EMC CORP
Form 10-Q
November 03, 2011
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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, 2011

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For transition period from ______ to ______

Commission File Number 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 **01748**
(Address of principal executive offices) (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 ¨

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

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

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

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

The number of shares of common stock, par value $.01 per share, of the registrant outstanding as of September 30, 2011 was 2,039,957,250.

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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 thousands, except per share amounts)

	September 30, 2011 (unaudited)	December 31, 2010
ASSETS		
Current assets:		
Cash and cash equivalents	$ 3,125,610	$ 4,119,138
Short-term investments	1,635,533	1,256,175
Accounts and notes receivable, less allowance for doubtful accounts of $60,264 and $57,385	2,650,392	2,569,523
Inventories	1,104,143	856,405
Deferred income taxes	642,716	609,832
Other current assets	789,329	372,249
Total current assets	9,947,723	9,783,322
Long-term investments	4,499,373	4,170,742
Property, plant and equipment, net	2,756,003	2,528,432
Intangible assets, net	1,851,967	1,624,267
Goodwill	12,153,651	11,772,650
Other assets, net	1,221,954	953,871
Total assets	$ 32,430,671	$ 30,833,284
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 1,007,805	$ 1,062,600
Accrued expenses	2,357,448	2,090,035
Income taxes payable		199,735
Convertible debt	3,280,957	3,214,771
Deferred revenue	3,325,466	2,810,873
Total current liabilities	9,971,676	9,378,014
Income taxes payable	243,206	265,549
Deferred revenue	2,398,596	1,853,263
Deferred income taxes	624,183	717,004
Other liabilities	242,967	217,449
Total liabilities	13,480,628	12,431,279
Convertible debt (See Note 4)	144,862	235,229
Commitments and contingencies (See Note 14)		
Shareholders equity:		

Preferred stock, par value $0.01; authorized 25,000 shares; none outstanding		
Common stock, par value $0.01; authorized 6,000,000 shares; issued and outstanding 2,039,957 and 2,069,246 shares	20,400	20,692
Additional paid-in capital	2,818,523	3,816,681
Retained earnings	15,288,575	13,659,284
Accumulated other comprehensive loss, net	(220,302)	(92,617)
Total EMC Corporation s shareholders equity	17,907,196	17,404,040
Non-controlling interest in VMware, Inc.	897,985	762,736
Total shareholders equity	18,805,181	18,166,776
Total liabilities and shareholders equity	$ 32,430,671	$ 30,833,284

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

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EMC CORPORATION

CONSOLIDATED INCOME STATEMENTS

(in thousands, except per share amounts)

(unaudited)

	For the Three Months Ended		For the Nine Months Ended	
	September 30, 2011	September 30, 2010	September 30, 2011	September 30, 2010
Revenues:				
Product sales	$ 3,074,367	$ 2,675,925	$ 9,049,610	$ 7,707,958
Services	1,905,834	1,536,346	5,383,547	4,418,502
	4,980,201	4,212,271	14,433,157	12,126,460
Costs and expenses:				
Cost of product sales	1,269,323	1,194,297	3,917,028	3,513,961
Cost of services	644,613	531,000	1,870,526	1,547,807
Research and development	548,021	483,264	1,589,020	1,395,922
Selling, general and administrative	1,612,914	1,343,325	4,684,534	3,888,260
Restructuring and acquisition-related charges	20,302	12,561	68,411	40,902
Operating income	885,028	647,824	2,303,638	1,739,608
Non-operating income (expense):				
Investment income	32,293	40,563	106,506	104,198
Interest expense	(44,322)	(44,827)	(135,777)	(132,539)
Other expense, net	(59,799)	(5,823)	(72,616)	(12,714)
Total non-operating expense	(71,828)	(10,087)	(101,887)	(41,055)
Income before provision for income taxes	813,200	637,737	2,201,751	1,698,553
Income tax provision	171,086	148,663	465,456	381,292
Net income	642,114	489,074	1,736,295	1,317,261
Less: Net income attributable to the non-controlling interest in VMware, Inc.	(36,465)	(16,558)	(107,004)	(45,825)
Net income attributable to EMC Corporation	$ 605,649	$ 472,516	$ 1,629,291	$ 1,271,436
Net income per weighted average share, basic attributable to EMC Corporation common shareholders	$ 0.29	$ 0.23	$ 0.79	$ 0.62
Net income per weighted average share, diluted attributable to EMC Corporation common shareholders	$ 0.27	$ 0.22	$ 0.72	$ 0.59
Weighted average shares, basic	2,054,007	2,055,876	2,060,242	2,053,026
Weighted average shares, diluted	2,207,099	2,146,753	2,244,508	2,132,948

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

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EMC CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(unaudited)

	For the Nine Months Ended September 30, 2011	For the Nine Months Ended September 30, 2010
Cash flows from operating activities:		
Cash received from customers	$ 15,434,151	$ 12,733,156
Cash paid to suppliers and employees	(11,577,038)	(9,567,360)
Dividends and interest received	77,706	92,834
Interest paid	(54,683)	(41,621)
Income taxes paid	(395,539)	(180,403)
Net cash provided by operating activities	3,484,597	3,036,606
Cash flows from investing activities:		
Additions to property, plant and equipment	(601,177)	(541,866)
Capitalized software development costs	(342,091)	(272,492)
Purchases of short- and long-term available-for-sale securities	(5,589,382)	(5,091,454)
Sales of short- and long-term available-for-sale securities	3,945,683	2,362,878
Maturities of short- and long-term available-for-sale securities	877,510	261,631
Business acquisitions, net of cash acquired	(536,624)	(851,380)
Increase in strategic and other related investments	(459,711)	(5,642)
Purchase of leasehold interest	(151,083)	
Net cash used in investing activities	(2,856,875)	(4,138,325)
Cash flows from financing activities:		
Issuance of EMC s common stock from the exercise of stock options	501,627	552,846
Issuance of VMware s common stock from the exercise of stock options	285,286	355,846
EMC repurchase of EMC s common stock	(1,899,208)	(800,267)
EMC purchase of VMware s common stock	(342,201)	(289,587)
VMware repurchase of VMware s common stock	(490,916)	(285,940)
Excess tax benefits from stock-based compensation	318,717	210,711
Payment of long-term and short-term obligations	(1,263)	(3,755)
Proceeds from long-term and short-term obligations	1,253	1,116
Net cash used in financing activities	(1,626,705)	(259,030)
Effect of exchange rate changes on cash and cash equivalents	5,455	(1,158)
Net decrease in cash and cash equivalents	(993,528)	(1,361,907)
Cash and cash equivalents at beginning of period	4,119,138	6,302,499
Cash and cash equivalents at end of period	$ 3,125,610	$ 4,940,592
Reconciliation of net income to net cash provided by operating activities:		
Net income	$ 1,736,295	$ 1,317,261

Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	1,048,151	862,964
Non-cash interest expense on convertible debt	76,398	78,731
Non-cash restructuring and other special charges	(2,325)	3,114
Stock-based compensation expense	613,233	484,141
Provision for doubtful accounts	8,525	18,599
Deferred income taxes, net	83,657	(41,355)
Excess tax benefits from stock-based compensation	(318,717)	(210,711)
Other, net	(28,740)	(9,192)
Changes in assets and liabilities, net of acquisitions:		
Accounts and notes receivable	(56,076)	(14,380)
Inventories	(416,898)	(55,862)
Other assets	(157,024)	(127,401)
Accounts payable	(75,263)	(71,839)
Accrued expenses	51,747	(38,343)
Income taxes payable	(13,740)	242,244
Deferred revenue	1,048,545	602,477
Other liabilities	(113,171)	(3,842)
Net cash provided by operating activities	$ 3,484,597	$ 3,036,606

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

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EMC CORPORATION

CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY

(in thousands)

(unaudited)

For the nine months ended September 30, 2011:

	Common Stock		Additional		Accumulated	Non-controlling	
	Shares	Par Value	Paid-in Capital	Retained Earnings	Other Comprehensive Loss	Interest in VMware	Shareholders Equity
Balance, January 1, 2011	2,069,246	$ 20,692	$ 3,816,681	$ 13,659,284	$ (92,617)	$ 762,736	$ 18,166,776
Stock issued through stock option and stock purchase plans	39,010	391	501,236				501,627
Tax benefit from stock options exercised			358,688				358,688
Restricted stock grants, cancellations and withholdings, net	8,894	89	(110,247)				(110,158)
Repurchase of common stock	(77,193)	(772)	(1,898,436)				(1,899,208)
EMC purchase of VMware stock			(304,022)			(38,179)	(342,201)
Stock options issued in business acquisitions			3,224				3,224
Stock-based compensation			629,301				629,301
Impact from equity transactions of VMware, Inc.			(268,269)			70,203	(198,066)
Change in market value of investments					(40,665)	(3,779)	(44,444)
Change in market value of derivatives					(81,703)		(81,703)
Translation adjustment					(5,317)		(5,317)
Reclassification of convertible debt (to)/from mezzanine (Note 4)			90,367				90,367
Net income				1,629,291		107,004	1,736,295
Balance, September 30, 2011	2,039,957	$ 20,400	$ 2,818,523	$ 15,288,575	$ (220,302)	$ 897,985	$ 18,805,181

For the nine months ended September 30, 2010:

	Common Stock		Additional		Accumulated	Non-controlling	
	Shares	Par Value	Paid-in Capital	Retained Earnings	Other Comprehensive Loss	Interest in VMware	Shareholders Equity
Balance, January 1, 2010	2,052,441	$ 20,524	$ 3,875,791	$ 11,759,289	$ (105,722)	$ 510,592	$ 16,060,474
Stock issued through stock option and stock purchase plans	46,884	469	552,377				552,846
Tax benefit from stock options exercised			223,807				223,807
Restricted stock grants, cancellations and withholdings, net	4,861	49	(60,126)				(60,077)
Repurchase of common stock	(43,790)	(438)	(799,829)				(800,267)
EMC purchase of VMware stock			(255,638)			(33,949)	(289,587)

Stock options issued in business acquisitions			1,841				1,841
Stock-based compensation			499,731				499,731
Impact from equity transactions of VMware, Inc.			(151,539)			177,977	26,438
Change in market value of investments					37,065	1,915	38,980
Change in market value of derivatives					(51,452)		(51,452)
Translation adjustment					(159)		(159)
Net income				1,271,436		45,825	1,317,261
Balance, September 30, 2010	2,060,396	$ 20,604	$ 3,886,415	$ 13,030,725	$ (120,268)	$ 702,360	$ 17,519,836

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

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EMC CORPORATION

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(in thousands)

(unaudited)

	For the Three Months Ended		For the Nine Months Ended	
	September 30, 2011	September 30, 2010	September 30, 2011	September 30, 2010
Net income	$ 642,114	$ 489,074	$ 1,736,295	$ 1,317,261
Other comprehensive income (loss), net of taxes (benefits):				
Foreign currency translation adjustments	(31,074)	30,292	(5,317)	(159)
Changes in market value of investments, including unrealized gains (losses) and reclassification adjustments to net income, net of taxes (benefits) of $(16,256), $15,481, $(25,533) and $22,785	(31,195)	26,734	(44,444)	38,980
Changes in market value of derivatives, net of taxes (benefits) of $(41,494), $(17,382), $(51,952) and $(29,559)	(64,748)	(31,034)	(81,703)	(51,452)
Other comprehensive income (loss)	(127,017)	25,992	(131,464)	(12,631)
Comprehensive income	515,097	515,066	1,604,831	1,304,630
Less: Net income attributable to the non-controlling interest in VMware, Inc.	(36,465)	(16,558)	(107,004)	(45,825)
Less: Other comprehensive (income) loss attributable to the non-controlling interest in VMware, Inc.	312	(1,401)	3,779	(1,915)
Comprehensive income attributable to EMC Corporation	$ 478,944	$ 497,107	$ 1,501,606	$ 1,256,890

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

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 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 VMware Virtual Infrastructure business, which is represented by EMC s majority equity stake in VMware, Inc. (VMware), is the leading provider of virtualization and cloud infrastructure software solutions.

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 and VMware, a company 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, 2010 which are contained in our Annual Report on Form 10-K filed with the Securities and Exchange Commission on February 28, 2011.

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, 2011 and 2010.

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 $1.701 billion 1.75% convertible senior notes due 2011 (the 2011 Notes), our $1.724 billion 1.75% convertible senior notes due 2013 (the 2013 Notes and, together with the 2011 Notes, the 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.

