

RED HAT INC
Form 10-Q
January 09, 2012
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended November 30, 2011

OR

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

Commission File Number: 001-33162

RED HAT, INC.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of incorporation or organization)

06-1364380

(I.R.S. Employer Identification No.)

1801 Varsity Drive, Raleigh, North Carolina 27606

(Address of principal executive offices, including zip code)

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(919) 754-3700

(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 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 No

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

Large accelerated filer Accelerated filer Non-accelerated filer 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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date:

As of December 30, 2011, there were 193,137,311 shares of common stock outstanding.

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RED HAT, INC.

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Table of Contents**RED HAT, INC.****CONSOLIDATED BALANCE SHEETS****(In thousands except share and per share amounts)**

	November 30, 2011 (Unaudited)	February 28, 2011 (1)
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 526,665	\$ 642,630
Investments in debt and equity securities, short-term	281,647	217,970
Accounts receivable, net of allowances for doubtful accounts of \$1,923 and \$1,379, respectively	206,449	184,741
Deferred tax assets, net	69,460	75,720
Prepaid expenses	67,422	62,364
Other current assets	2,175	1,133
Total current assets	1,153,818	1,184,558
Property and equipment, net of accumulated depreciation and amortization of \$159,288 and \$139,753, respectively	83,925	75,558
Goodwill	591,061	463,673
Identifiable intangibles, net	104,566	109,932
Investments in debt securities, long-term	408,455	331,791
Other assets, net	38,449	33,810
Total assets	\$ 2,380,274	\$ 2,199,322
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	\$ 22,405	\$ 16,285
Accrued expenses	101,107	90,229
Deferred revenue	609,746	572,637
Other current obligations	632	650
Total current liabilities	733,890	679,801
Deferred lease credits	5,058	5,215
Long-term deferred revenue	209,869	199,617
Other long-term obligations	24,060	23,990
Commitments and contingencies (NOTE 12 and NOTE 13)		
Stockholders' equity:		
Preferred stock, 5,000,000 shares authorized, none outstanding		
Common stock, \$0.0001 per share par value, 300,000,000 shares authorized, 226,208,941 and 223,778,248 shares issued, and 194,150,435 and 193,046,862 shares outstanding at November 30, 2011 and February 28, 2011, respectively	23	22
Additional paid-in capital	1,679,955	1,610,238
Retained earnings	355,707	245,050
Treasury stock at cost, 32,058,506 and 30,731,386 shares at November 30, 2011 and February 28, 2011, respectively	(619,744)	(562,792)
Accumulated other comprehensive loss	(8,544)	(1,819)
Total stockholders' equity	1,407,397	1,290,699
Total liabilities and stockholders' equity	\$ 2,380,274	\$ 2,199,322

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(1) Derived from audited financial statements.

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

Table of Contents**RED HAT, INC.****CONSOLIDATED STATEMENTS OF OPERATIONS****(In thousands except per share amounts)****(Unaudited)**

	Three Months Ended		Nine Months Ended	
	November 30,	November 30,	November 30,	November 30,
	2011	2010	2011	2010
Revenue:				
Subscriptions	\$ 246,538	\$ 198,842	\$ 710,408	\$ 564,101
Training and services	43,488	36,734	125,684	100,380
Total subscription and training and services revenue	290,026	235,576	836,092	664,481
Cost of subscription and training and services revenue:				
Cost of subscriptions	17,041	13,336	48,876	38,256
Cost of training and services	28,148	26,408	85,399	70,427
Total cost of subscription and training and services revenue	45,189	39,744	134,275	108,683
Gross profit	244,837	195,832	701,817	555,798
Operating expense:				
Sales and marketing	107,561	85,138	304,617	239,136
Research and development	53,739	43,083	153,515	126,102
General and administrative	29,965	29,655	92,277	84,294
Total operating expense	191,265	157,876	550,409	449,532
Income from operations	53,572	37,956	151,408	106,266
Interest income	2,075	1,608	6,138	5,046
Other income, net	(227)	462	(167)	2,140
Income before provision for income taxes	55,420	40,026	157,379	113,452
Provision for income taxes	17,180	14,009	46,722	39,708
Net income	\$ 38,240	\$ 26,017	\$ 110,657	\$ 73,744
Basic net income per common share	\$ 0.20	\$ 0.14	\$ 0.57	\$ 0.39
Diluted net income per common share	\$ 0.19	\$ 0.13	\$ 0.56	\$ 0.38
Weighted average shares outstanding				
Basic	193,393	191,296	193,162	189,410
Diluted	196,468	196,908	196,493	195,723

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

Table of Contents**RED HAT, INC.****CONSOLIDATED STATEMENTS OF CASH FLOWS****(In thousands)****(Unaudited)**

	Three Months Ended		Nine Months Ended	
	November 30,	November 30,	November 30,	November 30,
	2011	2010	2011	2010
Cash flows from operating activities:				
Net income	\$ 38,240	\$ 26,017	\$ 110,657	\$ 73,744
Adjustments to reconcile net income to net cash provided by operating activities:				
Depreciation and amortization	12,392	11,829	38,278	35,240
Share-based compensation expense	20,770	15,340	55,710	44,189
Deferred income taxes	17,015	7,911	36,225	29,697
Excess tax benefits from share-based payment arrangements	(7,626)	(10,800)	(24,298)	(31,999)
Gain on sale of investments in equity securities	0	(1,726)	(1,307)	(2,843)
Other	(233)	673	757	789
Changes in operating assets and liabilities net of effects of acquisitions:				
Accounts receivable	(35,014)	(23,762)	(23,429)	(11,030)
Prepaid expenses	(3,096)	(4,613)	(6,324)	(9,357)
Accounts payable	6,585	5,544	6,209	2,662
Accrued expenses	15,621	16,343	15,386	24,595
Deferred revenue	32,046	26,803	56,167	39,184
Other	(144)	1,261	(159)	877
Net cash provided by operating activities	96,556	70,820	263,872	195,748
Cash flows from investing activities:				
Purchase of investment in debt securities available-for-sale	(329,730)	(314,729)	(731,016)	(535,093)
Proceeds from sales and maturities of investment in debt securities available-for-sale	196,991	191,259	578,267	605,388
Proceeds from sales of investment in equity securities available-for-sale	0	1,843	1,346	3,000
Acquisition of business, net of cash acquired	(135,210)	(31,381)	(135,210)	(31,381)
Purchase of strategic equity investments	(1,622)	0	(2,622)	0
Purchase of developed technologies and other intangible assets	(643)	(9,481)	(4,245)	(12,426)
Purchase of property and equipment	(11,115)	(10,079)	(31,294)	(25,171)
Net cash provided by (used in) investing activities	(281,329)	(172,568)	(324,774)	4,317
Cash flows from financing activities:				
Excess tax benefits from share-based payment arrangements	7,626	10,800	24,298	31,999
Proceeds from exercise of common stock options	7,139	24,654	15,552	80,353
Payments related to net settlement of share-based compensation awards	(20,118)	(14,899)	(32,103)	(23,089)
Purchase of treasury stock	0	0	(56,952)	(79,355)
Proceeds from other borrowings	66	335	66	335
Payments on other borrowings	(136)	0	(825)	(877)
Net cash provided by (used in) financing activities	(5,423)	20,890	(49,964)	9,366
Effect of foreign currency exchange rates on cash and cash equivalents	(20,597)	6,545	(5,099)	(2,635)
Net increase (decrease) in cash and cash equivalents	(210,793)	(74,313)	(115,965)	206,796
Cash and cash equivalents at beginning of the period	737,458	669,227	642,630	388,118

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Cash and cash equivalents at end of the period	\$ 526,665	\$ 594,914	\$ 526,665	\$ 594,914
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The accompanying notes are an integral part of these consolidated financial statements.

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RED HAT, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

NOTE 1 Company

Red Hat, Inc., incorporated in Delaware, together with its subsidiaries (Red Hat or the Company) is a global leader in providing open source software solutions to the enterprise. The Company is also the market leader in providing enterprise-ready open source operating system platforms. The Company applies its technology leadership to create its: enterprise operating platform, Red Hat Enterprise Linux; enterprise middleware platform, JBoss Enterprise Middleware; virtualization solutions and other infrastructure technology solutions, based on open source technology. The Company's enterprise solutions are intended to meet the functionality requirements and performance demands of the enterprise and third-party computer hardware and software applications that are critical to the enterprise. The Company provides these solutions through content distribution and management services, Red Hat Network, RHN Satellite and JBoss Operations Network, which allow various Red Hat enterprise technologies to be updated and configured and the performance of these and other technologies to be monitored in an automated fashion. These solutions reflect the Company's continuing commitment to provide an enterprise-wide infrastructure platform and developer solutions based on open source technology. The Company derives its revenue and generates its cash from customers primarily from two sources: (i) subscriptions for its enterprise technologies and (ii) training and services revenue, as further described in NOTE 2, Summary of Significant Accounting Policies contained in the Company's Annual report on Form 10-K for the year ended February 28, 2011 (fiscal 2011).

NOTE 2 Summary of Significant Accounting Policies

Unaudited Interim Financial Information

The unaudited interim consolidated financial statements as of and for the three months and nine months ended November 30, 2011 have been prepared by the Company pursuant to the rules and regulations of the Securities and Exchange Commission (the SEC) for interim financial reporting. These consolidated statements are unaudited and, in the opinion of management, include all adjustments (consisting of normal recurring adjustments and accruals) necessary to present fairly the consolidated balance sheets, consolidated operating results and consolidated cash flows for the periods presented in accordance with accounting principles generally accepted in the United States of America. Operating results for the three months and nine months ended November 30, 2011 are not necessarily indicative of the results that may be expected for the fiscal year ending February 29, 2012 (fiscal 2012). Certain information and footnote disclosures normally included in annual financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been omitted in accordance with the SEC's rules and regulations for interim reporting. For further information, see the Company's Consolidated Financial Statements, including notes thereto, included in the Company's Annual Report on Form 10-K for the fiscal year ended February 28, 2011.

Principles of Consolidation

The accompanying Consolidated Financial Statements include the accounts of the Company and all of its wholly-owned subsidiaries. All significant inter-company accounts and transactions are eliminated in consolidation. There are no significant foreign exchange restrictions on the Company's foreign subsidiaries.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the balance sheet dates and the reported amounts of revenue and expenses during the reporting periods. Actual results could differ from such estimates.

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RED HAT, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Significant Accounting Policies

There have been no changes to the Company's significant accounting policies from those described in NOTE 2 to the Consolidated Financial Statements contained in the Company's Annual Report on Form 10-K for the year ended February 28, 2011. These unaudited financial statements should be read in conjunction with such Annual Report on Form 10-K.

Recent Accounting Pronouncements

In December 2011, the FASB issued Accounting Standards Update No. 2011-11, *Balance Sheet (Topic 210) Disclosures about Offsetting Assets and Liabilities* (ASU 2011-11). The update requires entities to disclose information about offsetting and related arrangements of financial instruments and derivative instruments. ASU 2011-11 is effective for the Company in the first quarter of its fiscal year ending February 28, 2014 (fiscal 2014). The Company currently believes there will be no significant impact on its consolidated financial statements.

In September 2011, the FASB issued Accounting Standards Update No. 2011-08, *Intangibles - Goodwill and Other (Topic 350) Testing Goodwill for Impairment* (ASU 2011-08), to simplify how entities test goodwill for impairment. ASU 2011-08 allows entities to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If a greater than 50 percent likelihood exists that the fair value is less than the carrying amount then a two-step goodwill impairment test as described in Topic 350 must be performed. ASU 2011-08 is effective for the Company in the first quarter of its fiscal year ending February 28, 2013 (fiscal 2013) but is eligible for early adoption. The Company currently believes there will be no significant impact on its consolidated financial statements.

In June 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update No. 2011-05, *Comprehensive Income (Topic 220) Presentation of Comprehensive Income* (ASU 2011-05), to require an entity to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. ASU 2011-05 eliminates the option to present the components of other comprehensive income as part of the statement of equity. ASU 2011-05 is effective for the Company in its first quarter of fiscal 2013 and should be applied retrospectively. The Company currently believes there will be no significant impact on its consolidated financial statements.

In May 2011, the FASB issued Accounting Standards Update No. 2011-04, *Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and International Financial Reporting Standards (Topic 820) Fair Value Measurement* (ASU 2011-04), to provide a consistent definition of fair value and ensure that the fair value measurement and disclosure requirements are similar between U.S. GAAP and International Financial Reporting Standards. ASU 2011-04 changes certain fair value measurement principles and enhances the disclosure requirements particularly for level 3 fair value measurements. ASU 2011-04 is effective for the Company in its fourth quarter of fiscal 2012 and should be applied prospectively. The Company does not currently have level 3 fair value measurements. The Company is currently evaluating the impact of adopting ASU 2011-04, but currently believes there will be no significant impact on its consolidated financial statements.

