30, 2015
Revenues:				
Product sales	$3,161	$3,225	$5,843	$6,130
Services	2,856	2,772	5,649	5,480
	6,017	5,997	11,492	11,610
Costs and expenses:				
Cost of product sales	1,307	1,433	2,557	2,762
Cost of services	974	977	1,939	1,922
Research and development	821	782	1,635	1,570
Selling, general and administrative	2,034	2,102	4,021	4,139
Restructuring and acquisition-related charges	(1)	23	48	158
Operating income	882	680	1,292	1,059
Non-operating income (expense):				
Investment income	26	26	39	51
Interest expense	(42)	(41)	(84)	(81)
Other income (expense), net	(14)	24	(9)	34
Total non-operating income (expense)	(30)	9	(54)	4
Income before provision for income taxes	852	689	1,238	1,063
Income tax provision	222	170	311	252
Net income	630	519	927	811
Less: Net income attributable to the non-controlling interests	(49)	(32)	(78)	(72)
Net income attributable to EMC Corporation	$581	$487	$849	$739
Net income per weighted average share, basic attributable to EMC Corporation common shareholders	$0.30	$0.25	$0.43	$0.38
Net income per weighted average share, diluted attributable to EMC Corporation common shareholders	$0.29	$0.25	$0.43	$0.37
Weighted average shares, basic	1,955	1,927	1,952	1,950
Weighted average shares, diluted	1,973	1,947	1,969	1,971
Cash dividends declared per common share	$0.12	$0.12	$0.23	$0.23

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 Six Months Ended	
	June 30, 2016	June 30, 2015	June 30, 2016	June 30, 2015
Net income	$630	$519	$927	$811
Other comprehensive income (loss), net of taxes (benefits):				
Foreign currency translation adjustments	(24)	18	(21)	(86)
Changes in market value of investments:				
Changes in unrealized gains, net of taxes of $6, $0, $18 and $12	12	1	32	20
Reclassification adjustment for net gains realized in net income, net of benefits (taxes) of $2, $(7), $2 and $(13)	2	(13)	4	(21)
Net change in market value of investments	14	(12)	36	(1)
Changes in market value of derivatives:				
Changes in unrealized gains (losses), net of taxes (benefits) of $2, $(2), $1 and $1	4	(5)	—	9
Reclassification adjustment for net losses (gains) included in net income, net of benefits of $2, $2, $4 and $2	5	—	9	(11)
Net change in the market value of derivatives	9	(5)	9	(2)
Other comprehensive income (loss)	(1)	1	24	(89)
Comprehensive income	629	520	951	722
Less: Net income attributable to the non-controlling interests	(49)	(32)	(78)	(72)
Less: Other comprehensive income attributable to the non-controlling interests	(2)	(2)	(6)	(3)
Comprehensive income attributable to EMC Corporation	$578	$486	$867	$647

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 Six Months Ended	
	June 30, 2016	June 30, 2015
Cash flows from operating activities:		
Cash received from customers	$12,953	$13,137
Cash paid to suppliers and employees	(9,749)	(10,076)
Dividends and interest received	57	68
Interest paid	(72)	(67)
Income taxes paid	(649)	(949)
Net cash provided by operating activities	2,540	2,113
Cash flows from investing activities:		
Additions to property, plant and equipment	(299)	(449)
Capitalized software development costs	(310)	(262)
Purchases of short- and long-term available-for-sale securities	(2,458)	(4,212)
Sales of short- and long-term available-for-sale securities	2,140	2,667
Maturities of short- and long-term available-for-sale securities	1,771	913
Business acquisitions, net of cash acquired	(59)	(61)
Purchases of strategic and other related investments	(25)	(160)
Sales of strategic and other related investments	41	109
Increase in restricted cash	(4)	—
Net cash provided by (used in) investing activities	797	(1,455)
Cash flows from financing activities:		
Proceeds from the issuance of EMC's common stock	144	170
Proceeds from the issuance of VMware's common stock	52	69
EMC repurchase of EMC's common stock	—	(2,063)
VMware repurchase of VMware's common stock	—	(850)
Excess tax benefits from stock-based compensation	9	54
Net proceeds (payments) for the issuance of short-term obligations	(503)	1,948
Dividend payment	(453)	(456)
Contributions from non-controlling interests	233	4
Net cash used in financing activities	(518)	(1,124)
Effect of exchange rate changes on cash and cash equivalents	(14)	(74)
Net increase (decrease) in cash and cash equivalents	2,805	(540)
Cash and cash equivalents at beginning of period	6,549	6,343
Cash and cash equivalents at end of period	$9,354	$5,803
Reconciliation of net income to net cash provided by operating activities:		
Net income	$927	$811
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	985	942
Non-cash restructuring and other special charges	3	13
Stock-based compensation expense	607	502
Provision for doubtful accounts	9	25
Deferred income taxes, net	(29)	(48)