Recent Accounting Pronouncements

In May 2011, the Financial Accounting Standards Board (FASB) issued new guidance to achieve common fair value measurement and disclosure requirements between GAAP and International Financial Reporting Standards. This new guidance amends current fair value measurement and disclosure guidance to include increased transparency around valuation inputs and investment categorization. This new guidance is effective for fiscal years and interim periods beginning after December 15, 2011.

EMC CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

In June 2011, the FASB issued new guidance on the presentation of comprehensive income. While the new guidance changes the presentation of comprehensive income, there are no changes to the components that are recognized in net income or other comprehensive income under current accounting guidance. This new guidance is effective for fiscal years and interim periods beginning after December 15, 2011.

In September 2011, the FASB issued new guidance intended to simplify goodwill impairment testing. Entities will be allowed to perform a qualitative assessment on goodwill impairment to determine whether a quantitative assessment is necessary. This new guidance is effective for goodwill impairment tests performed in interim and annual periods for fiscal years beginning after December 15, 2011, with early adoption permitted.

We do not believe the adoption of the new guidance above will have an impact on our consolidated financial position, results of operations or cash flows.

2. Non-controlling Interest in VMware, Inc.

The non-controlling interests share of equity in VMware is reflected as Non-controlling interest in VMware, Inc. in the accompanying Consolidated Balance Sheets and was $898.0 million and $702.4 million as of September 30, 2011 and 2010, respectively. At September 30, 2011, EMC held 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 thousands):

	For the Nine Months Ended	
	September 30, 2011	**September 30, 2010**
Net income attributable to EMC Corporation	$ 1,629,291	$ 1,271,436
Transfers (to) from the non-controlling interest in VMware, Inc.:		
Increase in EMC Corporation s additional paid-in-capital for VMware s equity issuances	102,612	123,970
Decrease in EMC Corporation s additional paid-in-capital for VMware s other equity activity	(370,881)	(275,509)
Net transfers to non-controlling interest	(268,269)	(151,539)
Change from net income attributable to EMC Corporation and transfers from the non-controlling interest in VMware, Inc.	$ 1,361,022	$ 1,119,897

3. Business Combinations, Intangibles and Goodwill

During the nine months ended September 30, 2011, we acquired all of the capital stock of NetWitness Corporation, a privately-held, market-leading provider of network security analysis solutions. This acquisition complements and expands our RSA Information Security segment. Additionally, during the nine months ended September 30, 2011, VMware acquired six companies. The aggregate consideration for these seven acquisitions was $539.8 million which consisted of $536.6 million of cash consideration, net of cash acquired and $3.2 million for the fair value of our stock options granted in exchange for the acquirees stock options. 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 allocation to goodwill, intangibles and net assets was approximately $375.8 million, $157.1 million and $6.9 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, individually or in the aggregate, to our consolidated results of operations for the three or nine months ended September 30, 2011 or 2010.

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EMC CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

Intangible Assets

Intangible assets, excluding goodwill, as of September 30, 2011 and December 31, 2010 consist of (tables in thousands):

	September 30, 2011		
	Gross Carrying Amount	Accumulated Amortization	Net Book Value
Purchased technology	$ 1,620,912	$ (982,625)	$ 638,287
Patents	224,865	(68,367)	156,498
Software licenses	88,993	(81,461)	7,532
Trademarks and tradenames	172,851	(88,916)	83,935
Customer relationships and customer lists	1,329,774	(560,646)	769,128
In-process research and development	43,900		43,900
Leasehold interest	151,083	(1,442)	149,641
Other	25,822	(22,776)	3,046
Total intangible assets, excluding goodwill	$ 3,658,200	$ (1,806,233)	$ 1,851,967

In the quarter ended June 30, 2011, we, along with three other technology companies, acquired specific patents from Novell, Inc. The purchase price for the patent portfolio was $450.0 million, of which we paid $112.5 million. We assigned the patent portfolio an average life of 10 years, based on average contractual term remaining on the patents we acquired. The cash outflow was included in strategic and other related investments in the investing activities section of the Consolidated Statements of Cash Flows.

In the quarter ended June 30, 2011, VMware closed an agreement to purchase all of the right, title and interest in a ground lease covering the property and improvements located on property adjacent to VMware s Palo Alto, California campus for $225.0 million. Based upon the respective fair values and preliminary assumptions, $51.9 million of the purchase price was recorded to property, plant and equipment, net on the June 30, 2011 Consolidated Balance Sheet, representing the estimated fair value of the buildings and site improvements. The remaining $173.1 million of the purchase price was recorded to intangible assets, net on the June 30, 2011 Consolidated Balance Sheet, for the fair value of the ground lease and the right to develop additional square footage on the parcel.

In the three months ended September 30, 2011, the gross amount classified to property, plant and equipment, net was increased by $22.0 million to $73.9 million to reflect the final assumptions regarding VMware s intended use of the existing structures. As a result of this adjustment, the gross amount of the value attributed to the leasehold interest was decreased by the same amount. These adjustments are reflected on the Consolidated Statements of Cash Flows for the nine months ended September 30, 2011 and the Consolidated Balance Sheets as of September 30, 2011. Concurrent with the closing of the transaction, VMware entered into an amended and restated ground lease for the related property. The buildings and site improvements will be depreciated from the date they are placed into service through the term of the amended and restated ground lease, and intangible assets will amortize through 2046.