Table of Contents**RED HAT, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)****NOTE 3 Changes in Equity and Other Comprehensive Income**

The following table summarizes the changes in the Company's stockholders' equity, including other comprehensive income, during the three months ended November 30, 2011 (in thousands):

	Common Stock	Additional Paid-In Capital	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income (Loss)	Total Stockholders Equity
Balance at August 31, 2011	\$ 22	\$ 1,664,433	\$ 317,467	\$ (619,744)	\$ (1,007)	\$ 1,361,171
Net income	0	0	38,240	0	0	38,240
Other comprehensive income:						
Foreign currency translation adjustment					(6,575)	
Unrealized gain (loss) on securities during period					(924)	
Reclassification for (gain) loss recognized during period					(38)	
Other comprehensive income, net of tax					(7,537)	(7,537)
Comprehensive income			38,240		(7,537)	30,703
Exercise of common stock options	1	7,138	0	0	0	7,139
Share-based compensation expense	0	20,770	0	0	0	20,770
Assumed employee share-based awards from acquisitions	0	1,244	0	0	0	1,244
Tax benefits related to share-based awards	0	6,488	0	0	0	6,488
Minimum tax withholdings paid by the Company on behalf of employees related to net settlement of employee share-based awards	0	(20,118)	0	0	0	(20,118)
Balance at November 30, 2011	\$ 23	\$ 1,679,955	\$ 355,707	\$ (619,744)	\$ (8,544)	\$ 1,407,397

The following table summarizes the changes in the Company's stockholders' equity, including other comprehensive income, during the three months ended November 30, 2010 (in thousands):

	Common Stock	Additional Paid-In Capital	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income (Loss)	Total Stockholders Equity
Balance at August 31, 2010	\$ 22	\$ 1,552,830	\$ 185,499	\$ (552,001)	\$ (4,357)	\$ 1,181,993
Net income	0	0	26,017	0	0	26,017
Other comprehensive income:						
Foreign currency translation adjustment					1,074	

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Unrealized gain (loss) on securities during period					865	
Reclassification for (gain) loss recognized during period					(1,377)	
Other comprehensive income, net of tax					562	562
Comprehensive income			26,017		562	26,579
Exercise of common stock options	0	24,654	0	0	0	24,654
Share-based compensation expense	0	15,340	0	0	0	15,340
Tax benefits related to share-based awards	0	(23,711)	0	0	0	(23,711)
Minimum tax withholdings paid by the Company on behalf of employees related to net settlement of employee share-based awards	0	(14,899)	0	0	0	(14,899)
Balance at November 30, 2010	\$ 22	\$ 1,554,214	\$ 211,516	\$ (552,001)	\$ (3,795)	\$ 1,209,956

Table of Contents**RED HAT, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)**

The following table summarizes the changes in the Company's stockholders' equity, including other comprehensive income, during the nine months ended November 30, 2011 (in thousands):

	Common Stock	Additional Paid-In Capital	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income (Loss)	Total Stockholders Equity
Balance at February 28, 2011	\$ 22	\$ 1,610,238	\$ 245,050	\$ (562,792)	\$ (1,819)	\$ 1,290,699
Net income	0	0	110,657	0	0	110,657
Other comprehensive income:						
Foreign currency translation adjustment					(3,960)	
Unrealized gain (loss) on securities during period					(1,411)	
Reclassification for (gain) loss recognized during period					(1,354)	
Other comprehensive income, net of tax					(6,725)	(6,725)
Comprehensive income			110,657		(6,725)	103,932
Exercise of common stock options	1	15,552	0	0	0	15,553
Common stock repurchase (also see NOTE 10)	0	0	0	(56,952)	0	(56,952)
Share-based compensation expense	0	55,710	0	0	0	55,710
Assumed employee share-based awards from acquisitions	0	1,244				1,244
Tax benefits related to share-based awards	0	29,314	0	0	0	29,314
Minimum tax withholdings paid by the Company on behalf of employees related to net settlement of employee share-based awards	0	(32,103)	0	0	0	(32,103)
Balance at November 30, 2011	\$ 23	\$ 1,679,955	\$ 355,707	\$ (619,744)	\$ (8,544)	\$ 1,407,397

The following table summarizes the changes in the Company's stockholders' equity, including other comprehensive income, during the nine months ended November 30, 2010 (in thousands):

	Common Stock	Additional Paid-In Capital	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income (Loss)	Total Stockholders Equity
Balance at February 28, 2010	\$ 22	\$ 1,444,848	\$ 137,772	\$ (472,646)	\$ 1,056	\$ 1,111,052
Net income	0	0	73,744	0	0	73,744
Other comprehensive income:						
Foreign currency translation adjustment					(2,927)	
Unrealized gain (loss) on securities during period					493	

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Reclassification for (gain) loss recognized during period					(2,417)	
Other comprehensive income, net of tax					(4,851)	(4,851)
Comprehensive income			73,744		(4,851)	68,893
Exercise of common stock options	0	80,353	0	0	0	80,353
Common stock repurchase	0	0	0	(79,355)	0	(79,355)
Share-based compensation expense	0	44,189	0	0	0	44,189
Tax benefits related to share-based awards	0	7,913	0	0	0	7,913
Minimum tax withholdings paid by the Company on behalf of employees related to net settlement of employee share-based awards	0	(23,089)	0	0	0	(23,089)
Balance at November 30, 2010	\$ 22	\$ 1,554,214	\$ 211,516	\$ (552,001)	\$ (3,795)	\$ 1,209,956

Table of Contents**RED HAT, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)****NOTE 4 Identifiable Intangible Assets**

Identifiable intangible assets consist primarily of purchased technologies, customer and reseller relationships, trademarks, copyrights and patents, which are amortized over the estimated useful life, generally on a straight-line basis with the exception of customer contracts and relationships which are generally amortized over the greater of straight-line or the related asset's pattern of economic benefit. Useful lives range from three to twelve years for purchased technologies and customer and reseller relationships and three to ten years for trademarks, copyrights and patents. As of November 30, 2011 and February 28, 2011, trademarks with an indefinite estimated useful life totaled \$9.4 million and \$9.1 million, respectively. The following is a summary of identifiable intangible assets (in thousands):

	November 30, 2011			February 28, 2011		
	Gross Amount	Accumulated Amortization	Net Amount	Gross Amount	Accumulated Amortization	Net Amount
Trademarks, copyrights and patents	\$ 61,639	\$ (19,432)	\$ 42,207	\$ 58,122	\$ (16,817)	\$ 41,305
Purchased technologies	58,780	(37,778)	21,002	59,233	(32,081)	27,152
Customer and reseller relationships	86,942	(45,585)	41,357	80,768	(39,293)	41,475
Total identifiable intangible assets	\$ 207,361	\$ (102,795)	\$ 104,566	\$ 198,123	\$ (88,191)	\$ 109,932

Amortization expense associated with identifiable intangible assets recognized in the Company's Consolidated Financial Statements for the three months and nine months ended November 30, 2011 and November 30, 2010 is summarized as follows (in thousands):

	Three Months Ended		Nine Months Ended	
	November 30, 2011	November 30, 2010	November 30, 2011	November 30, 2010
Cost of revenue	\$ 669	\$ 887	\$ 2,864	\$ 2,295
Sales and marketing	1,957	2,076	5,874	6,237
Research and development	940	925	3,254	2,775
General and administrative	905	839	2,616	2,494
Total amortization expense	\$ 4,471	\$ 4,727	\$ 14,608	\$ 13,801

NOTE 5 Income Taxes*Income Tax Expense*

During the three months and nine months ended November 30, 2011, the Company recorded \$17.2 million and \$46.7 million of income tax expense, respectively. Tax expense for the nine months ended November 30, 2011 includes a net discrete tax benefit primarily from a reversal of the valuation allowance on the NOL of a foreign subsidiary, which resulted in a net reduction of income tax expense of \$2.1 million. Excluding the impact of the discrete tax benefit, the Company's estimated annual effective tax rate was 31.0% for the three months and nine months ended November 30, 2011. The Company's estimated annual effective tax rate excluding the discrete item of 31.0% for fiscal 2012 differs from the U.S. federal statutory rate of 35.0% principally due to foreign income taxed at lower rates.

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During the three months and nine months ended November 30, 2010, the Company recorded \$14.0 million and \$39.7 million of income tax expense, which was based on an estimated annual effective tax rate of 35.0%. The effective tax rate for the full year ended February 28, 2011 was 30.0% due to reinstatement of the U.S. federal research tax credit, approval of a tax holiday in Israel and certain other events that occurred during the fourth quarter of fiscal 2011.

Table of Contents**RED HAT, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)**

The following table summarizes the Company's tax provision for the three months and nine months ended November 30, 2011 and November 30, 2010:

	Three Months Ended		Nine Months Ended	
	November 30, 2011	November 30, 2010	November 30, 2011	November 30, 2010
Provision for income taxes:				
Income before provision for income taxes	\$ 55,420	\$ 40,026	\$ 157,379	\$ 113,452
Estimated annual effective tax rate on current year ordinary income	31%	35%	31%	35%
Provision for income taxes on current year ordinary income	17,180	14,009	48,787	39,708
Net discrete tax benefit from a reversal of the valuation allowance on the NOL of a foreign subsidiary	0	0	2,065	0
Provision for income taxes	\$ 17,180	\$ 14,009	\$ 46,722	\$ 39,708

Deferred Taxes

As of November 30, 2011, deferred tax assets (current and non-current) totaled \$109.3 million, of which \$1.9 million was offset by a valuation allowance. The Company continues to maintain a valuation allowance against its deferred tax assets with respect to certain foreign NOLs.

As of November 30, 2011, the Company had state NOL carryforwards of approximately \$66.1 million. As of November 30, 2011, the Company had a U.S. federal research tax credit carryforward of approximately \$39.6 million and a U.S. foreign tax credit carryforward of approximately \$14.3 million. These NOL and tax credit carryforwards are scheduled to expire in varying amounts beginning in 2013.

Unrecognized tax benefits

The Company's unrecognized tax benefits were \$43.0 million as of November 30, 2011 and \$42.1 million as of February 28, 2011. The Company's unrecognized tax benefits at November 30, 2011 and February 28, 2011, which, if recognized, would affect the Company's effective tax rate, were \$39.0 million and \$38.1 million, respectively.

During the three months and nine months ended November 30, 2011, the amount of unrecognized tax benefits increased \$0.5 million and \$0.9 million, respectively, primarily as a result of changes with respect to tax positions taken during prior periods. The results and timing of the resolution of tax audits is highly uncertain and the Company is unable to estimate the range of possible changes to the balance of unrecognized tax benefits. However, the Company does not currently anticipate any significant changes in its unrecognized tax benefits for the next 12 months. During the nine months ended November 30, 2011, there was a settlement of an uncertain income tax position and a reduction in long term obligations related to unrecognized tax benefits, the amount of which is insignificant.

It is the Company's policy to recognize interest and penalties related to uncertain tax positions as income tax expense. Accrued interest and penalties related to unrecognized tax benefits totaled \$3.2 million as of November 30, 2011 and \$3.1 million as February 28, 2011.

Table of Contents**RED HAT, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)**

The Company or one of its subsidiaries files income tax returns in the U.S. federal jurisdiction and various states and foreign jurisdictions. The following table summarizes the tax years in the Company's major tax jurisdictions that remain subject to income tax examinations by tax authorities as of November 30, 2011. Due to NOL carryforwards, in some cases the tax years continue to remain subject to examination with respect to such NOLs:

Tax Jurisdiction	Years Subject to Income Tax Examination	
U.S. federal*	1994	Present
North Carolina	1999	Present
Ireland	2006	Present
Japan**	2012	Present

* An income tax examination by the U.S. Internal Revenue Service with respect to the Company's fiscal year ended February 28, 2007 has been completed. There were no significant adjustments resulting from the examination.

** The Company has been examined for income tax for years through February 28, 2011. However, the statute of limitations remains open for 5 years.

The Company or one of its subsidiaries is currently undergoing an income tax examination in India.

The tax examination in Japan has been concluded with no significant adjustments.

The Company believes it has adequately provided for any reasonably foreseeable outcomes related to tax audits.

NOTE 6 Assets and Liabilities Measured at Fair Value on a Recurring Basis

Fair value is defined as the exchange price that would be received for the purchase of an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for such asset or liability in an orderly transaction between market participants on the measurement date. Valuation techniques used to measure fair value should maximize the use of observable inputs and minimize the use of unobservable inputs. To measure fair value, the Company uses the following fair value hierarchy based on three levels of inputs, of which the first two are considered observable and the last unobservable:

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 are significant to the fair value of the assets or liabilities.

The Company's investments are comprised primarily of debt securities that are classified as available for sale and recorded at their fair market values. Liquid investments with effective original maturities of 90 days or less from the balance sheet date are classified as cash equivalents. Investments with remaining effective

Table of Contents**RED HAT, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)**

maturities of twelve months or less from the balance sheet date are classified as short-term investments. Investments with remaining effective maturities of more than twelve months from the balance sheet date are classified as long-term investments. The Company's Level 1 financial instruments are valued using quoted prices in active markets for identical instruments. The Company's Level 2 financial instruments, including derivative instruments, are valued using quoted prices for identical instruments in less active markets or using other observable market inputs for comparable instruments.

Unrealized gains and temporary losses on investments classified as available for sale are included within accumulated other comprehensive income, net of any related tax effect. Upon realization, such amounts are reclassified from accumulated other comprehensive income to other income, net. Realized gains and losses and other than temporary impairments, if any, are reflected in the statements of operations as other income, net. The Company does not recognize changes in the fair value of its investments in income unless a decline in value is considered other-than-temporary. The vast majority of the Company's investments are priced by pricing vendors. These pricing vendors use the most recent observable market information in pricing these securities or, if specific prices are not available for these securities, use other observable inputs. In the event observable inputs are not available, the Company assesses other factors to determine the security's market value, including broker quotes or model valuations. Independent price verifications of all holdings are performed by pricing vendors which are then reviewed by the Company. In the event a price fails a pre-established tolerance check, it is researched so that the Company can assess the cause of the variance to determine what the Company believes is the appropriate fair market value.

The Company minimizes its credit risk associated with investments by investing primarily in investment grade, liquid securities. The Company's policy is designed to limit exposures to any one issuer depending on credit quality. Periodic evaluations of the relative credit standing of those issuers are considered in the Company's investment strategy.

The following table summarizes the composition and fair value hierarchy of the Company's financial assets and liabilities at November 30, 2011 (in thousands):

	As of November 30, 2011	Quoted Prices In Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Money markets (1)	\$ 337,394	\$ 337,394	\$ 0	\$ 0
Available-for-sale securities (1):				
Treasuries	753	753	0	0
Certificates of deposit	15,716	0	15,716	0
Commercial paper	30,470	0	30,470	0
Agencies	325,636	0	325,636	0
Municipal bonds	13,160	0	13,160	0
Corporates	310,709	0	310,709	0
Equities (1)	1,683	1,683	0	0
Derivative instruments (2)	39	0	39	0
Liabilities:				
Derivative instruments (3)	(157)	0	(157)	0
Total	\$ 1,035,403	\$ 339,830	\$ 695,573	\$ 0

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- (1) Included in either cash and cash equivalents or investments in debt and equity securities in the Company's Consolidated Balance Sheet at November 30, 2011, in addition to \$181.3 million of cash.

Table of Contents**RED HAT, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)**

(2) Included in other current assets in the Company's Consolidated Balance Sheet at November 30, 2011.

(3) Included in accrued expenses in the Company's Consolidated Balance Sheet at November 30, 2011.

The following table summarizes the composition and fair value hierarchy of the Company's financial assets and liabilities at February 28, 2011 (in thousands):

	As of February 28, 2011	Quoted Prices In Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Money markets (1)	\$ 532,537	\$ 532,537	\$ 0	\$ 0
Available-for-sale securities (1):				
Certificates of deposit	1,840	0	1,840	0
Commercial paper	27,562	0	27,562	0
Agencies	312,136	0	312,136	0
Municipal bonds	13,249	0	13,249	0
Corporates	193,917	0	193,917	0
Equities (1)	2,677	2,677	0	0
Derivative instruments (2)	434	0	434	0
Liabilities:				
Derivative instruments (3)	(96)	0	(96)	0
Total	\$ 1,084,256	\$ 535,214	\$ 549,042	\$ 0

(1) Included in either cash and cash equivalents or investments in debt and equity securities in the Company's Consolidated Balance Sheet at February 28, 2011 in addition to \$108.5 million of cash.