Excess tax benefits from stock-based compensation	(9)	(54)
Impairment of joint venture	39	—
Other, net	17	18
Changes in assets and liabilities, net of acquisitions:		
Accounts and notes receivable	1,077	1,017
Inventories	(103)	(45)
Other assets	(76)	(3)
Accounts payable	(501)	(443)
Accrued expenses	(460)	(480)
Income taxes payable	(325)	(650)
Deferred revenue	389	509
Other liabilities	(10)	(1)
Net cash provided by operating activities	$2,540	$2,113

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 six months ended June 30, 2016:

	Common Stock Shares	Par Value	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Non-controlling Interests	Shareholders' Equity
Balance, January 1, 2016	1,943	$ 19	$ —	$21,700	$ (579)	$ 1,579	$ 22,719
Stock issued through stock option and stock purchase plans	8	1	144	—	—	—	145
Tax benefit from stock options exercised	—	—	(24)	—	—	—	(24)
Restricted stock grants, cancellations and withholdings, net	4	—	(45)	—	—	—	(45)
Reversal of reclass of previously repurchased common stock	—	—	(590)	590	—	—	—
Stock-based compensation	2	—	660	—	—	—	660
Cash dividends declared	—	—	—	(460)	—	—	(460)
Impact from equity transactions of non-controlling interests	—	—	(145)	—	—	354	209
Change in market value of investments	—	—	—	—	30	6	36
Change in market value of derivatives	—	—	—	—	9	—	9
Translation adjustment	—	—	—	—	(21)	—	(21)
Net income	—	—	—	849	—	78	927
Balance, June 30, 2016	1,957	$ 20	$ —	$22,679	$ (561)	$ 2,017	$ 24,155

For the six months ended June 30, 2015:

	Common Stock Shares	Par Value	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Non-controlling Interests	Shareholders' Equity
Balance, January 1, 2015	1,985	$ 20	$ —	$22,242	$ (366)	$ 1,629	$ 23,525
Stock issued through stock option and stock purchase plans	10	—	170	—	—	—	170
Tax benefit from stock options exercised	—	—	43	—	—	—	43
Restricted stock grants, cancellations and withholdings, net	6	—	(71)	—	—	—	(71)
Repurchase of common stock	(76)	(1)	(20)	(2,012)	—	—	(2,033)
Stock-based compensation	—	—	560	—	—	—	560
Cash dividends declared	—	—	—	(453)	—	—	(453)
Impact from equity transactions of non-controlling interests	—	—	(682)	—	—	(219)	(901)
Change in market value of investments	—	—	—	—	(5)	4	(1)
Change in market value of derivatives	—	—	—	—	(1)	(1)	(2)
Translation adjustment	—	—	—	—	(86)	—	(86)

Net income	—	—	—	739	—	72	811
Balance, June 30, 2015	1,925	$ 19	$ —	$20,516	$ (458)	$ 1,485	$ 21,562

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" or "the Company") 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 manages the Company as part of a federation of businesses: EMC Information Infrastructure, VMware Virtual Infrastructure, Pivotal and Virtustream.

EMC's Information Infrastructure business provides a foundation for organizations to store, manage, protect, analyze and secure ever-increasing quantities of information, while at the same time improving business agility, lowering cost, and enhancing competitive advantage. EMC's Information Infrastructure business comprises three segments – Information Storage, Enterprise Content Division and RSA Information Security. The results of Virtustream are currently reported within our Information Storage segment.

EMC's VMware Virtual Infrastructure business, which is represented by EMC's majority equity stake in VMware, Inc. ("VMware"), is a leader in virtualization and cloud infrastructure solutions that enable businesses to transform the way they build, deliver and consume IT resources in a manner that is based on their specific needs. VMware's virtualization infrastructure solutions, which include a suite of products and services designed to deliver a software-defined data center, run on industry-standard desktop computers, servers and mobile devices and support a wide range of operating system and application environments, as well as networking and storage infrastructures.