	December 31, 2010		
	Gross Carrying Amount	Accumulated Amortization	Net Book Value
Purchased technology	$ 1,509,616	$ (873,095)	$ 636,521
Patents	62,170	(62,134)	36
Software licenses	84,583	(72,115)	12,468
Trademarks and tradenames	171,651	(74,725)	96,926
Customer relationships and customer lists	1,275,908	(447,411)	828,497

In-process research and development	43,900		43,900
Other	25,632	(19,713)	5,919
Total intangible assets, excluding goodwill	$ 3,173,460	$ (1,549,193)	$ 1,624,267

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EMC CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

Goodwill

Changes in the carrying amount of goodwill, net, for the nine months ended September 30, 2011 and the year ended December 31, 2010 consist of (tables in thousands):

	Nine Months Ended September 30, 2011				
	Information Storage	Information Intelligence Group	RSA Information Security	VMware Virtual Infrastructure	Total
Balance, beginning of the period	$ 7,029,341	$ 1,467,903	$ 1,663,213	$ 1,612,193	$ 11,772,650
Goodwill resulting from acquisitions			187,445	188,395	375,840
Tax deduction from exercise of stock options	(73)		(95)		(168)
Finalization of purchase price allocations	4,038		(1,982)	3,273	5,329
Balance, end of the period	$ 7,033,306	$ 1,467,903	$ 1,848,581	$ 1,803,861	$ 12,153,651

	Year Ended December 31, 2010				
	Information Storage	Information Intelligence Group	RSA Information Security	VMware Virtual Infrastructure	Total
Balance, beginning of the year	$ 5,045,086	$ 1,476,520	$ 1,529,408	$ 1,159,362	$ 9,210,376
Goodwill resulting from acquisitions	2,287,712		140,013	178,201	2,605,926
Tax deduction from exercise of stock options	(548)	(2,424)	(1,103)		(4,075)
Other adjustments	(275,405)			275,405	
Finalization of purchase price allocations	(27,504)	(6,193)	(5,105)	(775)	(39,577)
Balance, end of the year	$ 7,029,341	$ 1,467,903	$ 1,663,213	$ 1,612,193	$ 11,772,650

Other adjustments to goodwill in the year ended December 31, 2010 include the transfer of the goodwill related to the Ionix information technology management business from the Information Storage segment to the VMware Virtual Infrastructure segment. The goodwill transfer related to the common control acquisition of certain software product technology and related capabilities of our Ionix business by VMware. See Note 15 for additional details.

4. Convertible Debt

In November 2006, we issued our Notes for total gross proceeds of $3.45 billion. The Notes are senior unsecured obligations and rank equally with all other existing and future senior unsecured debt.

The 2011 Notes are currently convertible because we are within three months of their maturity. The holders of the 2013 Notes may convert their Notes at their option on any day prior to the close of business on the scheduled trading day immediately preceding September 1, 2013 only under the following circumstances: (1) during the five business-day period after any five consecutive trading-day period (the measurement period) in which the price per Note for each day of that measurement period was less than 98% of the product of the last reported sale price of our common stock and the conversion rate on each such day; (2) during any calendar quarter, if the last reported sale price of our common stock for 20 or more trading days in a period of 30 consecutive trading days ending on the last trading day of the immediately preceding calendar quarter exceeds 130% of the applicable conversion price in effect on the last trading day of the immediately preceding calendar quarter; or (3) upon the occurrence of certain events specified in the Notes. Additionally, the 2013 Notes will become convertible during the last three months prior to their maturity.

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 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 Notes will be 62.1978 shares of our common stock per one thousand dollars of principal amount of Notes, which represents a 27.5% conversion premium from the date the Notes were issued and is equivalent to a conversion price of approximately $16.08

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EMC CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

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 Notes that elects to convert its Notes in connection with such fundamental change.

At December 31, 2010, the contingent conversion thresholds on the Notes were exceeded. As a result, the Notes became convertible at the option of the holder. Accordingly, since the terms of the Notes require the principal to be settled in cash, we reclassified from Shareholders Equity the portion of the Notes attributable to the conversion feature which had not yet been accreted to its face value, and the Notes were classified as a current liability.

At September 30, 2011, the 2011 Notes had less than three months to maturity and are therefore convertible at the option of the holder through November 30, 2011. In addition, based upon the closing price of our common stock for the prescribed measurement period during the three months ended September 30, 2011, the contingent conversion thresholds on the 2013 Notes were exceeded. As a result, the 2013 Notes are convertible at the option of the holder through December 31, 2011. We reclassified from Shareholders Equity the portion of the Notes attributable to the conversion feature which had not yet been accreted to its face value, and the Notes have been classified as a current liability. Contingencies continue to exist regarding the holders ability to convert the 2013 Notes in future quarters. The determination of whether the 2013 Notes are convertible will be performed on a quarterly basis. Approximately $24.2 million of the Notes have been converted as of September 30, 2011.

The carrying amount reported on the Consolidated Balance Sheet as of September 30, 2011 for our convertible debt was $3,425.8 million and the fair value was $4,707.6 million. The decrease in carrying amount during the nine months ended September 30, 2011 was due to the conversion of shares. The carrying amount of the equity component was $524.2 million at September 30, 2011.

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

	For the Three Months Ended	
	September 30, 2011	September 30, 2010
Contractual interest expense on the coupon	$ 15,078	$ 15,094
Amortization of the discount component recognized as interest expense	31,045	29,041
Total interest expense on the convertible debt	$ 46,123	$ 44,135

	For the Nine Months Ended	
	September 30, 2011	September 30, 2010
Contractual interest expense on the coupon	$ 45,266	$ 45,282
Amortization of the discount component recognized as interest expense	90,367	85,128
Total interest expense on the convertible debt	$ 135,633	$ 130,410

As of September 30, 2011, the unamortized discount on the 2011 Notes consists of $10.8 million which will be fully amortized by December 1, 2011, and the unamortized discount on the 2013 Notes consists of $134.1 million, which will be fully amortized by December 1, 2013. The effective interest rate on the Notes was 5.6% for the three and nine months ended September 30, 2011 and 2010.

In connection with the sale of the 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 Notes upon conversion. The Purchased Options will cover, subject to customary anti-dilution adjustments, approximately 215 million shares of our common stock. Half of the Purchased Options expire on December 1, 2011 and the remaining half of the Purchased Options expire on December 1, 2013. We paid an aggregate amount of $669.1 million of the proceeds from the sale of the Notes for the Purchased Options that was recorded as additional paid-in-capital in Shareholders Equity.

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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. Half of the associated warrants have expiration dates between February 15, 2012 and March 15, 2012 and the remaining half of the associated warrants have expiration dates between February 18, 2014 and March 18, 2014. We received aggregate proceeds of $391.1 million from the sale of the associated warrants. Upon exercise, the value of the warrants is required to be settled in shares.

The Purchased Options and associated warrants will generally have the effect of increasing the conversion price of the 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 Notes.

In 2010, we 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 forecasted issuance of debt in 2012 to replace the 2011 Notes. As such, the gain or loss on these hedges is recognized in other comprehensive loss until the underlying exposure is realized.