(2) Included in other current assets in the Company's Consolidated Balance Sheet at February 28, 2011.

(3) Included in accrued expenses in the Company's Consolidated Balance Sheet at February 28, 2011.

The following table represents the Company's investments measured at fair value as of November 30, 2011 (in thousands):

	Gross Unrealized		Aggregate	Balance Sheet Classification		
				Cash	Short-term	Long-term
Amortized	Gains	Losses (1)	Fair Value	Equivalent	Marketable	Marketable
Cost				Securities	Securities	Securities

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Money markets	\$ 337,394	\$ 0	\$ 0	\$ 337,394	\$ 337,394	\$ 0	\$ 0
Treasuries	753	0	0	753	0	753	0
Certificates of deposit	15,716	0	0	15,716	525	15,191	0
Commercial paper	30,463	7	0	30,470	7,500	22,970	0
Agencies	325,638	117	(119)	325,636	0	47,458	278,178
Municipal bonds	13,129	31	0	13,160	0	9,040	4,120
Corporates	314,318	146	(3,755)	310,709	0	184,552	126,157
Equities	45	1,638	0	1,683	0	1,683	0
Total	\$ 1,037,456	\$ 1,939	\$ (3,874)	\$ 1,035,521	\$ 345,419	\$ 281,647	\$ 408,455

- (1) Accumulated unrealized losses related to investments that have been in a continuous unrealized loss position for 12 months or longer totaled \$0.8 million at November 30, 2011.

Table of Contents**RED HAT, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)**

The following table represents the Company's investments measured at fair value as of February 28, 2011 (in thousands):

	Gross Unrealized			Aggregate Fair Value	Balance Sheet Classification		
	Amortized Cost	Gains	Losses (1)		Cash Equivalent Marketable Securities	Short-term Marketable Securities	Long-term Marketable Securities
Money markets	\$ 532,537	\$ 0	\$ 0	\$ 532,537	\$ 532,537	\$ 0	\$ 0
Certificates of deposit	1,840	0	0	1,840	20	1,820	0
Commercial paper	27,558	4	0	27,562	1,600	25,962	0
Agencies	313,133	70	(1,067)	312,136	0	85,350	226,786
Municipal bonds	13,259	0	(10)	13,249	0	13,249	0
Corporates	193,373	647	(103)	193,917	0	88,912	105,005
Equities	85	2,592	0	2,677	0	2,677	0
Total	\$ 1,081,785	\$ 3,313	\$ (1,180)	\$ 1,083,918	\$ 534,157	\$ 217,970	\$ 331,791

(1) As of February 28, 2011, there were no accumulated unrealized losses related to investments that have been in a continuous unrealized loss position for 12 months or longer.

NOTE 7 Derivative Instruments

The Company transacts business in various foreign countries and is, therefore, subject to risk of foreign currency exchange rate fluctuations. The Company from time to time enters into forward contracts to hedge transactional exposure associated with commitments arising from trade accounts receivable, trade accounts payable and fixed purchase obligations denominated in a currency other than the functional currency of the respective operating entity. These derivative instruments are recorded on the Consolidated Balance Sheets at their respective fair market values. The Company has elected not to prepare and maintain the documentation required to qualify for hedge accounting treatment and, therefore, changes in fair value are recorded in the Consolidated Statements of Operations.

The effects of forward contracts on the Company's Consolidated Financial Statements are as follows as of November 30, 2011 and for the three months and nine months then ended (in thousands):

As of November 30, 2011	Balance Sheet Location	Fair Value	Notional Value	Location of Gain (Loss) Recognized in Income on Derivative	Three Months Ended	Nine Months Ended
					November 30, 2011	November 30, 2011
					Amount of Gain (Loss) Recognized in Income on Derivative	
Assets	foreign currency forward contracts not designated as hedges					
	Other current assets	\$ 39	\$ 8,764	Other income, net	\$ 203	\$ 1,202
	Accrued expenses	\$ (157)	\$ 21,111	Other income, net	\$ (1,434)	\$ (2,151)

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Liabilities foreign currency
forward contracts not designated
as hedges

TOTAL	\$ (118)	\$ 29,875	\$ (1,231)	\$ (949)
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RED HAT, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

The effects of forward contracts on the Company's Consolidated Financial Statements are as follows as of November 30, 2010 and for the three months and nine months then ended (in thousands):

	As of November 30, 2010	Fair Value	Notional Value	Location of Gain (Loss) Recognized in Income on Derivative	Three Months Ended	Nine Months Ended
					November 30, 2011	November 30, 2010
	Balance Sheet Location				Amount of Gain (Loss) Recognized in Income on Derivative	
Assets foreign currency forward contracts not designated as hedges	Other current assets	\$ 22	\$ 1,929	Other income, net	\$ 472	\$ 917
Liabilities foreign currency forward contracts not designated as hedges	Accrued expenses	\$ (194)	\$ 19,351	Other income, net	\$ (324)	\$ (1,369)
TOTAL		\$ (172)	\$ 21,280		\$ 148	\$ (452)

The aggregate notional amount of outstanding forward contracts at February 28, 2011 was \$64.5 million. The fair value of these outstanding contracts at February 28, 2011 was a gross \$0.4 million asset and a gross \$0.1 million liability, and is recorded in other current assets and accrued expenses, respectively on the Consolidated Balance Sheets.

NOTE 8 Share-based Awards

The Company measures share-based compensation cost at grant date, based on the estimated fair value of the award and recognizes the cost over the employee requisite service period typically on a straight-line basis, net of estimated forfeitures. The Company estimates the fair value of stock options using the Black-Scholes-Merton valuation model. The fair value of nonvested share awards, nonvested share units and performance share units are measured at their underlying closing share price on the day of grant.

The following summarizes share-based compensation expense recognized in the Company's Consolidated Financial Statements for the three months and nine months ended November 30, 2011 and November 30, 2010 (in thousands):

	Three Months Ended		Nine Months Ended	
	November 30, 2011	November 30, 2010	November 30, 2011	November 30, 2010
Cost of revenue	\$ 2,245	\$ 1,607	\$ 5,877	\$ 4,168
Sales and marketing	7,157	4,922	18,829	13,469
Research and development	5,368	3,960	14,445	11,395
General and administrative	6,000	4,851	16,559	15,157
Total share-based compensation	\$ 20,770	\$ 15,340	\$ 55,710	\$ 44,189

Share-based compensation expense qualifying for capitalization was insignificant for each of the three months and nine months ended November 30, 2011 and November 30, 2010. Accordingly, no share-based compensation expense was capitalized during the three months and

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nine months ended November 30, 2011 and November 30, 2010.

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Estimated annual forfeitures An estimated forfeiture rate of 10.0% per annum, which approximates the Company's historical rate, was applied to options and nonvested share units. Awards are adjusted to actual forfeiture rates at vesting. The Company reassesses its estimated forfeiture rate annually or when new information, including actual forfeitures, indicate a change is appropriate.

During the three months and nine months ended November 30, 2011, the Company granted the following share-based awards:

	Three Months Ended		Nine Months Ended	
	Shares and Shares Underlying Awards	Weighted Average Fair Value Per Share	Shares and Shares Underlying Awards	Weighted Average Fair Value Per Share
Options	31,065	\$ 15.87	44,453	\$ 15.52
Nonvested shares and share units	1,782,920	\$ 45.38	2,108,684	\$ 45.16
Performance share units target (1)	0	\$ 0.00	316,668	\$ 43.60
Performance share awards (2)	0	\$ 0.00	167,820	\$ 43.57
Deferred share units	1,117	\$ 52.72	39,080	\$ 44.20
Total awards	1,815,102	\$ 44.88	2,676,705	\$ 44.37

- (1) On May 25, 2011, the Compensation Committee of the Company's Board of Directors (the Compensation Committee) approved a form of award agreement for use with grants of performance share units (PSUs) in FY2012 with payouts based on the Company's financial performance (the FY2012 Operating Performance PSU Agreement) and a form of award agreement for use with grants of PSUs in FY2012 with payouts based on the performance of the Company's common stock (the FY2012 Share Price Performance PSU Agreement). Under the FY2012 Operating Performance PSU Agreement, an executive will be granted an award for a target number of PSUs, and depending on the Company's financial performance, the executive may earn up to 200% of the target number of PSUs (the Maximum PSUs) over a performance period with three separate performance segments corresponding to three fiscal years of the Company. Up to 25% of the Maximum PSUs may be earned in respect of the first performance segment; up to 50% of the Maximum PSUs may be earned in respect of the second performance segment, less the amount earned in the first performance segment; and up to 100% of the Maximum PSUs may be earned in respect of the third performance segment, less the amount earned in the first and second performance segments. Under the FY2012 Share Price Performance PSU Agreement, an executive will be granted an award for a target number of PSUs, and depending on the performance of the Company's common stock over a thirty-six month period beginning on March 1, 2011 (the Share Price Performance Period), the executive may earn up to 200% of the target number of PSUs. The number of PSUs earned, according to the formula specified in the FY2012 Share Price Performance PSU Agreement, will be determined based on a comparison of the performance of the Company's stock price relative to the performance of the stock price of specified peer companies during the Share Price Performance Period. This performance is measured by the change in the average price of common stock calculated over the ninety-day periods ending at both the beginning and the end of the Share Price Performance Period.
- (2) On May 25, 2011, the Compensation Committee approved a form of award agreement for use with grants of performance-based restricted stock awards in FY2012 (the Performance RSA Agreement). Under the Performance RSA Agreement, executives are awarded shares of the Company's common stock subject to achievement of a specified dollar amount of total revenues established by the Committee as the performance objective for FY2012 (the RSA Performance Goal). If the Company fails to achieve the RSA Performance Goal for FY2012, then all shares of restricted stock subject to the award are forfeited. If the Company

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achieves the RSA Performance Goal for FY2012, 25% of the restricted stock vests on July 16, 2012, and the remainder vests ratably on a quarterly basis over the course of the subsequent three year period, provided that the executive's business relationship with the Company has not ceased.

NOTE 9 Earnings Per Share

The Company computes basic net income per common share by dividing net income available to common stockholders by the weighted average number of common shares outstanding. Diluted net income per common share is computed by dividing net income by the weighted average number of common shares and dilutive potential common share equivalents then outstanding. Potential common share equivalents consist of shares issuable upon the exercise of stock options or vesting of share-based awards.

The following table reconciles the numerators and denominators of the earnings per share calculation for the three months and nine months ended November 30, 2011 and November 30, 2010 (in thousands, except per share amounts):

	Three Months Ended		Nine Months Ended	
	November 30, 2011	November 30, 2010	November 30, 2011	November 30, 2010
Net income and net income diluted	\$ 38,240	\$ 26,017	\$ 110,657	\$ 73,744
Weighted average common shares outstanding	193,393	191,296	193,162	189,410
Incremental shares attributable to assumed vesting or exercise of outstanding equity awards shares	3,075	5,612	3,331	6,313
Diluted shares	196,468	196,908	196,493	195,723
Diluted net income per share	\$ 0.19	\$ 0.13	\$ 0.56	\$ 0.38

The following shares awards are not included in the computation of diluted earnings per share because the aggregate value of proceeds considered received upon either exercise or vesting were greater than the average market price of the Company's common stock during the related periods and the effect of including such share awards in the computation would be anti-dilutive (in thousands):

	Three Months Ended		Nine Months Ended	
	November 30, 2011	November 30, 2010	November 30, 2011	November 30, 2010
Number of shares considered anti-dilutive for calculating diluted net income per share:	771	32	286	314

NOTE 10 Share Repurchase Program

On March 24, 2010, the Company announced that its Board of Directors had authorized the repurchase of up to an aggregate of \$300.0 million of the Company's common stock from time to time in open market or privately negotiated transactions, as applicable. The program will expire on the earlier of (i) March 31, 2012 or (ii) a determination by the Board of Directors, Chief Executive Officer or Chief Financial Officer to discontinue the program.

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As of November 30, 2011, the amount available under the program for the repurchase of the Company's common stock was \$162.8 million. See NOTE 15 to the Consolidated Financial Statements for a discussion of shares repurchased under the program subsequent to November 30, 2011.

Table of Contents**RED HAT, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)****NOTE 11 Segment Reporting**

The Company is organized primarily on the basis of three geographic business segments: the Americas (U.S., Latin America and Canada), EMEA (Europe, Middle East and Africa) and Asia Pacific. These business segments are aggregated into one reportable segment due to the similarity in nature of products and services provided, financial performance economic characteristics (e.g., revenue growth and gross margin), methods of production and distribution and customer classes (e.g., distributors, resellers and enterprise).

The following table lists, for the three months and nine months ended November 30, 2011 and November 30, 2010, revenue from unaffiliated customers in the United States, the Company's country of domicile, revenue from unaffiliated customers in Japan, which in terms of revenue was the only individually material country outside the United States, and revenue from other foreign countries.

	Three Months Ended		Nine Months Ended	
	November 30, 2011	November 30, 2010	November 30, 2011	November 30, 2010
United States, the Company's country of domicile	\$ 159,875	\$ 130,962	\$ 457,203	\$ 373,701
Japan	22,901	19,874	66,781	54,351
Other foreign	107,250	84,740	312,108	236,429
Total revenue from unaffiliated customers	\$ 290,026	\$ 235,576	\$ 836,092	\$ 664,481

Total tangible long-lived assets located in the United States, the Company's country of domicile, and similar tangible long-lived assets held outside the United States are summarized in the following table as of November 30, 2011 and February 28, 2011:

	As of November 30, 2011	As of February 28, 2011
United States, the Company's country of domicile	\$ 57,490	\$ 53,722
Foreign	26,435	21,836
Total tangible long-lived assets	\$ 83,925	\$ 75,558

As of November 30, 2011, one customer accounted for 11% of the Company's accounts receivable. At February 28, 2011, no individual customer accounted for more than 10% of the Company's accounts receivable. For each of the three months and nine months ended November 30, 2011 and November 30, 2010 there were no individual customers from which the Company generated 10% or greater revenue.

NOTE 12 Commitments and Contingencies

As of November 30, 2011, the Company leased office space and certain equipment under various non-cancelable operating leases. Rent expense under operating leases was \$6.0 million for each of the three months ended November 30, 2011 and November 30, 2010. Rent expense under operating leases for the nine months ended November 30, 2011 and November 30, 2010 was \$18.2 million and \$17.1 million, respectively.