EMC's Pivotal business ("Pivotal") unites strategic technology, people and programs from EMC and VMware and has built a new platform comprised of next-generation data fabrics, application fabrics and a cloud independent platform-as-a-service ("PaaS") to support Big and Fast Data applications. On top of this platform is the Company's agile development services business. These capabilities are made available through Pivotal's three primary offerings: Pivotal Cloud Foundry, the Pivotal Big Data Suite and Pivotal Labs.

Proposed Transaction with Dell

On October 12, 2015, EMC entered into an Agreement and Plan of Merger (the "Merger Agreement") among EMC, Denali Holding Inc., a Delaware corporation ("Denali"), Dell Inc., a Delaware corporation ("Dell"), and Universal Acquisition Co., a Delaware corporation and direct wholly owned subsidiary of Denali ("Merger Sub"), pursuant to which, among other things and subject to the conditions set forth therein, Merger Sub will merge with and into EMC (the "Merger"), with EMC continuing as the surviving corporation and a wholly owned subsidiary of Denali.

At the effective time of the Merger ("Effective Time"), each share of EMC common stock issued and outstanding will be canceled and converted into the right to receive (i) $24.05 in cash and (ii) a number of shares of common stock of Denali designated as Class V Common Stock, par value $0.01 per share (the "Class V Common Stock"), equal to the quotient obtained by dividing (A) 222,966,450 by (B) the aggregate number of shares of EMC common stock issued and outstanding immediately prior to the Effective Time. The aggregate number of shares of Class V Common Stock issued as Merger consideration in the transaction is intended to represent 65% of EMC's economic interest in the approximately 81% of the outstanding shares of VMware currently owned by EMC, reflecting approximately 53% of the total economic interest in the outstanding shares of VMware. Upon completion of the transaction, Denali will retain the remaining 28% of the total economic interest in the outstanding shares of VMware. Based on the estimated number of shares of EMC common stock outstanding at the closing of the transaction, EMC shareholders are expected to receive approximately 0.111 shares of Class V Common Stock for each share of EMC common stock.

The Merger Agreement contains specified termination rights for both Denali and EMC, including that, in general, either party may terminate the agreement if the Merger is not consummated on or before December 16, 2016. If EMC terminates the Merger Agreement, EMC is required to pay Denali a termination fee of $2.5 billion. If Denali terminates the Merger Agreement, they are required to pay a termination fee of $4 billion under specified circumstances, and in certain instances, an alternative termination fee of $6 billion.

The transaction is expected to close during the third quarter of 2016. The completion of the Merger is subject to certain conditions including EMC shareholder approval, the receipt of certain other regulatory approvals in various jurisdictions and the effectiveness of the registration statement on Form S-4 to be filed by Denali in connection with the registration of shares of Class V Common Stock issuable in connection with the Merger. The registration statement on Form S-4 was declared effective on June 6, 2016 and EMC shareholders approved the Merger Agreement at a Special Meeting of Shareholders which was held on July 19, 2016.

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The Merger Agreement contains representations and warranties customary for transactions of this nature. EMC has agreed to various customary covenants and agreements, including, among others, agreements to conduct its business in the ordinary course during the period between the execution of the Merger Agreement and the effective time of the Merger. In addition, without the consent of Denali, EMC may not take, authorize, agree or commit to do certain actions outside of the ordinary course of business, including acquiring businesses or incurring capital expenditures above specified thresholds, issuing additional debt facilities and repurchasing outstanding EMC common stock.

Under the terms of the Merger Agreement, EMC is required to provide Denali with access to EMC's cash to help fund the Merger consideration. If there is a need to transfer cash to the U.S. in order to meet the requirements of the Merger, EMC does not expect that taxes and other costs incurred would be material.

Other than transaction expenses associated with the proposed Merger, the terms of the Merger Agreement did not impact EMC's consolidated financial statements as of and for the three and six months ended June 30, 2016.

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 VMware and Pivotal, 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, 2015 which are contained in our Annual Report on Form 10-K filed with the Securities and Exchange Commission on February 25, 2016.

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 six-month periods ended June 30, 2016 and 2015.

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. 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.