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 securities, with the exception of some of our U.S. government and agency obligations, which are classified as Level 1 securities, and all of our auction rate securities, which are classified as Level 3. At September 30, 2011, the vast majority of our Level 2 investments 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. Our publicly traded equity securities are classified as Level 1.

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. As a result of the lack of liquidity for auction rate securities, we have classified these as long-term investments as of September 30, 2011 and December 31, 2010. At September 30, 2011 and December 31, 2010, 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, 2011 and December 31, 2010, auction rate securities were valued using a discounted cash flow model.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

The following tables summarize the composition of our short- and long-term investments at September 30, 2011 and December 31, 2010 (tables in thousands):

	September 30, 2011			
	Amortized Cost	Unrealized Gains	Unrealized (Losses)	Aggregate Fair Value
U.S. government and agency obligations	$ 2,294,101	$ 14,889	$ (2,268)	$ 2,306,722
U.S. corporate debt securities	1,391,063	10,175	(3,595)	1,397,643
High yield corporate debt securities	448,200	4,549	(27,557)	425,192
Asset-backed securities	31,411	103	(11)	31,503
Municipal obligations	775,608	1,953	(479)	777,082
Auction rate securities	91,350		(10,259)	81,091
Foreign debt securities	1,048,249	7,391	(2,600)	1,053,040
Total fixed income securities	6,079,982	39,060	(46,769)	6,072,273
Publicly traded equity securities	58,205	4,428		62,633
Total	$ 6,138,187	$ 43,488	$ (46,769)	$ 6,134,906

We held approximately $1.1 billion in foreign debt securities at September 30, 2011. These securities have an average credit rating of AA-, and approximately 6% 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 or Spain. Additionally, we have an immaterial amount of exposure to French agencies and financial institutions.

	December 31, 2010			
	Amortized Cost	Unrealized Gains	Unrealized (Losses)	Aggregate Fair Value
U.S. government and agency obligations	$ 1,737,782	$ 11,286	$ (2,674)	$ 1,746,394
U.S. corporate debt securities	1,239,325	13,608	(1,307)	1,251,626
High yield corporate debt securities	421,469	18,306	(1,943)	437,832
Asset-backed securities	34,730	152	(1)	34,881
Municipal obligations	1,095,338	3,829	(3,266)	1,095,901
Auction rate securities	155,950		(9,906)	146,044
Foreign debt securities	653,251	6,878	(714)	659,415
Total fixed income securities	5,337,845	54,059	(19,811)	5,372,093
Publicly traded equity securities	22,376	32,448		54,824
Total	$ 5,360,221	$ 86,507	$ (19,811)	$ 5,426,917

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

The following table represents our fair value hierarchy for our financial assets and liabilities measured at fair value as of September 30, 2011 (in thousands):

	Level 1	Level 2	Level 3	Total
Cash	$ 1,186,959	$	$	$ 1,186,959
Cash equivalents	1,838,607	100,044		1,938,651
U.S. government and agency obligations	1,277,304	1,029,418		2,306,722
U.S. corporate debt securities		1,397,643		1,397,643
High yield corporate debt securities		425,192		425,192
Asset-backed securities		31,503		31,503
Municipal obligations		777,082		777,082
Auction rate securities			81,091	81,091
Foreign debt securities		1,053,040		1,053,040
Publicly traded equity securities	62,633			62,633
Total cash and investments	$ 4,365,503	$ 4,813,922	$ 81,091	$ 9,260,516
Other items:				
Foreign exchange derivative assets	$	$ 60,341	$	$ 60,341
Foreign exchange derivative liabilities		(58,617)		(58,617)
Commodity derivative liabilities		(708)		(708)
Interest rate swap contracts		(145,934)		(145,934)

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 for the forecasted issuance of debt in 2012 to replace the 2011 Notes. As such, the gain or loss on these hedges is recognized in other comprehensive loss until the underlying exposure is realized. As of September 30, 2011, the interest rate swaps have unrealized losses of $145.9 million primarily due to the change in interest rates since the contracts inception.

Our auction rate securities are predominantly rated AAA and are primarily collateralized by student loans. The underlying loans of all but two of our auction rate securities, with a market value of $18.4 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. The two securities whose underlying loans are not guaranteed by the U.S. government have credit enhancements and are insured by third party agencies. We believe the quality of the collateral underlying all of our auction rate securities will enable us to recover our principal balance in full.

To determine the estimated fair value of our investment in auction rate securities, we used a discounted cash flow model. 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 2% at September 30, 2011 compared to 1% at December 31, 2010 due to the widening of credit spreads on AA-rated banks during 2011.

The following table provides a summary of changes in fair value of our Level 3 financial assets for the three and nine months ended September 30, 2011 (table in thousands):

	Three Months Ended September 30, 2011	Nine Months Ended September 30, 2011
Balance, beginning of the period	$ 99,154	$ 146,044
Calls at par value	(13,100)	(64,600)
Decrease in previously recognized unrealized losses included in other comprehensive income	(4,963)	(353)
Balance, end of the period	$ 81,091	$ 81,091

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EMC CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

Investment Gains and Losses

Unrealized losses on investments at September 30, 2011 by investment category and length of time the investment has been in a continuous unrealized loss position are as follows (table in thousands):

	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	$ 747,809	$ (2,122)	$ 6,491	$ (146)	$ 754,300	$ (2,268)
U.S. corporate debt securities	549,667	(3,595)			549,667	(3,595)
High yield corporate debt securities	306,934	(27,557)			306,934	(27,557)
Asset-backed securities	7,047	(10)	5	(1)	7,052	(11)
Municipal obligations	304,076	(472)	8,147	(7)	312,223	(479)
Auction rate securities			81,091	(10,259)	81,091	(10,259)
Foreign debt securities	326,419	(2,600)			326,419	(2,600)
Total	$ 2,241,952	$ (36,356)	$ 95,734	$ (10,413)	$ 2,337,686	$ (46,769)

As of September 30, 2011, there were no publicly traded equity securities in a continuous unrealized loss position. For all of our securities for which the amortized cost basis was greater than the fair value at September 30, 2011, 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.

During the three months ended June 30, 2011, a realized gain of $56.0 million was recorded in other expense, net on the Consolidated Income Statements for the sale of VMware s investment in Terremark Worldwide, Inc.