Product Indemnification

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The Company is a party to a variety of agreements pursuant to which it may be obligated to indemnify the other party from losses arising in connection with the Company's services or products, or from losses arising in connection with certain events defined within a particular contract, which may include litigation or claims

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RED HAT, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

relating to intellectual property infringement, certain losses arising from damage to property or injury to persons or other matters. In each of these circumstances, payment by the Company is conditioned on the other party making a claim pursuant to the procedures specified in the particular contract, which procedures typically allow the Company to challenge the other party's claims. Further, the Company's obligations under these agreements may in certain cases be limited in terms of time and/or amount, and in some instances, the Company may have recourse against third-parties for certain payments made by the Company.

It is not possible to predict the maximum potential amount of future payments under these or similar agreements due to the conditional nature of the Company's obligations and the facts and circumstances involved in each particular agreement. The Company does not record a liability for claims related to indemnification unless the Company concludes that the likelihood of a material claim is probable and estimable. Historically, payments pursuant to these indemnifications have been immaterial.

NOTE 13 Legal Proceedings

Commencing on or about March 2001, the Company and certain of its officers and directors were named as defendants in a series of purported class action suits arising out of the Company's initial public offering and secondary offering. Approximately 310 other IPO issuers were named as defendants in similar class action complaints (together, the IPO Allocation Actions). On August 8, 2001, Chief Judge Michael Mukasey of the U.S. District Court for the Southern District of New York issued an order that transferred all of the IPO Allocation Actions, including the complaints involving the Company, to one judge for coordinated pre-trial proceedings (Case No. 21 MC 92). The plaintiffs contend that the defendants violated federal securities laws by issuing registration statements and prospectuses that contained materially false and misleading information and failed to disclose material information. Plaintiffs also challenge certain IPO allocation practices by underwriters and the lack of disclosure thereof in initial public offering documents. On April 19, 2002, plaintiffs filed amended complaints in each of the 310 consolidated actions, including the Red Hat action. The relief sought consists of unspecified damages, attorneys' and expert fees and other unspecified costs. In October of 2002, the individual director and officer defendants of the Company were dismissed from the case without prejudice. In October of 2004, the District Court certified a class in six of the 310 actions (the focus cases) and noted that the decision is intended to provide strong guidance to all parties regarding class certification in the remaining cases. The Company's action is not one of the focus cases. On December 5, 2006, the U.S. Court of Appeals for the Second Circuit vacated the District Court's class certification with respect to the focus cases and remanded the matter for further consideration. In September 2007, discovery moved forward in the focus cases and plaintiff filed and amended complaints against the focus case issuer and underwriter defendants. Defendants in the focus cases filed motions to dismiss the second amended complaints in November 2007 and filed their oppositions to plaintiffs' motion for class certification in December 2007. The motions to dismiss in the focus cases were granted in part. On April 2, 2009, the plaintiffs' executive committee on behalf of the proposed class filed a motion for preliminary approval of a settlement agreement to resolve the lawsuit, to which the Company has consented and for which payments called for by the settlement agreement are to be paid by the defendant insurers. The trial court heard arguments on September 10, 2009 on the fairness of the settlement. In an opinion and order filed October 5, 2009, the trial court approved the class, granted plaintiffs' motion for approval of the settlement and directed the clerk of the court to close the action. Appeals have been filed and briefed before the Court of Appeals for the Second Circuit. On May 17, 2011, the Second Circuit issued a ruling on the two pending appeals, granting the motion to dismiss one of the appeals, and remanding the other appeal back to the District Court to determine procedural issues relating to the standing of the remaining objector-appellant. On August 25, 2011, the Court rejected the claims of that remaining objector-appellant. A notice of appeal of this decision was filed on September 26, 2011. On November 10, 2011, Plaintiffs moved to dismiss with prejudice the appeal by the remaining objector-appellant, and requested that the Court consider the motion on an expedited basis. The remaining objector-appellant filed a brief in opposition to Plaintiffs motion to dismiss on November 4, 2011.

Table of Contents**RED HAT, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)**

In the summer of 2004, 14 class action lawsuits were filed against the Company and several of its former officers on behalf of investors who purchased the Company's securities during various periods from June 19, 2001 through July 13, 2004. All 14 suits were filed in the U.S. District Court for the Eastern District of North Carolina. In each of the actions, plaintiffs sought to represent a class of purchasers of the Company's common stock during some or all of the period from June 19, 2001 through July 13, 2004. All of the claims arose in connection with the Company's announcement on July 13, 2004 that it would restate certain of its financial statements (the Restatement). One or more of the plaintiffs asserted that certain former officers (the Individual Defendants) and the Company violated Sections 10(b) and 20(a) of the Securities Exchange Act of 1934, as amended (the Securities Exchange Act), and Rule 10b-5 thereunder by issuing the financial statements that the Company subsequently restated. One or more of the plaintiffs sought unspecified damages, interest, costs, attorneys' and experts' fees, an accounting of certain profits obtained by the Individual Defendants from trading in the Company's common stock, disgorgement by the Company's former chief executive officer and former chief financial officer of certain compensation and profits from trading in the Company's common stock pursuant to Section 304 of the Sarbanes-Oxley Act of 2002 and other relief. As of September 8, 2004, all of these class action lawsuits were consolidated into a single action referenced as Civil Action No. 5:04-CV-473BR and titled In re Red Hat, Inc. Securities Litigation. On May 6, 2005, the plaintiffs filed an amended consolidated class action complaint. On July 29, 2005, the Company, on behalf of itself and the Individual Defendants, filed a motion to dismiss the action for failure to state a claim upon which relief may be granted. Also on that date, PricewaterhouseCoopers LLP (PwC), another defendant, filed a separate motion to dismiss. On May 12, 2006, the Court issued an order granting the motion to dismiss the Securities Exchange Act claims against several of the Individual Defendants, but denying the motion to dismiss the Securities Exchange Act claims against the Company, its former chief executive officer and former chief financial officer. The Court dismissed the claims under the Sarbanes-Oxley Act in their entirety, and also granted PwC's motion to dismiss. On November 6, 2006, the plaintiffs filed a motion for class certification. Subsequent to the filing of that motion, several plaintiffs withdrew as potential class representatives, and the Company opposed the certification of the remaining proposed class representatives. On May 11, 2007, the Court entered an order denying class certification and denying all other pending motions as moot. Thereafter, on July 13, 2007 Charles Gilbert filed a renewed motion for appointment as lead plaintiff and approval of selection of lead counsel. On November 13, 2007, the Court entered an Order allowing Gilbert's motion, appointing him lead plaintiff, adding him as a party plaintiff and appointing lead counsel. On January 14, 2008, Gilbert's counsel filed a motion to certify the action as a class action. On August 28, 2009, the Court entered an Order certifying the action as a class action, appointing Gilbert as the class representative, and defining the class as all purchasers of the common stock of Red Hat, Inc. between December 17, 2002, and July 12, 2004, inclusive and who were damaged thereby, excluding Company insiders. On December 15, 2009, the Company announced that it had reached an agreement in principle to settle this matter, subject, among other matters, to completion of a final written settlement agreement and court approval. The Company recorded, for its quarter ended November 30, 2009, an estimated liability in the amount of \$8.8 million for its portion of the proposed settlement. On March 29, 2010, counsel for the class filed a Motion for Preliminary Approval of the Settlement and, on June 11, 2010, a United States Magistrate Judge issued a Memorandum and Recommendation to the presiding judge that the motion be approved. On July 8, 2010, the presiding judge approved the motion and set the hearing for the final fairness hearing on December 7, 2010. The settlement was approved by the District Court in an order dated December 10, 2010. On March 30, 2011, the Court ordered the cases removed from the active docket. Since that time, the Court has approved a Motion for Disbursement of Funds and currently has before it a final motion for disbursement of additional funds.

The Company also experiences routine litigation in the normal course of its business, including patent litigation. The Company presently believes that the outcome of this routine litigation will not have a material adverse effect on its financial position, results of operations or cash flows.

Table of Contents**RED HAT, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)****NOTE 14 Business Combinations***Acquisition of Gluster, Inc.*

On October 7, 2011, the Company completed its acquisition of all issued and outstanding shares of Gluster, Inc. (Gluster), a provider of open source storage software. The acquisition expands the Company's enterprise software offerings to include storage management of unstructured data and in-cloud deployments. The consideration transferred by the Company in connection with the acquisition totaled \$137.2 million. The Company incurred \$0.5 million in transactions costs including legal and accounting fees relating to the acquisition. These costs have been expensed as incurred and included in general and administrative expense on the Consolidated Statement of Operations.

The total consideration transferred by the Company in connection with the acquisition is summarized in the following table (in thousands):

	Total Consideration Transferred
Cash consideration paid to and or on behalf of Gluster stockholders	\$ 135,906
Fair value of unvested employee share-based awards assumed and attributed to pre-combination services	1,244
Total	\$ 137,150

The table below represents the tangible and identifiable intangible assets and liabilities (in thousands) based on management's preliminary assessment of the acquisition date fair value of the assets acquired and liabilities assumed:

	Total Consideration Allocated
Estimated identifiable intangible assets (see detail below)	\$ 6,800
Cash	696
Accounts receivable	321
Fixed assets	454
Deferred tax assets, net	3,263
Other assets	1,093
Accrued liabilities	(1,828)
Deferred revenue	(321)
Goodwill	126,672
Total	\$ 137,150

Table of Contents**RED HAT, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)**

The following table summarizes the allocation of estimated identifiable intangible assets resulting from the acquisition. For purposes of this preliminary allocation, the Company has assessed a fair value of Gluster identifiable intangible assets related to customer relationships and trade names and trademarks based on the net present value of the projected income stream of these identifiable intangible assets. The Company expects to finalize its valuation assessment of intangible assets by the end of fiscal 2012. The fair value of the identifiable intangible assets is being amortized over the estimated useful life of each intangible asset on a straight-line basis which approximates the economic pattern of benefits (in thousands):

	Expense Type	Estimated Life (Years)	Total
Customer relationships	Sales and marketing	5	\$ 6,200
Trade names and trademark	General and administrative	Indefinite	600
Total estimated identifiable intangible assets			\$ 6,800

Pro forma consolidated financial information

The following unaudited pro forma consolidated financial information reflects the results of operations of the Company for the three months and nine months ended November 30, 2011 and November 30, 2010 (in thousands, except per share amounts) as if the acquisition of Gluster had occurred at March 1, 2010, after giving effect to certain purchase accounting adjustments. These pro forma results are not necessarily indicative of what the Company's operating results would have been had the acquisition actually taken place at the beginning of the period.

	Three Months Ended		Nine Months Ended	
	November 30, 2011	November 30, 2010	November 30, 2011	November 30, 2010
Revenue (1)	\$ 290,075	\$ 235,644	\$ 836,356	\$ 664,631
Net income	36,787	24,806	105,592	70,524
Diluted net income	36,787	24,806	105,592	70,524
Basic net income per common share	\$ 0.19	\$ 0.13	\$ 0.55	\$ 0.37
Diluted net income per common share	\$ 0.19	\$ 0.13	\$ 0.54	\$ 0.36

(1) Pro forma revenue attributed to Gluster is net of a nonrecurring \$0.7 million fair value adjustment for deferred revenue.

Post acquisition financial information

The following is a summary of Gluster's revenue, expenses and earnings for the period October 7, 2011 through November 30, 2011 that are included in the Company's Consolidated Statement of Operations for the three months ended November 30, 2011 (in thousands):

**Three Months
Ended
November 30,
2011**

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Revenue	\$	53
Operating expenses		(2,410)
Operating loss		(2,357)
Tax benefit		731
Net loss	\$	(1,626)

Table of Contents**RED HAT, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)***Related party matters*

Dr. Naren Gupta, a director of Red Hat since 2005, was a director of Gluster and is the Managing Director of Nexus Venture Partners (Nexus), a venture capital fund that was a principal investor in Gluster. Nexus held approximately 36.4% percent of the shares of Gluster capital stock and vested options outstanding on the closing date.

Dr. Gupta did not attend the meeting at which Red Hat's Board of Directors (the Board) approved the transaction and recused himself from Board deliberations with respect to the transaction. The purchase price in the transaction was determined through arms length negotiations between Red Hat and Gluster.

Goodwill

The following is a summary of changes in goodwill for the nine months ended November 30, 2011 (in thousands):

Balance at February 28, 2011	\$ 463,673
Acquisition of Gluster	126,672
Purchase price adjustments on prior acquisitions	1,340
Impact of foreign currency fluctuations	(624)
Balance at November 30, 2011	\$ 591,061

NOTE 15 Subsequent Events

On December 27, 2011, the Company entered into a Sublease Agreement with Carolina Power & Light Company d/b/a Progress Energy Carolinas, Inc., pursuant to which the Company has agreed to sublease the building located at 100 E. Davie Street, Raleigh, North Carolina, which includes approximately 380,000 square feet of office and retail space and an integrated parking deck. For more information about the terms of the sublease, see the Company's Current Report on Form 8-K filed with the Securities and Exchange Commission on December 28, 2011.

From December 1, 2011 through January 4, 2012, the Company repurchased an aggregate of 1,559,786 shares of its common stock for \$64.2 million. These repurchases were made pursuant to the Company's previously announced repurchase program. See NOTE 10 to the Consolidated Financial Statements for further discussion of the repurchase program. As of January 4, 2012, the amount available for the repurchase of common stock under the program was \$98.6 million.

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

We are a global leader in providing open source software solutions to the enterprise, including our core enterprise operating system platform, Red Hat Enterprise Linux (RHEL), our enterprise middleware platform, JBoss Enterprise Middleware, our virtualization and cloud solutions and other Red Hat enterprise technologies.

Open source software is an alternative to proprietary software and represents a different model for the development and licensing of commercial software code than that typically used for proprietary software. Because open source software code is often freely shared, there are customarily no licensing fees for the distribution of open source software. Therefore, we do not recognize revenue from the licensing of the code itself. We provide value to our customers through the aggregation, integration, testing, certification, delivery, maintenance and support of our Red Hat enterprise technologies, and by providing a level of scalability, stability and accountability for the enterprise technologies we package and distribute. Moreover, because communities of developers not employed by us assist with the creation of our open source offerings, opportunities for further innovation of our offerings are supplemented by these communities.

We sell our enterprise technologies through subscriptions, and we recognize revenue over the period of the subscription agreements with our customers. We market our offerings primarily to enterprise customers including large enterprises, government organizations, small- and medium-size businesses and educational institutions.

We have focused on introducing and gaining acceptance for Red Hat enterprise technologies that comprise our open source architecture. Since introducing our initial enterprise open source operating system platform, Red Hat Enterprise Linux, it has gained widespread independent software vendor (ISV) and independent hardware vendor (IHV) support. We have continued to build our open source architecture by expanding our enterprise offerings and introducing new systems management services, middleware, integrated virtualization and clustering capability, file management systems, directory and certificate technologies and enhanced security functionality. We intend to bring the value of open source technology to other key areas of the enterprise infrastructure as the development community efforts support and customer needs dictate. For example, our acquisition of Gluster, Inc., discussed below, adds open source storage capability to our product portfolio.