Recent Accounting Pronouncements

In March 2016, the Financial Accounting Standards Board ("FASB") issued updated guidance related to stock-based compensation which is intended to simplify several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. This standard is effective beginning January 1, 2017, with early application permitted. We are currently evaluating the impact of the new guidance on our consolidated financial statements and related disclosures.

In February 2016, the FASB issued a standard on leases which amends a number of aspects of lease accounting, including requiring lessees to recognize operating leases with a term greater than one year on their balance sheet as a right-of-use asset and corresponding lease liability, measured at the present value of the lease payments. The guidance also requires qualitative and quantitative disclosures designed to assess the amount, timing, and uncertainty of cash flows arising from leases. The standard requires modified retrospective adoption and is effective beginning January 1, 2019, with early adoption permitted. We are currently evaluating the impact of the new guidance on our consolidated financial statements and related disclosures.

In May 2014, the FASB issued a standard on revenue recognition providing a single, comprehensive revenue recognition model for all contracts with customers. The revenue standard is based on the principle that revenue should be recognized to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The standard, as amended, is effective beginning January 1, 2018, with early adoption permitted but not earlier than the original effective date of January 1, 2017. The principles may be applied retrospectively

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EMC CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

to each prior period presented or retrospectively with the cumulative effect recognized as of the date of initial application. We are currently evaluating the adoption method options and the impact of the new guidance on our consolidated financial statements.

2. Non-controlling Interests

The non-controlling interests' share of equity in VMware is reflected as a component of the non-controlling interests in the accompanying consolidated balance sheets and was $1,678 million and $1,481 million as of June 30, 2016 and December 31, 2015, respectively. At June 30, 2016, EMC held approximately 97% of the combined voting power of VMware's outstanding common stock and approximately 81% of the economic interest in VMware.

GE's interest in Pivotal is in the form of a preferred equity instrument. Consequently, there is no net income attributable to the GE 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. In May 2016, Pivotal sold an additional $233 million of preferred equity instruments to GE, Ford and Microsoft, with similar terms as the initial GE preferred instrument.

The portion of the results of operations of Pivotal allocable to its other owners, along with the interest in the net assets of Pivotal attributable to those other owners are shown as a reduction of net income attributable to EMC shareholders and as a component of non-controlling interests on EMC's consolidated balance sheets, respectively. 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 $339 million and $98 million as of June 30, 2016 and December 31, 2015, respectively. At June 30, 2016, EMC consolidated held approximately 78% of the economic interest in Pivotal.

The effect of changes in our ownership interest in VMware and Pivotal on our equity was as follows (table in millions):

	For the Six Months Ended	
	June 30, 2016	June 30, 2015
Net income attributable to EMC Corporation	$849	$ 739
Transfers (to) from the non-controlling interests:		
Increase in EMC Corporation's additional paid-in-capital for VMware and Pivotal equity issuances	21	29
Decrease in EMC Corporation's additional paid-in-capital for VMware's and Pivotal's other equity activity	(166)	(711)
Net transfers to non-controlling interest	(145)	(682)
Change from net income attributable to EMC Corporation and transfers from the non-controlling interests	$704	$ 57

3. Business Combinations, Intangibles and Goodwill

During the three months ended June 30, 2016, VMware acquired all of the remaining outstanding shares of Arkin Net, Inc. ("Arkin"), a provider of software-defined data center security and operations, as part of a strategy to accelerate customers' adoption of VMware NSX and software-defined data centers, for $67 million of cash, net of liabilities assumed. The consideration 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 preliminary aggregate allocation to goodwill, intangibles and net assets was approximately $38 million, $26 million and $3 million, respectively. The intangible assets acquired were primarily comprised of purchased technology which have an amortization period of four to five years. The proforma financial information assuming the acquisition had occurred as of the beginning of the calendar year prior to the year of acquisition, as well as the revenues and earnings generated during the current year, were not material for disclosure purposes. During the six months ended June 30, 2016, Pivotal acquired two businesses, which were not material either individually or in the aggregate to the June 30, 2016 results.

Most of our intangible assets are being amortized based upon the pattern in which the economic benefits of the intangible assets are being utilized; the remainder are amortized on a straight-line basis. Goodwill is calculated as the excess of the consideration over the fair value of the net assets, including intangible assets, and is primarily related to expected synergies from the transaction. The goodwill is not expected to be deductible for U.S. federal income tax purposes.