Contractual Maturities

The contractual maturities of fixed income securities held at September 30, 2011 are as follows (table in thousands):

	September 30, 2011	
	Amortized Cost Basis	Aggregate Fair Value
Due within one year	$ 1,602,305	$ 1,604,979
Due after 1 year through 5 years	3,661,373	3,678,241
Due after 5 years through 10 years	356,779	346,741
Due after 10 years	459,525	442,312
Total	$ 6,079,982	$ 6,072,273

Short-term investments on the Consolidated Balance Sheet include $30.6 million of variable rate demand notes, which have contractual maturities ranging from 2013 through 2045, and are not classified within investments due within one year above.

6. Inventories

Inventories consist of (table in thousands):

	September 30, 2011	December 31, 2010
Work-in-process	$ 555,343	$ 508,426
Finished goods	548,800	347,979
	$ 1,104,143	$ 856,405

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EMC CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

7. Accounts and Notes Receivable and Allowance for Credit Losses

Our 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. 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 September 30, 2011 were as follows (table in thousands):

Year	Contractual Amounts Due Under Leases
Due within one year	$ 106,198
Due within two years	90,288
Due within three years	74,466
Thereafter	2,302
Total	273,254
Less amounts representing interest	(6,362)
Present value	266,892
Current portion (included in accounts and notes receivable)	94,111
Long-term portion (included in other assets, net)	$ 172,781

Subsequent to September 30, 2011, we sold $12.2 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, 2011, 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, 2011 and 2010 (table in thousands):

	September 30, 2011	September 30, 2010
$	31,248,709	$ 33,304,890
Specialty	1,078,779	1,756,730
Corporate	2,061,030	1,548,488
Total assets	$ 34,388,518	$ 36,610,108

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HENRY BROS. ELECTRONICS, INC AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) – (continued)

10. Contingent Liabilities

From time to time, the Company is subject to various claims with respect to matters arising out of the normal course of business. In management’s opinion, none of these claims is likely to have a material affect on the Company’s consolidated financial statements.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

OVERVIEW

We are an established leader in the electronic physical security industry, specializing in integrated security systems and emergency preparedness. Our operations are divided into two business segments – Security System Integration (“Integration”) and Specialty Products and Services (“Specialty”). The Integration segment provides “cradle to grave” services for a wide variety of security, communications and control systems. The Company specializes in turn-key systems that integrate many different technologies. Systems are customized to meet the specific needs of its customers. Through the Specialty segment we provide emergency preparedness programs, and specialized radio frequency communication equipment and integration. Each of the Company’s segments markets nationwide with an emphasis in Arizona, California, Colorado, Maryland, New Jersey, New York, Texas and Virginia. Customers are primarily medium and large businesses and governmental agencies. The Company derives a majority of its revenues from project installations and, to a smaller extent, maintenance service revenue.

OUR VISION AND STRATEGY

Our vision is to maintain our leadership position in security technology. We intend to do this in part by:

- Providing advice on product selection and system design;
- Examining and thoroughly testing each security product as it would be set up for use in our customers’ facilities; and,
- Using only systems and components that are reliable and efficient to use.

In addition to growing the business organically, we have been actively pursuing the strategic acquisition of synergistic integrators and specialty products and service companies to further fuel steady growth. Consistent with our expansion strategy, we acquired seven companies since August of 2002.

To finance our acquisitions, we have used a combination of internally generated cash, the sale of Company common stock and bank debt. We currently have an $8 million revolving credit facility with TD Bank. Borrowings under the revolving credit facility were $6,235,898, at June 30, 2009. It is our expectation and intent to use cash and to incur additional debt as appropriate to finance future working capital and acquisitions. Additionally, to fund future acquisitions we would consider the issuance of subordinated debt, the sale of equity securities, or the sale of existing Company assets.

TRENDS

As a result of the protracted credit freeze and severe recession which are having a significant negative impact on construction markets and capital spend patterns of commercial businesses, we are revising our revenue forecast for 2009 to fall within a range of $65 million to $70 million, from the previous estimate of $80 million. We anticipate our overall average operating margins for our business to now be 3.0% to 5.0% for the year ended December 31, 2009, from a previous estimate of 6.0%, as compared to an operating margin of 5.0% in 2008 and essentially breakeven operating margin in 2007.

There are several factors impacting operating margins, including levels of competition for a particular project and the size of the project. As a significant amount of our costs are relatively fixed, such as labor costs, increases or decreases in revenues can have a significant impact on operating margins. The Company continually monitors costs and pursues various cost control measures and sales initiatives to improve operating margins.

In February 2008, the Company entered into a subcontractor agreement with Global Security & Engineering Solutions, a division of L-3 Services, Inc. (the "L-3 Contract") pursuant to which L-3 would issue task orders under its Indefinite Quantity Firm Fixed Price Contract with the U.S. Marine Corp Systems Command to deliver a Tactical Video Capture System ("TVCS"). TVCS is used for real-time visualization and situational awareness while Marine units are conducting military operations in urban terrain training exercises. The performance period of the contract is three years. In the first two quarters of 2009, the revenue recognized under this contract represented $4.0 million and there were outstanding task orders included in our backlog of approximately $2.5 million at June 30, 2009. There was no revenue recognized under this contract for the first two quarters of 2008.

Three Months Ended June 30, 2009 compared to June 30, 2008

	(Unaudited) Three months ended June 30,		
	2009	2008	% change
Revenue	$ 13,971,980	$ 15,123,951	-7.6%
Cost of revenue	10,081,871	11,282,000	-10.6%
Gross profit	3,890,109	3,841,951	1.3%
Operating expenses:			
Selling, general & administrative expenses	3,691,785	3,126,987	18.1%
Operating profit	198,324	714,964	-72.3%
Interest income	2,067	22,937	-91.0%
Other income	2,608	4,034	-35.4%
Interest expense	(99,706)	(65,995)	51.1%
Income before tax expense	103,293	675,940	-84.7%
Tax expense	48,040	338,679	-85.8%
Net income	$ 55,253	$ 337,261	-83.6%

Revenue - Revenue for the three months ended June 30, 2009 was $13,971,980, representing a decrease of $1,151,971 or 7.6%, as compared to revenue of $15,123,951 for the three months ended June 30, 2008. Revenue was down in all of the Company's integration regions in the second quarter of 2009 versus the same quarter in the prior year, with the exception of Colorado, which was up 57.7%. The New Jersey region had the greatest decrease, as a result of the winding down of large projects that were not replaced by similar projects due to competitive margin pressure. These declines are due principally to the protracted credit freeze and economic downturn which is having a significant negative impact on construction markets and capital spending patterns of commercial businesses. Partially offsetting these declines was an increase in revenue resulting from the L-3 Contract.