We derive our revenue and generate cash from customers primarily from two sources: (i) subscription revenue and (ii) training and services revenue. These arrangements typically involve subscriptions to Red Hat enterprise technologies. Our revenue is affected by, among other factors, corporate, government and consumer spending levels. In evaluating the performance of our business, we consider a number of factors, including total revenue, deferred revenue, operating income, operating margin and cash flows from operations. The arrangements with our customers that produce this revenue and cash are explained in further detail in Part II, Item 7 under Critical Accounting Policies and Estimates and in NOTE 2 to the Consolidated Financial Statements of our Annual Report on Form 10-K for the year ended February 28, 2011.

Revenue. For the three months ended November 30, 2011, total revenue increased 23.1% or \$54.5 million to \$290.0 million from \$235.6 million for the three months ended November 30, 2010. Subscription revenue increased 24.0% or \$47.7 million, driven primarily by additional subscriptions related to our principal RHEL technologies, which continue to gain broader market acceptance in mission-critical areas of computing, and our expansion of sales channels and geographic footprint. The increase is, in part, a result of the continued migration of enterprises in industries such as financial services, government, technology and telecommunications to our open source solutions from proprietary technologies. Training and services revenue increased 18.4% or \$6.8 million for the three months ended November 30, 2011 as compared to the three months ended November 30, 2010. The increase is driven primarily by customer interest in new products and technologies.

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We believe the success of our business model is influenced by:

- the extent to which we can expand the breadth and depth of our technology and service offerings;
- our ability to enhance the value of subscriptions for Red Hat enterprise technologies through frequent and continuous innovations to these technologies;
- the acceptance and widespread deployment of open source solutions by small, medium and large enterprises and government agencies;
- our ability to generate increasing revenue from channel partner and other strategic relationships, including distributors, OEMs, other hardware partners, ISVs, cloud computing providers, VARs and system integrators;
- our ability to generate subscription revenue for Red Hat enterprise technologies; and
- our ability to provide customers with consulting and training services that generate additional revenue.

Deferred Revenue. Our deferred revenue, current and long-term, balance at November 30, 2011 was \$819.6 million. Because of our subscription model and revenue recognition policies, deferred revenue improves predictability of future revenue. Deferred revenue at November 30, 2011 increased \$ 47.4 million or 6.1% as compared to the balance at February 28, 2011 of \$772.3 million.

The change in deferred revenue reported on our Consolidated Balance Sheets of \$47.4 million differs from the \$56.2 million change in deferred revenue we reported on our Consolidated Statement of Cash Flows for the nine months ended November 30, 2011 due to changes in foreign currency exchange rates used to translate deferred revenue balances from our foreign subsidiaries' functional currency into U.S. dollars.

Subscription revenue. Our enterprise technologies are sold under subscription agreements. These agreements typically have a one- or three-year subscription period. The subscription entitles the end user to maintenance, which generally consists of a specified level of support, as well as security updates, bug fixes, functionality enhancements and upgrades to the technology, when and if available, during the term of the subscription. Our customers have the ability to purchase higher levels of subscriptions that increase the level of support the customer is entitled to receive. Subscription revenue increased for the first, second and third quarters of fiscal 2012 and sequentially for each quarter of fiscal 2011, 2010 and 2009 and is being driven primarily by the increased market acceptance and use of open source software by the enterprise and our expansion of sales channels and geographic footprint during these periods.

Revenue by geography. We operate our business in three geographic regions: the Americas (U.S., Latin America and Canada); EMEA (Europe, Middle East and Africa); and Asia Pacific (principally Japan, Singapore, India, Australia, South Korea and China). Revenue generated by the Americas, EMEA and APAC for the three months ended November 30, 2011 totaled \$184.0 million, \$66.0 million and \$40.0 million, respectively, which resulted in year-over-year revenue growth in the Americas, EMEA and APAC of 22.0%, 22.5% and 29.5% respectively. As we expand further within each region, we anticipate revenue growth rates to be similar among our geographic regions due to the similarity of products and services offered and the similarity in customer types or classes.

In the three months ended November 30, 2011, approximately \$130.1 million or 44.9% of our revenue was generated outside the United States compared to approximately \$104.6 million or 44.4% for the three months ended November 30, 2010. Our international operations are expected to continue to grow as our international sales force and channels become more mature and as we enter new locations or expand our presence in existing locations. As of November 30, 2011, we had offices in more than 70 locations throughout the world.

Gross profit margin. Gross profit margin increased to 84.4% for the three months ended November 30, 2011 from 83.1% for the three months ended November 30, 2010 as a result of both a product mix shift to subscriptions and an overall increase in profit margins related to training and services. Subscription revenue as a

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percent of total revenue increased to 85.0% for the three months ended November 30, 2011 from 84.4% for the three months ended November 30, 2010. Gross profit margin on training and services revenue increased to 35.3% for the three months ended November 30, 2011 from 28.1% for the three months ended November 30, 2010, as a result of better utilization of training classes and consulting resources.

Gross profit margin by geography. Gross profit margins generated by our geographic segments for the three months ended November 30, 2011 were as follows: Americas 85.0%, EMEA 86.7% and APAC 83.5%. For the three months ended November 30, 2010, gross profit margins generated by our geographic segments were as follows: Americas 83.0%, EMEA 87.6% and APAC 81.0%. As we continue to expand our sales and support services within our geographic segments, we expect gross profit margins to further converge over the long run due to the similarity of products and services offered, similarity in production and distribution methods and the similarity in customer types or classes. The decrease in EMEA's gross profit margin to 86.7% for the three months ended November 30, 2011 from 87.6% for the three months ended November 30, 2010 was due to a product mix shift in which training and services revenue as a percentage of total revenue increased to 15.3% for the three months ended November 30, 2011 from 14.7% as compared to the same period ended November 30, 2010.

Income from operations. Operating income was 18.5% and 16.1% of total revenue for the three months ended November 30, 2011 and November 30, 2010, respectively. The increase in operating income as a percentage of revenue is a result of both the increase in gross profit margin and a decrease in operating expenses as a percent of revenue. Operating expenses as a percent of revenue, decreased to 65.9% for the three months ended November 30, 2011 from 67.0% for the three months ended November 30, 2010. The decrease in operating expenses results from a reduction in litigation related expenses of \$5.7 million. Partially offsetting reduced litigation expenses was an increase in selling costs primarily related to process and technology infrastructure enhancements.

Income from operations by geography. Operating income as a percentage of revenue generated by our geographic segments for the three months ended November 30, 2011 was as follows: Americas 25.3%, EMEA 28.5% and APAC 22.7%. For the three months ended November 30, 2010, income from operations as a percentage of revenue generated by our geographic segments was as follows: Americas 21.2%, EMEA 29.0% and APAC 17.9%. These geographic operating margins exclude the impact of share-based compensation expense which is recognized at a world-wide consolidated level. Operating margin for the Americas increased to 25.3% for the three months ended November 30, 2011 from 21.2% primarily as a result of reduced litigation related expenses, as described above, for litigation that arose in the Americas. Operating margin for EMEA decreased to 28.5% for the three months ended November 30, 2011 from 29.0% as a result of both a product mix shift from subscriptions to services and investments made to expand our sales force within the region. Operating margin for APAC increased to 22.7% for the three months ended November 30, 2011 from 17.9% as a result of both a product mix shift to subscriptions and a decrease in operating expenses relative to sales as the region continues to scale and leverage its selling and general and administrative functions.

Cash, cash equivalents, investments in debt and equity securities and cash flow from operations. Cash, cash equivalents and short-term and long-term available-for-sale investments in securities balances at November 30, 2011 totaled \$1.2 billion. Cash generated from operating activities for the three months ended November 30, 2011 totaled \$96.6 million, primarily as a result of the increase in subscription revenue, billings and collections during the same period.

Our significant cash balance gives us a measure of flexibility to take advantage of opportunities such as acquisitions, increasing investment in international areas and repurchasing our own common stock.

Foreign currency exchange rates impact on results of operations. Approximately 44.9% of our revenue for the three months ended November 30, 2011 was produced by sales outside the United States. We are exposed to significant risks of foreign currency fluctuation primarily from receivables denominated in foreign currency and are subject to transaction gains and losses, which are recorded as a component in determining net income. The income statements of our non-U.S. operations are translated into U.S. dollars at the average exchange rates

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for each applicable month in a period. To the extent the U.S. dollar weakens against foreign currencies, the translation of these foreign-currency-denominated transactions results in increased revenue and operating expenses from operations for our non-U.S. operations. Similarly, our revenue and operating expenses will decrease for our non-U.S. operations if the U.S. dollar strengthens against foreign currencies.

Using the average foreign currency exchange rates from the third quarter of our prior fiscal year ended February 28, 2011, our revenue and operating expenses from non-U.S. operations for the three months ended November 30, 2011 would have been lower than we reported using the average exchange rates for the third quarter of our current fiscal year ending February 29, 2012 by approximately \$2.0 million and \$1.0 million, respectively, which would have resulted in income from operations being lower by \$1.0 million.

Using the average foreign currency exchange rates from the first nine months of our prior fiscal year ended February 28, 2011, our revenue and operating expenses from non-U.S. operations for the nine months ended November 30, 2011 would have been lower than we reported using the average exchange rates for the first nine months of our current fiscal year ending February 29, 2012 by approximately \$5.9 million and \$3.6 million, respectively, which would have resulted in income from operations being lower by \$2.3 million.

In our fiscal year ended February 28, 2011, we focused and expect in our fiscal year ending February 29, 2012 to continue to focus on, among other things, (i) gaining widespread acceptance and deployment of Red Hat enterprise technologies by enterprise users globally, (ii) generating increasing revenue from our existing customer base by renewing existing subscriptions, providing additional value to our customers and by growing the number of enterprise technologies that comprise our open source architecture, (iii) generating increased revenue by providing additional systems evaluation, deployment and management and other targeted services and (iv) generating increasing revenue from additional market penetration through a broader and deeper set of channel partner relationships, including OEMs, VARs and systems integrators and our own international expansion, among other means.

Business combination. On October 7, 2011, we acquired Gluster, Inc. (Gluster). Gluster develops, distributes and provides support for open-source, scale-out storage software. The acquisition expands our enterprise software offerings to include management of unstructured data. Total consideration transferred as part of the acquisition was \$137.1 million and includes cash consideration of \$135.9 million and equity consideration related to assumed, nonvested employee share-based awards of \$1.2 million. The total fair value, as of October 7, 2011, of all assumed nonvested awards was \$14.5 million, of which \$1.2 million has been attributed to pre-acquisition employee services and accordingly has been recognized as consideration transferred. The remaining \$13.3 million of fair value will be recognized as compensation expense over the remaining vesting period. See NOTE 14 to our Consolidated Financial Statements for further discussion related to our acquisition of Gluster.

Table of Contents**RESULTS OF OPERATIONS****Three months ended November 30, 2011 and November 30, 2010**

The following table is a summary of our results of operations for the three months ended November 30, 2011 and November 30, 2010 (in thousands):

	Three Months Ended (Unaudited)		\$ Change	% Change
	November 30, 2011	November 30, 2010		
Revenue:				
Subscriptions	\$ 246,538	\$ 198,842	\$ 47,696	24.0%
Training and services	43,488	36,734	6,754	18.4
Total subscription and training and services revenue	290,026	235,576	54,450	23.1
Cost of subscription and training and services revenue:				
Cost of subscriptions	17,041	13,336	3,705	27.8
As a % of subscription revenue	6.9%	6.7%		
Cost of training and services	28,148	26,408	1,740	6.6
As a % of training and services revenue	64.7%	71.9 %		
Total cost of subscription and training and services revenue	45,189	39,744	5,445	13.7
As a % of total revenue	15.6%	16.9%		
Total gross profit	244,837	195,832	49,005	25.0
Operating expense:				
Sales and marketing	107,561	85,138	22,423	26.3
Research and development	53,739	43,083	10,656	24.7
General and administrative	29,965	29,655	310	1.0
Total operating expense	191,265	157,876	33,389	21.1
Income from operations	53,572	37,956	15,616	41.1
Interest income	2,075	1,608	467	29.0
Other income, net	(227)	462	(689)	(149.1)
Income before provision for income taxes	55,420	40,026	15,394	38.5
Provision for income taxes	17,180	14,009	3,171	22.6
Net income	\$ 38,240	\$ 26,017	\$ 12,223	47.0%
Gross profit margin-subscriptions	93.1%	93.3%		
Gross profit margin-training and services	35.3%	28.1%		
Gross profit margin	84.4%	83.1%		
As a % of total revenue:				
Subscription revenue	85.0%	84.4%		
Training and services revenue	15.0%	15.6%		
Sales and marketing expense	37.1%	36.1%		
Research and development expense	18.5%	18.3%		
General and administrative expense	10.3%	12.6%		

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Total operating expenses	65.9%	67.0%
Income from operations	18.5%	16.1%
Income before provision for income taxes	19.1%	17.0%
Net income	13.2%	11.0%
Estimated annual effective income tax rate	31.0%	35.0%

Table of Contents**Revenue***Subscription revenue*

Subscription revenue, which is primarily comprised of direct and indirect sales of Red Hat enterprise technologies, increased by 24.0% or \$47.7 million to \$246.5 million for the three months ended November 30, 2011 from \$198.8 million for the three months ended November 30, 2010. The increase in subscription revenue is primarily due to increases in volumes sold, including additional subscriptions attributable to geographic expansion, and continuing innovation, which attracts new customers and helps to drive renewals from existing customers. Subscription revenue increased as a percentage of total revenue to 85.0% for the three months ended November 30, 2011 from 84.4% for the three months ended November 30, 2010.

Training and services revenue

Training revenue includes fees paid by our customers for delivery of educational materials and instruction. Services revenue includes fees received from customers for consulting services regarding our offerings, deployment of Red Hat enterprise technologies and for delivery of added functionality to Red Hat enterprise technologies for our major customers and OEM partners. Total training and services revenue increased by 18.4% or \$6.8 million to \$43.5 million for the three months ended November 30, 2011 from \$36.7 million for the three months ended November 30, 2010. Training revenue increased 11.7% or \$1.5 million as some enterprises continued to increase overall spending on discretionary items such as training despite the current economic environment. Our services revenue increased by 21.8% or \$5.3 million as a result of both a continued increase in discretionary spending and increased subscription sales.