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EMC CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

Intangible Assets
Intangible assets, excluding goodwill, as of June 30, 2016 and December 31, 2015 consist of (tables in millions):

	June 30, 2016		
	Gross Carrying Amount	Accumulated Amortization	Net Book Value
Purchased technology	$3,298	$ (2,017)	$ 1,281
Patents	225	(139)	86
Software licenses	115	(94)	21
Trademarks and tradenames	254	(168)	86
Customer relationships and customer lists	1,524	(1,131)	393
Leasehold interest	152	(23)	129
Other	46	(44)	2
Total intangible assets, excluding goodwill	$5,614	$ (3,616)	$ 1,998

	December 31, 2015		
	Gross Carrying Amount	Accumulated Amortization	Net Book Value
Purchased technology	$3,272	$ (1,903)	$ 1,369
Patents	225	(132)	93
Software licenses	112	(94)	18
Trademarks and tradenames	254	(157)	97
Customer relationships and customer lists	1,523	(1,087)	436
Leasehold interest	152	(20)	132
Other	46	(42)	4
Total intangible assets, excluding goodwill	$5,584	$ (3,435)	$ 2,149

Goodwill
Changes in the carrying amount of goodwill, net, on a consolidated basis and by segment, for the six months ended June 30, 2016 consist of (table in millions):

	Six Months Ended June 30, 2016					
	Information Storage	Enterprise Content Division	RSA Information Security	Pivotal	VMware Virtual Infrastructure	Total
Balance, beginning of the period	$9,185	$ 1,478	$ 2,203	$ 187	$ 4,037	$17,090
Goodwill resulting from acquisitions	—	—	—	9	38	47
Balance, end of the period	$9,185	$ 1,478	$ 2,203	$ 196	$ 4,075	$17,137

4. Debt

Short-Term Debt

On February 27, 2015, we entered into a credit agreement with the lenders named therein, Citibank, N.A., as Administrative Agent, Bank of America, N.A. and JPMorgan Chase Bank, N.A., as Syndication Agents, and Citigroup Global Markets Inc., Merrill Lynch, Pierce, Fenner & Smith Incorporated and J.P. Morgan Securities LLC, as Joint Lead Arrangers and Joint Bookrunners (the “Credit Agreement”). The Credit Agreement provides for a $2.5 billion unsecured revolving credit facility to be used for general corporate purposes that is scheduled to mature on February 27, 2020. At our option, subject to certain conditions, any loan under the Credit Agreement will bear interest at a rate equal to, either (i) the LIBOR Rate or (ii) the Base Rate (defined as the highest of (a) the Federal Funds rate plus 0.50%, (b) Citibank, N.A.'s "prime rate" as announced from time to time, or (c) one-month LIBOR plus 1.00%), plus, in each case the Applicable Margin, as defined in the Credit Agreement. The Credit Agreement contains customary representations and warranties, covenants and events of default. We may also, upon the agreement of the existing lenders and/or additional lenders not currently parties to the agreement, increase the commitments under the credit facility by up to an additional $1.0 billion. In addition, we may request to extend the maturity date of the credit facility, subject to certain conditions,

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for additional one-year periods. As of June 30, 2016, we were in compliance with customary required covenants. At June 30, 2016, we had no funds borrowed and at December 31, 2015, we had $600 million outstanding under the credit facility. Amounts outstanding under the credit facility are presented in short-term debt in the consolidated balance sheets with the issuances and proceeds presented on a net basis in the consolidated statement of cash flows due to their short term nature. At August 8, 2016, we had $900 million outstanding under the credit facility.

On March 23, 2015, we established a short-term debt financing program whereby we may issue short-term unsecured commercial paper notes (“Commercial Paper”). Amounts available under the program may be borrowed, repaid and re-borrowed from time to time, with the aggregate face or principal amount of the notes outstanding at any time not to exceed $2.5 billion. The Commercial Paper will have maturities of up to 397 days from the date of issue. The net proceeds from the issuance of the Commercial Paper are expected to be used for general corporate purposes. As of June 30, 2016, we were in compliance with customary required covenants. At June 30, 2016, we had $800 million of Commercial Paper outstanding, with a weighted-average interest rate of 0.81% and maturities ranging from 8 days to 29 days at the time of issuance. At December 31, 2015, we had $699 million of Commercial Paper outstanding. Commercial Paper outstanding is presented in short-term debt in the consolidated balance sheets, and the issuances and proceeds of the Commercial Paper are presented on a net basis in the consolidated statement of cash flows due to their short term nature. At August 8, 2016, we had no Commercial Paper outstanding.