Cost of Revenue - Cost of revenue for the three months ended June 30, 2009 was $10,081,872 as compared to $11,282,000 for the three months ended June 30, 2008. The gross profit margin for the three months ended June 30, 2009 was 27.8% as compared to 25.4% for the three months ended June 30, 2008. Our Arizona and Mid-Atlantic operations had lower quarter over quarter gross profit margin dollars due to their respective decline in revenues. While revenues and gross profit dollars were down in our New Jersey / New York operation, margins improved as we closed out several of the jobs with large public agencies in the New York Metropolitan area referenced above in “Revenue”. Also contributing to the increase in gross profit was the profit recognized under the L-3 Contract.

Selling, General and Administrative Expenses - Selling, general and administrative expense was $3,691,785 for the three months ended June 30, 2009 as compared to $3,126,987 for the three months ended June 30, 2008. This increase of 18.1% or $564,798 was mainly attributable to higher personnel related costs. As part of our strategic growth initiative, we have increased our sales force by over 60% starting in the last quarter of 2008 and continuing throughout the second quarter of 2009. This initiative was implemented in order to take advantage of an anticipated increase in security spending related to public projects and the expansion of the Company’s national footprint into Houston, Texas and Grand Junction, Colorado.

Interest Income – Interest income for the three months ended June 30, 2009 was $2,067 as compared to $22,937 for the three months ended June 30, 2008. This decrease was attributable to lower average cash balances during the three month period ended June 30, 2009 versus the same period in the prior year.

Interest Expense - Interest expense for the three months ended June 30, 2009 was $99,706 as compared to $65,995 for the three months ended June 30, 2008. The increase is due to the average outstanding revolving debt balance being $1,816,484 higher in the three month period ended June 30, 2009 versus that in the three months ended June 30, 2008, offset in part by a 175 basis point lower average prime rate of interest in 2009 compared to the same period in 2008.

Tax Expense – The effective tax rate for the three months ended June 30, 2009 was 46.5%, based upon income before tax expense of $103,293. The effective tax rate for the three months ended June 30, 2008 was 50.1%, based upon income before tax expense of $675,940. These tax rates are a result of the Company operating in multiple states and jurisdictions with higher tax rates than the average of all states combined.

Net Income - As a result of the above noted factors our net income was $55,253 for the three months ended June 30, 2009 compared to net income of $337,261 for the three months ended June 30, 2008. This resulted in diluted earnings per share of $0.01 on weighted average diluted common shares outstanding of 6,064,742 for the three months ended June 30, 2009, as compared to diluted earnings per share of $0.06 on weighted average diluted common shares outstanding of 5,976,008 for the three month period ended June 30, 2008.

Six Months Ended June 30, 2009 compared to June 30, 2008

	(Unaudited) Six months ended June 30, 2009	2008	% change
Revenue	$ 29,280,192	$ 31,029,997	-5.6%
Cost of revenue	21,168,069	23,498,938	-9.9%
Gross profit	8,112,123	7,531,059	7.7%
Operating expenses:			
Selling, general & administrative expenses	7,562,645	6,256,168	20.9%
Operating profit	549,478	1,274,891	56.9%
Interest income	9,037	52,981	-82.9%
Other income	15,794	8,248	91.5%
Interest expense	(165,407)	(142,728)	15.9%
Income before tax expense	408,902	1,193,392	-65.7%
Tax expense	187,527	572,174	-67.2%
Net income	$ 221,375	$ 621,218	-64.4%

Revenue - Revenue for the six months ended June 30, 2009 was $29,280,192, representing a decrease of $1,749,805 or 5.6%, as compared to revenue of $31,029,997 for the six months ended June 30, 2008. Revenue was down in all of the Company's integration regions in the second half of 2009 versus the same period in the prior year 2009, with the exception of Colorado, which was up 38.7%. The New Jersey region had the greatest decrease, as a result of the winding down of large projects that were not replaced by similar projects due to competitive margin pressure. These declines are due principally to the protracted credit freeze and economic downturn which is having a significant negative impact on construction markets and capital spending patterns of commercial businesses. Partially offsetting these declines was an increase in revenue resulting from the L-3 Contract.

Cost of Revenue - Cost of revenue for the six months ended June 30, 2009 was $21,168,069 as compared to $23,498,938 for the six months ended June 30, 2008. The gross profit margin for the six months ended June 30, 2009 was 27.7% as compared to 24.3% for the six months ended June 30, 2008. In the first quarter of 2008, our Airorlite subsidiary incurred significant losses in order to complete work on certain open contracts which depresses gross profit for that period in 2008. Our Arizona and Mid-Atlantic operations had lower period over period gross profit margin dollars due to their respective decline in revenues. While revenues and gross profit dollars were down in our New Jersey / New York operation, margins improved as we closed out several of the jobs with large public agencies in the New York Metropolitan area referenced above in “Revenue”. Also contributing to the increase in gross profit was the profit recognized under the L-3 Contract.

Selling, General and Administrative Expenses - Selling, general and administrative expense was $7,562,645 for the six months ended June 30, 2009 as compared to $6,256,168 for the six months ended June 30, 2008. This increase of 20.9% or $1,306,476 was mainly attributable to higher personnel related costs. As part of our strategic growth initiative, we have increased our sales force by over 60% starting in the last quarter of 2008 and continuing throughout the second quarter of 2009. This initiative was implemented in order to take advantage of an anticipated increase in security spending related to public projects and the expansion of the Company's national footprint into Houston, Texas and Grand Junction, Colorado. Higher training costs for our sales and technical staff were also incurred during the current quarter, which contributed to the overall increase.

Interest Income – Interest income for the six months ended June 30, 2009 was $9,037 as compared to $52,981 for the six months ended June 30, 2008. This decrease was attributable to lower average cash balances during the six month period ended June 30, 2009 versus the same period in the prior year.