Cost of revenue*Cost of subscription revenue*

The cost of subscription revenue primarily consists of expenses we incur to support, distribute, manufacture and package Red Hat enterprise technologies. These costs include labor related cost to provide technical support and maintenance, as well as cost for fulfillment, physical media, literature, packaging and shipping. Cost of subscription revenue increased by 27.8% or \$3.7 million to \$17.0 million for the three months ended November 30, 2011 from \$13.3 million for the three months ended November 30, 2010. The increase primarily relates to increased compensation costs which totaled \$2.5 million and relates to increased technical support staff to meet the demands of our growing subscriber base for support and maintenance. The remaining increase is primarily increased facilities costs related to staff expansion. As a result of these investments made to expand our support staff, the cost of subscription revenue increased at a rate greater than that of subscription revenue for the three months ended November 30, 2011 from the three months ended November 30, 2010. Although we expect associated support cost will continue to increase, we expect such cost to grow at a rate slower than that of subscription revenue growth due to economies of scale. As a result of investments in staffing, our gross profit margin on subscriptions decreased to 93.1% for the three months ended November 30, 2011 from 93.3% for the three months ended November 30, 2010.

Cost of training and services revenue

Cost of training and services revenue is mainly comprised of personnel and third-party consulting costs for the design, development and delivery of custom engineering, training courses and professional services provided to various types of customers. Cost of training and services revenue increased by 6.6% or \$1.7 million to \$28.1 million for the three months ended November 30, 2011 from \$26.4 million for the three months ended November 30, 2010. The cost to deliver training decreased 8.0% or \$0.7 million to \$7.9 million for the three months ended November 30, 2011 compared to \$8.6 million for the three months ended November 30, 2010. The decrease in training costs was due to better utilization of both instructors and class room space as we transition from an on-site, employee-based, fixed-cost delivery model to a third-party, variable-cost delivery model. Costs to deliver our services revenue increased by 13.5% or \$2.4 million and primarily relate to additional

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compensation expense and travel associated with additions to our staff. Total costs to deliver training and services as a percentage of training and services revenue decreased to 64.7% for the three months ended November 30, 2011 from 71.9% for the three months ended November 30, 2010.

Gross profit

Gross profit margin increased to 84.4% for the three months ended November 30, 2011 from 83.1% for the three months ended November 30, 2010 as a result of both a product mix shift to subscriptions and an overall increase in profit margins related to training and services.

Subscription revenue as a percent of total revenue increased to 85.0% for the three months ended November 30, 2011 from 84.4% for the three months ended November 30, 2010. Gross profit margin on training and services revenue increased to 35.3% for the three months ended November 30, 2011 from 28.1% for the three months ended November 30, 2010, as a result of better utilization of training classes and consulting resources.

Operating expenses*Sales and marketing*

Sales and marketing expense consists primarily of salaries and other related costs for sales and marketing personnel, sales commissions, travel, public relations and marketing materials and trade shows. Sales and marketing expense increased by 26.3% or \$22.4 million to \$107.6 million for the three months ended November 30, 2011 from \$85.1 million for the three months ended November 30, 2010. This increase was primarily due to a \$17.0 million increase in selling costs, which includes \$13.9 million of additional compensation expense, which was primarily attributable to the expansion of our sales force during the current fiscal year. The remaining increase relates to marketing costs, which grew \$5.4 million or 29.7% for the three months ended November 30, 2011 as compared to the three months ended November 30, 2010. The increase in marketing costs includes \$3.4 million of additional compensation expense and incremental advertising expense of \$1.3 million. Sales and marketing expense increased as a percentage of revenue to 37.1% for the three months ended November 30, 2011 from 36.1% for the three months ended November 30, 2010 as we continue to invest in our sales and marketing functions to expand the breadth of our global sales coverage and depth of our product sales coverage.

Research and development

Research and development expense consists primarily of personnel and related costs for development of software technologies and systems management offerings. Research and development expense increased by 24.7% or \$10.7 million to \$53.7 million for the three months ended November 30, 2011 from \$43.1 million for the three months ended November 30, 2010. The increase in research and development costs primarily resulted from the expansion of our engineering group through both direct hires and acquisitions. Compensation related expenses increased by \$7.7 million. The remaining increase in research and development costs relates primarily to process and technology infrastructure enhancements, which increased \$1.9 million. Research and development expense was 18.5% and 18.3% of total revenue for the three months ended November 30, 2011 and November 30, 2010, respectively.

General and administrative

General and administrative expense consists primarily of personnel and related costs for general corporate functions, including information systems, finance, accounting, legal, human resources and facilities expense. General and administrative expense increased by 1.0% or \$0.3 million to \$30.0 million for the three months ended November 30, 2011 from \$29.7 million for the three months ended November 30, 2010. Increased general and administrative expenses of \$6.0 million were partially offset by litigation related expenses which were \$5.7 million lower for the three months ended November 30, 2011 as compared to the three months ended November 30, 2010. For further discussion related to current legal proceedings see NOTE 13 to the consolidated

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financial statements. Excluding the litigation related expenses, the increase in other general and administrative expenses of \$6.0 million result primarily from increased compensation costs of \$3.9 million and increased professional services costs of \$1.7 million. The increase in professional services costs result from investments made to improve data processing systems. Primarily as a result of reduced litigation costs, general and administrative expense decreased as a percentage of revenue to 10.3% for the three months ended November 30, 2011 from 12.6% for the three months ended November 30, 2010.

Interest income

Interest income increased by 29.0% or \$0.5 million to \$2.1 million for the three months ended November 30, 2011 from \$1.6 million for the three months ended November 30, 2010. The increase in interest income for the three months ended November 30, 2011 is attributable to yields earned on our higher cash and investment balances.

Other income, net

Other income, net decreased \$0.7 million for the three months ended November 30, 2011 as compared to the three months ended November 30, 2010. The decrease is due to reduced gains from the sale of available-for-sale equity securities for the three months ended November 30, 2011 as compared to the same period ended November 30, 2010.

Income taxes

During the three months ended November 30, 2011, we recorded \$17.2 million of income tax expense, which is based on an estimated annual effective tax rate of 31.0%. Our estimated annual effective tax rate of 31.0% is less than the U.S. federal statutory rate of 35% principally due to foreign income taxed at lower rates.

During the three months ended November 30, 2010, we recorded \$14.0 million of income tax expense, which was based on a then estimated annual effective tax rate of 35%. Our estimated annual effective tax rate for the three months ended November 30, 2010, was 35% but the effective rate for the full year ended February 28, 2011 was 30% due to reinstatement of the U.S. federal research tax credit, approval of a tax holiday in Israel and certain other events that occurred during the fourth quarter of fiscal 2011.

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The following table is a summary of our results of operations for the nine months ended November 30, 2011 and November 30, 2010 (in thousands):

	Nine Months Ended (Unaudited)		\$ Change	% Change
	November 30, 2011	November 30, 2010		
Revenue:				
Subscriptions	\$ 710,408	\$ 564,101	\$ 146,307	25.9%
Training and services	125,684	100,380	25,304	25.2
Total subscription and training and services revenue	836,092	664,481	171,611	25.8
Cost of subscription and training and services revenue:				
Cost of subscriptions	48,876	38,256	10,620	27.8
As a % of subscription revenue	6.9%	6.8%		
Cost of training and services	85,399	70,427	14,972	21.3
As a % of training and services revenue	67.9%	70.2%		
Total cost of subscription and training and services revenue	134,275	108,683	25,592	23.5
As a % of total revenue	16.1%	16.4%		
Total gross profit	701,817	555,798	146,019	26.3
Operating expense:				
Sales and marketing	304,617	239,136	65,481	27.4
Research and development	153,515	126,102	27,413	21.7
General and administrative	92,277	84,294	7,983	9.5
Total operating expense	550,409	449,532	100,877	22.4
Income from operations	151,408	106,266	45,142	42.5
Interest income	6,138	5,046	1,092	21.6
Other income, net	(167)	2,140	(2,307)	(107.8)
Income before provision for income taxes	157,379	113,452	43,927	38.7
Provision for income taxes	46,722	39,708	7,014	17.7
Net income	\$ 110,657	\$ 73,744	\$ 36,913	50.1%
Gross profit margin-subscriptions	93.1%	93.2%		
Gross profit margin-training and services	32.1%	29.8%		
Gross profit margin	83.9%	83.6%		
As a % of total revenue:				
Subscription revenue	85.0%	84.9%		
Training and services revenue	15.0%	15.1%		
Sales and marketing expense	36.4%	36.0%		
Research and development expense	18.4%	19.0%		
General and administrative expense	11.0%	12.7%		
Total operating expenses	65.8%	67.7%		
Income from operations	18.1%	16.0%		

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Income before provision for income taxes	18.8%	17.1%
Net income	13.2%	11.1%
Estimated annual effective income tax rate (1)	31.0%	35.0%

- (1) Estimated annual effective tax rate is based on estimated ordinary income and excludes certain discrete tax benefits of \$2.1 million that we recognized during the nine months ended November 30, 2011.

Table of Contents**Revenue***Subscription revenue*

Subscription revenue increased by 25.9% or \$146.3 million to \$710.4 million for the nine months ended November 30, 2011 from \$564.1 million for the nine months ended November 30, 2010. The increase in subscription revenue is primarily due to increases in volumes sold, including additional subscriptions attributable to geographic expansion, and continuing innovation, which attracts new customers and helps to drive renewals from existing customers.

Training and services revenue

Total training and services revenue increased by 25.2% or \$25.3 million to \$125.7 million for the nine months ended November 30, 2011 from \$100.4 million for the nine months ended November 30, 2010. Training revenue increased 17.7% or \$6.0 million as some enterprises continued to increase overall spending on discretionary items such as training and related travel. Our services revenue increased by 29.0% or \$19.3 million as a result of both a continued increase in discretionary spending and increased subscription sales. Combined training and services revenue decreased as a percentage of total revenue to 15.0% for the nine months ended November 30, 2011 from 15.1% for the nine months ended November 30, 2010.

Cost of revenue*Cost of subscription revenue*

Cost of subscription revenue increased by 27.8% or \$10.6 million to \$48.9 million for the nine months ended November 30, 2011 from \$38.3 million for the nine months ended November 30, 2010. Compensation expense increased \$7.7 million for the nine months ended November 30, 2011 as compared to the same period ended November 30, 2010 due primarily to continued additions to our technical support staff to meet the demands of our growing subscriber base for support and maintenance. The remaining variance is due to increased expense related to purchased technology of \$1.6 million and expansion of support facilities of \$1.3 million. As a result of these investments made to expand our support staff, the cost of subscription revenue increased at a rate greater than that of subscription revenue for the nine months ended November 30, 2011 from the nine months ended November 30, 2010. Although we expect associated support cost will continue to increase, we expect such cost to grow at a rate slower than that of subscription revenue growth due to economies of scale. As a result of investments in purchased technology and facilities, gross profit margin on subscriptions decreased to 93.1% for the nine months ended November 30, 2011 from 93.2% for the nine months ended November 30, 2010.

Cost of training and services revenue

Cost of training and services revenue increased by 21.3% or \$15.0 million to \$85.4 million for the nine months ended November 30, 2011 from \$70.4 million for the nine months ended November 30, 2010. The cost to deliver training increased 2.3% or \$0.6 million to \$24.7 million for the nine months ended November 30, 2011 as compared to \$24.1 million for the nine months ended November 30, 2010. Costs to deliver our training decreased as a percentage of training revenue to 62.3% for the nine months ended November 30, 2011 from 71.7% for the nine months ended November 30, 2010 due to better utilization of both instructors and class room space as we transition from an on-site, employee-based, fixed-cost delivery model to a third-party, variable-cost delivery model. Costs to deliver our services revenue increased by 30.9% or \$14.4 million and primarily relate to additional compensation and travel expenses of \$9.8 million associated with additions to our staff. Use of outside contractors increased costs \$1.3 million for the nine months ended November 30, 2011 as compared to the same period ended November 30, 2010. The remaining increase in costs to deliver our engineering and professional services relates to process and technology infrastructure investments we continue to make to enhance the delivery of our services. Total costs to deliver training and services as a percentage of training and services revenue decreased to 67.9% for the nine months ended November 30, 2011 from 70.2% for the nine months ended November 30, 2010.

Table of Contents**Gross profit**

Gross profit margin increased to 83.9% for the nine months ended November 30, 2011 from 83.6% for the nine months ended November 30, 2010 as a result of both a product mix shift to subscriptions and an overall increase in profit margins related to training and services. Subscription revenue as a percent of total revenue increased to 85.0% for the nine months ended November 30, 2011 from 84.9% for the nine months ended November 30, 2010. Gross profit margin on training and services revenue increased to 32.1% for the nine months ended November 30, 2011 from 29.8% for the nine months ended November 30, 2010, as a result of better utilization of training classes and consulting resources.

Operating expenses*Sales and marketing*

Sales and marketing expense increased by 27.4% or \$65.5 million to \$304.6 million for the nine months ended November 30, 2011 from \$239.1 million for the nine months ended November 30, 2010. This increase was primarily due to a \$51.8 million increase in selling costs, which includes \$45.1 million of additional compensation expense, which was primarily attributable to the expansion of our sales force during the current fiscal year. The remaining increase relates to marketing costs, which grew \$13.6 million or 27.1% for the nine months ended November 30, 2011 as compared to the nine months ended November 30, 2010. The increase in marketing costs includes \$8.7 million of additional compensation expense and incremental advertising expense of \$2.2 million. Sales and marketing expense increased as a percentage of revenue to 36.4% for the nine months ended November 30, 2011 from 36.0% for the nine months ended November 30, 2010 as we continue to invest in our sales and marketing function to expand the breadth of our global sales coverage and depth of our product sales coverage.

Research and development

Research and development expense increased by 21.7% or \$27.4 million to \$153.5 million for the nine months ended November 30, 2011 from \$126.1 million for the nine months ended November 30, 2010. The increase in research and development costs primarily resulted from the expansion of our engineering group through both direct hires and acquisitions. Compensation related expenses increased by \$22.4 million. The remaining increase in research and development costs relates primarily to process and technology infrastructure enhancements, which increased \$4.9 million. Research and development expense was 18.4% and 19.0% of total revenue for the nine months ended November 30, 2011 and November 30, 2010, respectively.

General and administrative

General and administrative expense increased by 9.5% or \$8.0 million to \$92.3 million for the nine months ended November 30, 2011 from \$84.3 million for the nine months ended November 30, 2010. The increase in general and administrative expenses results from increased compensation expense of \$7.5 million, outside professional service fees, primarily related to data processing systems upgrades, which increased \$4.2 million, costs related to technology infrastructure enhancements which increased \$2.1 million and additional allowances for bad debts of \$0.8 million. These increases in general and administrative costs were partially offset by litigation related expenses which were \$6.4 million lower for the nine months ended November 30, 2011 as compared to the nine months ended November 30, 2010. Primarily as a result of reduced litigation costs, general and administrative expense decreased as a percentage of revenue to 11.0% for the nine months ended November 30, 2011 from 12.7% for the nine months ended November 30, 2010.