Long-Term Debt

During 2013, we issued $5.5 billion of Notes which pay a fixed rate of interest semi-annually in arrears. The proceeds from the Notes were used to repay the $1.725 billion 1.75% convertible senior notes due 2013 as well as for general corporate purposes including stock repurchases, dividend payments, business acquisitions, 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 June 30, 2016, we were in compliance with all debt covenants, which are customary in nature.

Our long-term debt as of June 30, 2016 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 %	1,997
$1.0 billion 3.375% Notes due 2023	99.925 %	1,000
		$ 5,496
Debt issuance costs		(17)
Net long-term debt		$ 5,479

The unamortized discount on the Notes consists of $4 million, which will be fully amortized by June 1, 2023. The effective interest rate on the Notes was 2.55% for both the three and six months ended June 30, 2016.

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 June 30, 2016, 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 December 31, 2015. During the three months ended June 30, 2016, EMC sold all of our auction rate securities. At June 30, 2016 and December 31, 2015, 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 December 31, 2015, 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 June 30, 2016 and December 31, 2015 (tables in millions):

	June 30, 2016			
	Amortized Cost	Unrealized Gains	Unrealized (Losses)	Aggregate Fair Value
U.S. government and agency obligations	$1,639	$ 8	$ (1)	$ 1,646
U.S. corporate debt securities	2,172	14	—	2,186
High yield corporate debt securities	68	1	(2)	67
Asset-backed securities	8	—	—	8
Municipal obligations	517	—	—	517
Foreign debt securities	2,236	11	—	2,247
Total fixed income securities	6,640	34	(3)	6,671
Publicly traded equity securities	113	18	(8)	123
Total	$6,753	$ 52	$ (11)	$ 6,794

	December 31, 2015			
	Amortized Cost	Unrealized Gains	Unrealized (Losses)	Aggregate Fair Value
U.S. government and agency obligations	$2,449	$ —	$ (8)	$ 2,441
U.S. corporate debt securities	2,257	1	(10)	2,248
High yield corporate debt securities	307	2	(22)	287
Asset-backed securities	20	—	—	20
Municipal obligations	731	1	—	732
Auction rate securities	27	—	(2)	25
Foreign debt securities	2,332	—	(9)	2,323
Total fixed income securities	8,123	4	(51)	8,076
Publicly traded equity securities	126	40	(8)	158

Total	$8,249	$ 44	$ (59)	$ 8,234

We held approximately $2,247 million in foreign debt securities at June 30, 2016. 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 Argentina, Greece, Italy, Ireland, Portugal, Spain, Cyprus or Puerto Rico.

The following tables represent our fair value hierarchy for our financial assets and liabilities measured at fair value as of June 30, 2016 and December 31, 2015 (tables in millions):

	June 30, 2016			
	Level 1	Level 2	Level 3	Total
Cash	$2,284	$—	$—	$2,284
Cash equivalents	6,560	510	—	7,070
U.S. government and agency obligations	1,005	641	—	1,646
U.S. corporate debt securities	—	2,186	—	2,186
High yield corporate debt securities	—	67	—	67
Asset-backed securities	—	8	—	8
Municipal obligations	—	517	—	517
Foreign debt securities	—	2,247	—	2,247
Publicly traded equity securities	123	—	—	123
Total cash and investments	$9,972	$6,176	$—	$16,148
Other items:				
Strategic investments held at cost	$—	$—	$404	$404
Long-term debt carried at discounted cost	—	(5,281)	—	(5,281)
Foreign exchange derivative assets	—	45	—	45
Foreign exchange derivative liabilities	—	(61)	—	(61)
Commodity derivative liabilities	—	(4)	—	(4)