Interest Expense - Interest expense for the six months ended June 30, 2009 was $165,407 as compared to $142,728 for the six months ended June 30, 2008. While the average outstanding revolving debt balance was $1,400,552 higher in the six month period ended June 30, 2009 versus that in the six months ended June 30, 2008, the average prime rate of interest paid was 241 basis points lower in the 2009 period than it was in 2008 resulting in interest expense that is lower than expected.

Tax Expense – The effective tax rate for the six months ended June 30, 2009 was 45.9%, based upon income before tax expense of $408,902. The effective tax rate for the six months ended June 30, 2008 was 47.9%, based upon income before tax expense of $1,193,192. These tax rates are a result of the Company operating in multiple states and jurisdictions with higher tax rates than the average of all states combined.

Net Income - As a result of the above noted factors our net income was $221,375 for the six months ended June 30, 2009 compared to net income of $621,218 for the six months ended June 30, 2008. This resulted in diluted earnings per share of $0.01 on weighted average diluted common shares outstanding of 6,044,499 for the six months ended June 30, 2009, as compared to diluted earnings per share of $0.06 on weighted average diluted common shares outstanding of 5,976,008 for the six month period ended June 30, 2008.

Liquidity and Capital Resources

As of June 30, 2009, we had cash and cash equivalents of $1,265,070. Our net current assets were $10,123,730 at June 30, 2009 versus $13,944,121 at December 31, 2008. Total debt at June 30, 2009 was $7,232,471 compared to the December 31, 2008 balance of $5,485,404.

Cash used in operating activities was $99,310 during the six months ended June 30, 2009. The most significant use of cash resulted from a net decrease in accounts payable and accrued expenses of $3,052,553 and $1,183,517, respectively. Partially offsetting this use of cash was an increase in costs in excess of billings and estimated profits of $2,065,552, which includes the deferral of costs related to the L-3 Contract, a decrease in accounts receivable of $1,270,740 and an increase in billings in excess of costs and profits of $572,394.

Cash used in investing activities was $234,076, comprised of $196,576 for the purchase of property and equipment and $37,500 of earn-out payments associated with the CIS acquisition.

Cash provided by financing activities was $1,570,752, of which $1,900,000 represents borrowings from our revolving bank line and $185,069 of proceeds from stock option exercises, partially offset by $271,869 representing the repayments of bank loans and other debt.

Borrowings under the revolving credit facility were $6,235,898 at June 30, 2009 and were $4,335,898 at December 31, 2008. On October 6, 2008, the Company executed an amendment to its revolving credit agreement with TD Bank, increasing its line of credit from $4 million to $8 million. The term of the agreement has been extended to June 30, 2010 and interest continues to be paid monthly in arrears at TD Bank’s prime rate. The Company is required to maintain certain financial and reporting covenants and restrictions on dividend payments under the terms of the Loan Agreement with TB Bank, N.A. (See Note 6 to the Condensed Consolidated Financial Statements included in this Quarterly Report on Form 10-Q).

Backlog and Bookings

Booked orders increased 58.3% to $16,350,960 in the second quarter of 2009, as compared to $10,328,622 same quarter of 2008. Booked orders increased 27.3% to $28,091,723 in the first half of 2009, as compared to $22,071,938 first half of 2008.

The Company’s backlog as of June 30, 2009 was $22,662,774 and was $17,609,108 at June 30, 2008. The increase in backlog is due to new public sector service agreements, several integration contracts with new public agencies and L-3 Contract bookings.

Critical Accounting Policies and Estimates

Disclosure of the Company’s significant accounting policies is included in Note 1 to the consolidated financial statements of the Company’s Annual Report on Form 10-K for year ended December 31, 2008. Some of these policies require management to make estimates and assumptions that may affect the reported amounts in the Company’s financial statements.

Forward Looking Statements

When used in this discussion, the words "believes", "anticipates", "contemplated", "expects", or similar expressions are intended to identify forward looking statements. Such statements are subject to certain risks and uncertainties that could cause actual results to differ materially from those projected. Those risks and uncertainties include changes in interest rates, the ability to control costs and expenses, significant variations in recognized revenue due to customer caused delays in installations, cancellations of contracts by our customers, and general economic conditions which could cause actual results to differ materially from historical earnings and those presently anticipated or projected. The Company undertakes no obligation to publicly release the results of any revisions to those forward looking statements that may be made to reflect events or circumstances after this date or to reflect the occurrence of unanticipated events.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

We have one revolving credit facility for which the interest rate on outstanding borrowings is variable and is based upon the prime rate of interest. At June 30, 2009, there was $6,235,898 outstanding under this credit facility.

Our business is impacted by the health of the U.S economy. Current economic conditions have caused a decline in business spending which has adversely affected our business and financial performance and our operating results. Accordingly, our business and financial performance has been adversely affected by current economic conditions, and any future d of economic conditions, could cause a further reduction in the availability of credit to our customers.

Item 4. Controls and Procedures

(a) Evaluation of Disclosure Controls and Procedures

The Company’s Chief Executive Officer, Chief Operating Officer and Chief Financial Officer have evaluated the effectiveness of our disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the “Exchange Act”)) as of June 30, 2009. Based on such evaluation, such officers have concluded that, as of June 30, 2009, the Company’s disclosure controls and procedures are effective.

(b) Changes in Internal Control Over Financial Reporting

During the three months ended June 30, 2009, management did not identify any changes in the Company’s internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, the Company’s internal control over financial reporting.

Part II - Other Information

Item 1.Legal Proceedings

We know of no material litigation or proceeding, pending or threatened, to which we are or may become a party.

Item 6.Exhibits

Number	Description
31.1	Rule 13a-14(a) 15d-14(a) Certification of Chief Executive Officer
31.2	Rule 13a-14(a) 15d-14(a) Certification of Chief Operating Officer
31.3	Rule 13a-14(a) 15d-14(a) Certification of Chief Financial Officer
32	Section 1350 Certification

In accordance with the requirements of the Securities and Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto authorized.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Henry Bros. Electronics, Inc.
(Registrant)

Date: August 13, 2009	By: /s/ JAMES E. HENRY
	James E. Henry
	Chairman, Chief Executive Officer, Treasurer and Director
Date: August 13, 2009	By: /s/ BRIAN REACH
	Brian Reach
	President, Chief Operating Officer, Secretary and Director
Date: August 13, 2009	By: /s/ JOHN P. HOPKINS
	John P. Hopkins
	Chief Financial Officer