Interest income

Interest income increased by 21.6% or \$1.1 million to \$6.1 million for the nine months ended November 30, 2011 from \$5.0 million for the nine months ended November 30, 2010. The increase in interest income for the nine months ended November 30, 2011 is attributable to yields earned on our higher cash and investment balances.

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Other income, net

Other income, net decreased \$2.3 million for the nine months ended November 30, 2011 as compared to the nine months ended November 30, 2010. The decrease is due to reduced gains from the sale of available-for-sale equity securities for the nine months ended November 30, 2011 as compared to the same period ended November 30, 2010.

Income taxes

During the nine months ended November 30, 2011, we recorded \$46.7 million of income tax expense, which is based on an estimated annual effective tax rate of 31.0%, net of a discrete tax benefit of \$2.1 million primarily related to a reversal of the valuation allowance on the NOL of a foreign subsidiary. Excluding the impact of the discrete tax benefit, our estimated annual effective tax rate of 31.0% is less than the U.S. federal statutory rate of 35% principally due to foreign income taxed at lower rates.

During the nine months ended November 30, 2010, we recorded \$39.7 million of income tax expense, which was based on a then estimated annual effective tax rate of 35%. Our estimated annual effective tax rate for the nine months ended November 30, 2010, was 35% but the effective rate for the full year ended February 28, 2011 was 30% due to reinstatement of the U.S. federal research tax credit, approval of a tax holiday in Israel and certain other events that occurred during the fourth quarter of fiscal 2011.

LIQUIDITY AND CAPITAL RESOURCES

We have historically derived a significant portion of our liquidity and operating capital from cash flows from operations as well as the sale of equity securities, including private sales of preferred stock and the sale of common stock in our initial and follow-on public offerings, and the issuance of convertible debentures. At November 30, 2011, we had total cash and investments of \$1.2 billion, which was comprised of \$526.7 million in cash and cash equivalents, \$264.8 million of short-term, available-for-sale fixed-income investments, \$1.7 million of available-for-sale equity securities, \$408.5 million of long-term, available-for-sale fixed-income investments, and \$15.2 million in certificates of deposit with maturity dates greater than 30 days. This compares to total cash and investments of \$1.2 billion at February 28, 2011.

With \$526.7 million in cash and cash equivalents on hand, we believe our cash and cash equivalent balances, together with our ability to generate additional cash from operations, should be sufficient to satisfy our cash requirements for the next twelve months and for the foreseeable future. We presently do not intend to liquidate our short and long-term investments in debt securities prior to their scheduled maturity dates. However, in the event that we did liquidate these investments prior to their scheduled maturities and there were adverse changes in market interest rates or the overall economic environment, we could be required to recognize a realized loss on those investments when we liquidate. At November 30, 2011 and February 28, 2011, accumulated unrealized losses on our available-for-sale debt securities totaled \$3.5 million and \$0.5 million, respectively. At November 30, 2011 and February 28, 2011, accumulated unrealized gains related to our short-term equity securities available for sale totaled \$1.6 million and \$2.6 million, respectively.

Nine months ended November 30, 2011

Cash flows overview

At November 30, 2011, cash and cash equivalents totaled \$526.7 million, a decrease of \$116.0 million as compared to February 28, 2011. The decrease in cash and cash equivalents for the nine months ended November 30, 2011 is primarily the result of cash used in investing activities, including net purchases of available-for-sale debt securities of \$152.7 million and cash used to purchase Gluster, which totaled \$135.2 million, net of cash acquired. Also contributing to the overall decrease in cash was the repurchase of 1.3 million

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shares of our common stock for \$57.0 million. Partially offsetting cash used in investing and financing activities was cash provided by operating activities which totaled \$263.9 million for the nine months ended November 30, 2011. Net cash generated by operating activities and used for investing and financing activities is further described below.

Cash flows from operations

Cash provided by operations of \$263.9 million during the nine months ended November 30, 2011 includes net income of \$110.7 million, adjustments to exclude the impact of non-cash revenues and expenses, which totaled \$105.4 million net source of cash, and changes in operating assets and liabilities, which totaled a \$47.9 million net source of cash. Cash provided by changes in operating assets and liabilities for the nine months ended November 30, 2011 was primarily the result of an increase in our deferred revenue which generated operating cash flow of \$56.2 million. Cash generated from deferred income taxes of \$36.2 million was primarily due to share-based compensation deductions which were in excess of amounts originally recognized in our consolidated statements of operations. Excess tax benefits from share-based compensation, which totaled \$24.3 million, is considered a financing source of cash.

Cash flows from investing

Cash used in investing activities of \$324.8 million for the nine months ended November 30, 2011 includes net purchases of available-for-sale debt securities of \$152.7 million, investments in property and equipment of \$31.3 million, primarily related to process and information technology infrastructure enhancements and investments in other intangible assets, primarily patents, of \$4.2 million. On October 7, 2011, we acquired Gluster which included cash consideration of \$135.2 million, net of \$0.7 million cash acquired. Gluster develops, distributes and provides support for open-source storage software. For further discussion regarding our purchase of Gluster, see NOTE 14 to the consolidated financial statements.

Cash flows from financing

Cash used in financing activities of \$50.0 million for the nine months ended November 30, 2011 includes \$57.0 million used to repurchase 1.3 million shares of our common stock. Payments made in return for common shares received from employees to satisfy employees' minimum tax withholding obligations related to restricted share awards vesting during the nine months ended November 30, 2011 totaled \$32.1 million. Partially offsetting financing activities using cash were proceeds from excess tax benefits related to share-based employee compensation which totaled \$24.3 million and proceeds from employees' exercise of common stock options which totaled \$15.6 million. Payments on other borrowings totaled \$0.8 million for the nine months ended November 30, 2011.

Investments in debt and equity securities

Our investments are comprised primarily of debt securities that are classified as available for sale and recorded at their fair market values. At November 30, 2011 and February 28, 2011, the vast majority of our investments were priced by pricing vendors. These pricing vendors use the most recent observable market information in pricing these securities or, if specific prices are not available for these securities, use other observable inputs. In the event observable inputs are not available, we assess other factors to determine the securities' market value, including broker quotes or model valuations. Independent price verifications of all of our holdings are performed by the pricing vendors, which we review. 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.

Capital requirements

We have experienced a substantial increase in our operating expenses since our inception in connection with the growth of our operations, the development of our enterprise technologies, the expansion of our services

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operations and our acquisition activity. Our capital requirements during the year ending February 29, 2012 will depend on numerous factors, including the amount of resources we devote to:

- funding the continued development of our enterprise technology offerings;
- accelerating the development of our systems management services;
- improving and extending our services and the technologies used to deliver these services to our customers and support our business;
- pursuing strategic acquisitions and alliances; and
- investing in businesses, products and technologies.

We have utilized, and will continue from time to time to utilize, cash and investments to fund, among other potential uses, purchases of our common stock, purchases of fixed assets, purchases of intellectual property and mergers and acquisitions.

Given our historically strong operating cash flow and the \$1.2 billion of cash and investments held at November 30, 2011, we do not presently anticipate the need to raise cash to fund our operations, either through the sale of additional equity or through the issuance of debt, in the foreseeable future. However, we may take advantage of favorable capital market situations that may arise from time to time to raise additional capital.

We believe that cash flow from operations will continue to improve; however, there can be no assurances that we will improve our cash flow from operations from the current rate or that such cash flows will be adequate to fund other investments or acquisitions that we may choose to make. We may choose to accelerate the expansion of our business from our current plans, which may require us to raise additional funds through the sale of equity or debt securities or through other financing means. There can be no assurances that any such financing would occur in amounts or on terms favorable to us, if at all.

Off-balance sheet arrangements

As of November 30, 2011 and February 28, 2011, we have no off-balance sheet financing arrangements and do not utilize any structured debt, special purpose or similar unconsolidated entities for liquidity or financing purposes.

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ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are exposed to the impact of interest rate changes, foreign currency exchange rate fluctuations and changes in the market value of our investments.

Interest Rate Risk

Our exposure to market rate risk for changes in interest rates relates primarily to our investment portfolio. The primary objective of our investment activities is to preserve principal and liquidity while at the same time maximizing yields without significantly increasing risk. To achieve this objective, we maintain our portfolio of cash equivalents and short-term and long-term investments in a variety of fixed-income securities, including both government and corporate obligations and money market funds. Investments in both fixed rate and floating rate interest earning instruments carry a degree of interest rate risk. Fixed rate securities may have their fair market value adversely impacted due to a rise in prevailing interest rates, while floating rate securities may produce less income than expected if interest rates fall. Due in part to these factors, our future investment income may fall short of expectations due to changes in interest rates, or we may suffer losses in principal if forced to sell securities which have declined in market value due to changes in interest rates or perceived credit risk related to the securities issuers. A hypothetical one percentage point change in interest rates, assuming a parallel shift of all interest rates, would result in an \$8.8 million change in annual interest income derived from investments in our portfolio as of November 30, 2011. For further discussion related to our investments as of November 30, 2011 and February 28, 2011, see NOTE 6 to the Consolidated Financial Statements.

Investment Risk

The fair market value of our investment portfolio is subject to interest rate risk. Based on a sensitivity analysis performed on this investment portfolio, a hypothetical one percentage change in interest rates, assuming a parallel shift of all interest rates, would result in an approximate \$9.8 million decrease in the fair value of our available-for-sale investment securities as of November 30, 2011. For further discussion related to our investments as of November 30, 2011 and February 28, 2011, see NOTE 6 to the Consolidated Financial Statements.

Credit Risk

The fair market values of our investment portfolio and cash balances are exposed to counterparty credit risk. Accordingly, while we periodically review our portfolio in an effort to mitigate counterparty risk, the principal values of our cash balances, money market accounts and investments in available-for-sale securities could suffer a loss of value.

Foreign Currency Risk

Approximately 44.9% of our revenue for the three months ended November 30, 2011 was produced by sales outside the United States. We are exposed to significant risks of foreign currency fluctuation primarily from receivables denominated in foreign currency and are subject to transaction gains and losses, which are recorded as a component in determining net income. The income statements of our non-U.S. operations are translated into U.S. dollars at the average exchange rates for each applicable month in a period. Thus, to the extent the U.S. dollar weakens against foreign currencies, the translation of these foreign currency statements results in increased revenue and operating expenses for our non-U.S. operations. Similarly, our revenue and operating expenses for our non-U.S. operations decreases if the U.S. dollar strengthens against foreign currencies.

Using the average foreign currency exchange rates from the third quarter of our prior fiscal year ended February 28, 2011, our revenue and operating expenses from non-U.S. operations for the three months ended November 30, 2011 would have been lower than we reported using the average exchange rates for the third quarter of our current fiscal year ending February 29, 2012 by approximately \$2.0 million and \$1.0 million, respectively, which would have resulted in income from operations being lower by \$1.0 million.

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Using the average foreign currency exchange rates from the nine month period ended November 30, 2010, our revenue and operating expenses from non-U.S. operations for the nine months ended November 30, 2011 would have been lower than we reported using the average exchange rates for the third quarter of our current fiscal year ending February 29, 2012 by approximately \$5.9 million and \$3.6 million, respectively, which would have resulted in income from operations being lower by \$2.3 million.

Derivative Instruments

We transact business in various foreign countries and are, therefore, subject to risk of foreign currency exchange rate fluctuations. We sometimes enter into forward contracts to economically hedge transactional exposure associated with commitments arising from trade accounts receivable, trade accounts payable and fixed purchase obligations denominated in a currency other than the functional currency of the respective operating entity. All derivative instruments are recorded on the Consolidated Balance Sheets at their respective fair market values in accordance with FASB ASC Section 815 (formerly referenced as Statement of Financial Accounting Standards No. 133, Accounting for Derivative Instruments and Hedging Activities). The Company has elected not to prepare and maintain the documentation required to qualify its forward contracts for hedge accounting treatment and, therefore, changes in fair value are recorded in the Consolidated Statements of Operations. For further discussion related to our management of foreign currency risk see NOTE 7 to the Consolidated Financial Statements.

The aggregate notional amount of outstanding forward contracts at November 30, 2011 was \$29.9 million. The fair value of these outstanding contracts at November 30, 2011 was a gross less than \$0.1 million asset and a gross \$0.2 million liability, and is recorded in other current assets and accrued expenses, respectively on the Consolidated Balance Sheets. The forward contracts generally expire within three months of the period ended November 30, 2011. The forward contracts will settle in Euros, Japanese yen, Swiss francs, Swedish krona, Czech koruna, Canadian dollars, Singapore dollars, Australian dollars, New Zealand dollars, Israeli shekels, Mexican pesos and Norwegian krona.

The aggregate notional amount of outstanding forward contracts at February 28, 2011 was \$64.5 million. The fair value of these outstanding contracts at February 28, 2011 was a gross \$0.4 million asset and a gross \$0.1 million liability, and is recorded in other current assets and accrued expenses, respectively on the Consolidated Balance Sheets. The forward contracts generally expire within three months of the period ended February 28, 2011. The forward contracts will settle in Australian dollars, British pounds, Canadian dollars, Czech koruna, Hong Kong dollars, Japanese yen, New Zealand dollars, Swiss francs, Swedish krona and Singapore dollars.

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RECENT ACCOUNTING PRONOUNCEMENTS

In December 2011, the FASB issued Accounting Standards Update No. 2011-11, *Balance Sheet (Topic 210) Disclosures about Offsetting Assets and Liabilities* (ASU 2011-11). The update requires entities to disclose information about offsetting and related arrangements of financial instruments and derivative instruments. ASU 2011-11 is effective for us in the first quarter of our fiscal year ending February 28, 2014 (fiscal 2014). We currently believe there will be no significant impact on our consolidated financial statements.

In September 2011, the FASB issued Accounting Standards Update No. 2011-08, *Intangibles Goodwill and Other (Topic 350) Testing Goodwill for Impairment* (ASU 2011-08), to simplify how entities test goodwill for impairment. ASU 2011-08 allows entities to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If a greater than 50 percent likelihood exists that the fair value is less than the carrying amount then a two-step goodwill impairment test as described in Topic 350 must be performed. ASU 2011-08 is effective for us in our first quarter of fiscal 2013 but is eligible for early adoption. We currently believe there will be no significant impact on our consolidated financial statements.