	December 31, 2015			
	Level 1	Level 2	Level 3	Total
Cash	$2,095	$—	$—	$2,095
Cash equivalents	3,861	593	—	4,454
U.S. government and agency obligations	1,495	946	—	2,441
U.S. corporate debt securities	—	2,248	—	2,248
High yield corporate debt securities	—	287	—	287
Asset-backed securities	—	20	—	20
Municipal obligations	—	732	—	732
Auction rate securities	—	—	25	25
Foreign debt securities	—	2,323	—	2,323
Publicly traded equity securities	158	—	—	158
Total cash and investments	$7,609	$7,149	$25	$14,783
Other items:				
Strategic investments held at cost	$—	$—	$384	$384
Investment in joint venture	—	—	39	39
Long-term debt carried at discounted cost	—	(4,999)	—	(4,999)
Foreign exchange derivative assets	—	39	—	39
Foreign exchange derivative liabilities	—	(78)	—	(78)
Commodity derivative liabilities	—	(4)	—	(4)

EMC had a 49% ownership percentage of LenovoEMC Limited, a joint venture with Lenovo that was formed in 2012. During the three months ended June 30, 2016, EMC and Lenovo entered into an agreement to terminate the joint venture. Accordingly, EMC recognized an impairment loss of $39 million which is reflected in other income (expense), net on the consolidated income statements.

The carrying value of the strategic investments held at cost were accounted for under the cost method. As part of our quarterly impairment review, we perform a fair value calculation of our strategic investments held at cost 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 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 June 30, 2016 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	$128	$ (1)	$—	$ —	$128	$ (1)
High yield corporate debt securities	20	(1)	15	(1)	35	(2)
Publicly traded equity securities	2	(1)	2	(7)	4	(8)
Total	$150	$ (3)	$17	$ (8)	$167	$ (11)

For all of our securities for which the amortized cost basis was greater than the fair value at June 30, 2016, 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 and the time to maturity.

Contractual Maturities

The contractual maturities of fixed income securities held at June 30, 2016 are as follows (table in millions):

	June 30, 2016	
	Amortized Cost Basis	Aggregate Fair Value
Due within one year	$2,378	$ 2,379
Due after 1 year through 5 years	3,910	3,938
Due after 5 years through 10 years	162	163
Due after 10 years	190	191
Total	$6,640	$ 6,671

Short-term investments on the consolidated balance sheet include $28 million in variable rate notes which have contractual maturities in 2016, and are not classified within investments due within one year above.

6. Inventories

Inventories consist of (table in millions):

	June 30, 2016	December 31, 2015
Work-in-process	$ 676	$ 592
Finished goods	567	653

$ 1,243	$ 1,245

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.

The contractual amounts due under the leases we retained as of June 30, 2016 were as follows (table in millions):

Year	Contractual Amounts Due Under Leases
Due within one year	$ 72
Due within two years	49
Due within three years	38
Thereafter	3
Total	162
Less: Amounts representing interest	7
Present value	155
Current portion (included in accounts and notes receivable)	68
Long-term portion (included in other assets, net)	$ 87

Subsequent to June 30, 2016, we sold $3 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 June 30, 2016, amounts from lease receivables past due for more than 90 days were not significant.

During the three and six months ended June 30, 2016 and 2015, there were no material changes to our allowance for credit losses related to lease receivables. Gross lease receivables totaled $162 million and $154 million as of June 30, 2016 and December 31, 2015, 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):

	June 30, 2016	December 31, 2015
Furniture and fixtures	$283	$ 283
Equipment and software	7,439	7,378
Buildings and improvements	2,401	2,373
Land	172	171
Building construction in progress	106	83
	10,401	10,288
Accumulated depreciation	(6,676)	(6,438)
	$3,725	$ 3,850

Property, plant and equipment at June 30, 2016 includes $66 million for facilities not yet placed in service that we are holding for future use.

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EMC CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

9. Accrued Expenses
Accrued expenses consist of (table in millions):

	June 30, 2016	December 31, 2015
Salaries and benefits	$ 1,037	$ 1,189
Product warranties	136	172
Dividends payable (see Note 11)	242	234
Partner rebates	204	221
Restructuring, current (See Note 12)	153	333
Derivatives	73	82
Other	894	892
	$ 2,739	$ 3,123

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 six months ended June 30, 2016 and 2015 (table in millions):

	For the Three Months Ended		For the Six Months Ended	
	June 30, 2016	June 30, 2015	June 30, 2016	June 30, 2015
Balance, beginning of the period	$ 151	$ 188	$ 172	$ 207
Provision	26	44	51	77
Amounts charged against the accrual	(41)	(43)	(87)	(95)
Balance, end of the period	$ 136	$ 189	$ 136	$ 189

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.
10. Income Taxes

Our effective income tax rates were 26.1% and 25.1% for the three and six months ended June 30, 2016, respectively. Our effective income tax rates were 24.6% and 23.7% for the three and six months ended June 30, 2015, 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 six months ended June 30, 2016, 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 and 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. For the three and six months ended June 30, 2015, 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 and state taxes. On December 19, 2014, the Tax Increase Prevention Act was signed into law. Some of the provisions were retroactive to January 1, 2014 including an extension of the U.S. federal tax credit for increasing research activities through December 31, 2014. On December 18, 2015, the Consolidated Appropriations

Act, 2016 was signed into law. Some of the provisions were retroactive to January 1, 2015 including a permanent extension of the U.S. federal tax credit for increasing research activities. Our effective income tax rates for the three and six months ended June 30, 2015 do not reflect any federal tax credit for increasing research activities.

Our effective income tax rate increased in the three and six months ended June 30, 2016 from the three and six months ended June 30, 2015 due primarily to a lower tax rate differential for international jurisdictions. There were also differences in change in tax contingency reserves and discrete items, the net impact of which is immaterial.

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. In the third quarter of 2012, the IRS commenced a federal income tax audit for the tax years 2009 and 2010. The IRS completed their field audit for the tax years 2009 and 2010 and issued Revenue Agent Reports ("RARs") in the first quarter of 2016. We disagree with certain proposed adjustments and have filed a formal protest to the IRS Appeals Division. In the first quarter of 2015, the IRS commenced a federal income tax audit for the tax year 2011, which is still ongoing. 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 2004. 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 benefits to change in the next twelve months, we do not expect the change to have a significant impact on our consolidated results of operations or financial position.

11. 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 Six Months Ended	
	June 30, 2016	June 30, 2015	June 30, 2016	June 30, 2015
Numerator:				
Net income attributable to EMC Corporation	$581	$ 487	$849	$ 739
Incremental dilution from VMware	(1)	(1)	(1)	(2)
Net income – dilution attributable to EMC Corporation	$580	$ 486	$848	$ 737
Denominator:				
Weighted average shares, basic	1,955	1,927	1,952	1,950
Weighted common stock equivalents	18	20	17	21
Weighted average shares, diluted	1,973	1,947	1,969	1,971

Restricted stock awards, restricted stock units and options to acquire shares of our common stock in the amount of 1 million for the six months ended June 30, 2016 and 1 million for both the three and six months ended June 30, 2015, were excluded from the calculation of diluted earnings per share because they were anti-dilutive. The incremental dilution from VMware represents the impact of VMware's dilutive securities on EMC's consolidated diluted net income per share and is calculated by multiplying the difference between VMware's basic and diluted earnings per share by the number of VMware shares owned by EMC.

Repurchase of Common Stock

We utilize both authorized and unissued shares (including repurchased shares) for all issuances under our equity plans. Our Board of Directors authorized the repurchase of 250 million shares of our common stock in December 2014. For the six months ended June 30, 2016, we did not repurchase any shares of our common stock. Of the 250 million shares authorized for repurchase, we have repurchased 27 million shares to-date at a total cost of $715 million, leaving a remaining balance of 223 million shares authorized for future repurchases.

During April 2016, VMware’s Board of Directors authorized the repurchase of up to an aggregate of $1.2 billion of VMware’s Class A common stock through the end of 2016, which includes the amount remaining from VMware’s previous stock repurchase authorization announced on January 27, 2015, which was $835 million as of June 30, 2016. All shares repurchased under VMware’s stock repurchase programs are retired. For the six months ended June 30, 2016, VMware did not repurchase any shares of its Class A common stock as it was subject to a number of legal and regulatory constraints resulting from the Merger Agreement, which impacted the timing and ability to execute repurchases of VMware’s shares.

Cash Dividend on Common Stock

EMC pays a quarterly dividend of $0.115 per share of common stock to EMC shareholders, subject to the approval of our Board of Directors. Our Board of Directors declared the following dividends during 2016 and 2015:

Declaration Date	Dividend Per Share	Record Date	Total Amount (in millions)	Payment Date
2016:				
February 11, 2016	$ 0.115	April 1, 2016	$ 229	April 22, 2016
May 12, 2016	$ 0.115	July 1, 2016	$ 231	July 22, 2016
2015:				
February 27, 2015	$ 0.115	April 1, 2015	$ 229	April 23, 2015
May 20, 2015	$			