In June 2011, the FASB issued Accounting Standards Update No. 2011-05, *Comprehensive Income (Topic 220) Presentation of Comprehensive Income* (ASU 2011-05), to require an entity to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. ASU 2011-05 eliminates the option to present the components of other comprehensive income as part of the statement of equity. ASU 2011-05 is effective for us in our first quarter of fiscal 2013 and should be applied retrospectively. We currently believe there will be no significant impact on our consolidated financial statements.

In May 2011, the FASB issued Accounting Standards Update No. 2011-04, *Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and International Financial Reporting Standards (Topic 820) Fair Value Measurement* (ASU 2011-04), to provide a consistent definition of fair value and ensure that the fair value measurement and disclosure requirements are similar between U.S. GAAP and International Financial Reporting Standards. ASU 2011-04 changes certain fair value measurement principles and enhances the disclosure requirements particularly for level 3 fair value measurements. ASU 2011-04 is effective for us in our fourth quarter of fiscal 2012 and should be applied prospectively. We do not currently have level 3 fair value measurements. We are currently evaluating the impact of adopting ASU 2011-04, but currently believe there will be no significant impact on our consolidated financial statements.

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ITEM 4. CONTROLS AND PROCEDURES

Role of Controls and Procedures

Our management, including our chief executive officer and chief financial officer, does not expect that our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) or our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) will prevent all errors and all fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system's objectives will be met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of the controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within a company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty and that breakdowns can occur because of simple error and mistake. Controls can also be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the controls. The design of any system of controls is based in part on certain assumptions about the likelihood of future events. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected. Also projections of any evaluation of effectiveness of controls and procedures to future periods are subject to the risk that the controls and procedures may become inadequate because of changes in conditions, or that the degree of compliance with the controls and procedures may have deteriorated.

Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our chief executive officer and chief financial officer, evaluated the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report. Based on this evaluation, our chief executive officer and chief financial officer concluded that, as of the end of the period covered by this report, our disclosure controls and procedures were effective at a reasonable assurance level.

Changes in Internal Control Over Financial Reporting

No changes in our internal control over financial reporting occurred during the fiscal quarter covered by this report that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents**PART II****ITEM 1. LEGAL PROCEEDINGS**

Commencing on or about March 2001, the Company and certain of its officers and directors were named as defendants in a series of purported class action suits arising out of the Company's initial public offering and secondary offering. Approximately 310 other IPO issuers were named as defendants in similar class action complaints (together, the IPO Allocation Actions). On August 8, 2001, Chief Judge Michael Mukasey of the U.S. District Court for the Southern District of New York issued an order that transferred all of the IPO Allocation Actions, including the complaints involving the Company, to one judge for coordinated pre-trial proceedings (Case No. 21 MC 92). The plaintiffs contend that the defendants violated federal securities laws by issuing registration statements and prospectuses that contained materially false and misleading information and failed to disclose material information. Plaintiffs also challenge certain IPO allocation practices by underwriters and the lack of disclosure thereof in initial public offering documents. On April 19, 2002, plaintiffs filed amended complaints in each of the 310 consolidated actions, including the Red Hat action. The relief sought consists of unspecified damages, attorneys' and expert fees and other unspecified costs. In October of 2002, the individual director and officer defendants of the Company were dismissed from the case without prejudice. In October of 2004, the District Court certified a class in six of the 310 actions (the focus cases) and noted that the decision is intended to provide strong guidance to all parties regarding class certification in the remaining cases. The Company's action is not one of the focus cases. On December 5, 2006, the U.S. Court of Appeals for the Second Circuit vacated the District Court's class certification with respect to the focus cases and remanded the matter for further consideration. In September 2007, discovery moved forward in the focus cases and plaintiff filed and amended complaints against the focus case issuer and underwriter defendants. Defendants in the focus cases filed motions to dismiss the second amended complaints in November 2007 and filed their oppositions to plaintiffs' motion for class certification in December 2007. The motions to dismiss in the focus cases were granted in part. On April 2, 2009, the plaintiffs' executive committee on behalf of the proposed class filed a motion for preliminary approval of a settlement agreement to resolve the lawsuit, to which the Company has consented and for which payments called for by the settlement agreement are to be paid by the defendant insurers. The trial court heard arguments on September 10, 2009 on the fairness of the settlement. In an opinion and order filed October 5, 2009, the trial court approved the class, granted plaintiffs' motion for approval of the settlement and directed the clerk of the court to close the action. Appeals have been filed and briefed before the Court of Appeals for the Second Circuit. On May 17, 2011, the Second Circuit issued a ruling on the two pending appeals, granting the motion to dismiss one of the appeals, and remanding the other appeal back to the District Court to determine procedural issues relating to the standing of the remaining objector-appellant. On August 25, 2011, the Court rejected the claims of that remaining objector-appellant. A notice of appeal of this decision was filed on September 26, 2011. On November 10, 2011, Plaintiffs moved to dismiss with prejudice the appeal by the remaining objector-appellant, and requested that the Court consider the motion on an expedited basis. The remaining objector-appellant filed a brief in opposition to Plaintiffs' motion to dismiss on November 4, 2011.

In the summer of 2004, 14 class action lawsuits were filed against the Company and several of its former officers on behalf of investors who purchased the Company's securities during various periods from June 19, 2001 through July 13, 2004. All 14 suits were filed in the U.S. District Court for the Eastern District of North Carolina. In each of the actions, plaintiffs sought to represent a class of purchasers of the Company's common stock during some or all of the period from June 19, 2001 through July 13, 2004. All of the claims arose in connection with the Company's announcement on July 13, 2004 that it would restate certain of its financial statements (the Restatement). One or more of the plaintiffs asserted that certain former officers (the Individual Defendants) and the Company violated Sections 10(b) and 20(a) of the Securities Exchange Act of 1934, as amended (the Securities Exchange Act), and Rule 10b-5 thereunder by issuing the financial statements that the Company subsequently restated. One or more of the plaintiffs sought unspecified damages, interest, costs, attorneys' and experts' fees, an accounting of certain profits obtained by the Individual Defendants from trading in the Company's common stock, disgorgement by the Company's former chief executive officer and former chief financial officer of certain compensation and profits from trading in the Company's common stock

pursuant to Section 304 of the Sarbanes-Oxley Act of 2002 and other relief. As of September 8, 2004, all of these

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class action lawsuits were consolidated into a single action referenced as Civil Action No. 5:04-C V-473BR and titled In re Red Hat, Inc. Securities Litigation. On May 6, 2005, the plaintiffs filed an amended consolidated class action complaint. On July 29, 2005, the Company, on behalf of itself and the Individual Defendants, filed a motion to dismiss the action for failure to state a claim upon which relief may be granted. Also on that date, PricewaterhouseCoopers LLP (PwC), another defendant, filed a separate motion to dismiss. On May 12, 2006, the Court issued an order granting the motion to dismiss the Securities Exchange Act claims against several of the Individual Defendants, but denying the motion to dismiss the Securities Exchange Act claims against the Company, its former chief executive officer and former chief financial officer. The Court dismissed the claims under the Sarbanes-Oxley Act in their entirety, and also granted PwC's motion to dismiss. On November 6, 2006, the plaintiffs filed a motion for class certification. Subsequent to the filing of that motion, several plaintiffs withdrew as potential class representatives, and the Company opposed the certification of the remaining proposed class representatives. On May 11, 2007, the Court entered an order denying class certification and denying all other pending motions as moot. Thereafter, on July 13, 2007 Charles Gilbert filed a renewed motion for appointment as lead plaintiff and approval of selection of lead counsel. On November 13, 2007, the Court entered an Order allowing Gilbert's motion, appointing him lead plaintiff, adding him as a party plaintiff and appointing lead counsel. On January 14, 2008, Gilbert's counsel filed a motion to certify the action as a class action. On August 28, 2009, the Court entered an Order certifying the action as a class action, appointing Gilbert as the class representative, and defining the class as all purchasers of the common stock of Red Hat, Inc. between December 17, 2002, and July 12, 2004, inclusive and who were damaged thereby, excluding Company insiders. On December 15, 2009, the Company announced that it had reached an agreement in principle to settle this matter, subject, among other matters, to completion of a final written settlement agreement and court approval. The Company recorded, for its quarter ended November 30, 2009, an estimated liability in the amount of \$8.8 million for its portion of the proposed settlement. On March 29, 2010, counsel for the class filed a Motion for Preliminary Approval of the Settlement and, on June 11, 2010, a United States Magistrate Judge issued a Memorandum and Recommendation to the presiding judge that the motion be approved. On July 8, 2010, the presiding judge approved the motion and set the hearing for the final fairness hearing on December 7, 2010. The settlement was approved by the District Court in an order dated December 10, 2010. On March 30, 2011, the Court ordered the cases removed from the active docket. Since that time, the Court has approved a Motion for Disbursement of Funds and currently has before it a final motion for disbursement of additional funds.

The Company also experiences routine litigation in the normal course of its business, including patent litigation. The Company presently believes that the outcome of this routine litigation will not have a material adverse effect on its financial position, results of operations or cash flows.

ITEM 1A. RISK FACTORS

Set forth below are certain risks and cautionary statements, which supplement other disclosures in this report.

Moreover, certain statements contained in this report and the documents incorporated by reference in this report, including in Management's Discussion and Analysis of Financial Condition and Results of Operations, constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements provide current expectations of future events based on certain assumptions and include any statement that is not strictly a historical statement (for example, statements regarding current or future financial performance, management's plans and objectives for future operations, product plans and performance, management's expectations regarding market risk and market penetration, management's assessment of market factors or strategies, objectives and plans of Red Hat and its partners). Words such as anticipates, believes, expects, estimates, intends, plans, projects, and similar expressions, may also identify such forward-looking statements. Investors are cautioned that these forward-looking statements are not guarantees of Red Hat's future performance and are subject to a number of risks and uncertainties that could cause Red Hat's actual results to differ materially from those found in the forward-looking statements and from historical trends. These risks and uncertainties include the risks and cautionary statements detailed below and elsewhere in this report as well as in Red Hat's other filings with the Securities and Exchange Commission

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(SEC), copies of which may be accessed through the SEC's web site at <http://www.sec.gov>. Readers are urged to carefully review these risks and cautionary statements. The forward-looking statements included in this report represent our views as of the date of this report. We specifically disclaim any obligation to update these forward-looking statements in the future. These forward-looking statements should not be relied upon as representing our views as of any date subsequent to the date of this report.

RISKS RELATED TO BUSINESS UNCERTAINTY

Ongoing uncertainty regarding the duration and extent of the recent economic downturn and in global economic and market conditions generally could adversely affect our business, financial condition and results of operations.

Economic weakness and uncertainty, tightened credit markets and constrained IT spending from time to time contribute to slowdowns in the technology industry, as well as in the specific segments and markets in which we operate, which may result in reduced demand and increased price competition for our products and services. Our operating results in one or more geographic regions may also be affected by uncertain or changing economic conditions within that region, such as the challenges that are currently affecting economic conditions in the United States and elsewhere. Continuing uncertainty about future economic conditions may, among other things, negatively impact our current and prospective customers and result in delays or reductions in technology purchases or lengthen our sales cycle. Adverse economic conditions also may negatively impact our ability to obtain payment for outstanding debts owed to us by our customers or other parties with whom we do business. In addition, these conditions may impact our investment portfolio, and we could determine that some of our investments have experienced an other-than-temporary decline in fair value, requiring an impairment charge that could adversely impact our financial condition and results of operations. Also, these conditions may make it more difficult to forecast operating results. If global economic and market conditions, or economic conditions in the United States or other key markets, remain uncertain or persist, spread or deteriorate further, companies may delay or reduce their IT spending, which could adversely affect our business, financial condition and results of operations.

If we fail to continue to establish and maintain strategic distribution and other collaborative relationships with industry-leading companies, we may not be able to attract and retain a larger customer base.

Our success depends in part on our ability to continue to establish and maintain strategic distribution and other collaborative relationships with industry-leading hardware manufacturers, distributors, software vendors and enterprise solutions providers such as Cisco Systems, Inc. (Cisco), Dell Inc. (Dell), Fujitsu Limited (Fujitsu), Hewlett-Packard Co. (HP), International Business Machines Corporation (IBM), NEC Corporation (NEC), Oracle Corporation (Oracle), SAP AG (SAP) and others. These relationships allow us to offer our products and services to a much larger customer base than we would otherwise be able through our direct sales and marketing efforts. We may not be able to maintain these relationships or replace them on attractive terms. In addition, our existing strategic relationships do not, and any future strategic relationships may not, afford us any exclusive marketing or distribution rights. Some of our channel partners offer competing products and services. As a result of these factors, many of the companies with which we have strategic alliances may choose to pursue alternative technologies and develop alternative products and services in addition to or in lieu of our products and services, either on their own or in collaboration with others, including our competitors. Moreover, we cannot guarantee that the companies with which we have strategic relationships will market our products effectively or continue to devote the resources necessary to provide us with effective sales, marketing and technical support.

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We rely, to a significant degree, on indirect sales channels for the distribution of our products and services, and disruption within these channels could adversely affect our business and results of operations.

We use a variety of different indirect distribution methods to sell our products and services, including channel partners such as OEMs, distributors and resellers. A number of these partners in turn distribute via their own networks of channel partners with whom we have no direct relationship. We rely, to a significant degree, on each of our channel partners to select, screen and maintain relationships with its distribution network and for the distribution of our products and services in a manner that is consistent with Red Hat's quality standards. Our channel partners may not distribute and market our products and services effectively.

Recruiting and retaining qualified channel partners and training them in the use of our enterprise technologies requires significant time and resources. If we fail to devote sufficient resources to support and expand our network of channel partners, our results of operations may be adversely affected. In addition, because we rely on channel partners for the indirect distribution of our enterprise technologies, we may have little or no contact with the ultimate end-users of our products, thereby making it more difficult for us to establish brand awareness, ensure proper delivery and installation of our products, support ongoing customer requirements, estimate end-user demand, respond to evolving customer needs and obtain subscription renewals from end-users.

If our indirect distribution channel is disrupted, we may be required to devote more resources to distribute our products directly and support our customers, which may not be as effective and could lead to higher costs, reduced revenue and growth that is slower than expected.

We have entered into and may continue to enter into or seek to enter into business combinations and acquisitions, which may be difficult to complete and integrate, disrupt our business, divert management's attention, adversely affect our financial condition or results of operations and dilute stockholder value.

As part of our business strategy, we have in the past entered into business combinations and acquisitions, and we may continue to do so in the future. Acquisitions present significant challenges and risks, including:

- The difficulty of integrating the operations, systems, technology and personnel of the acquired business;
- The difficulty of gathering full information regarding a company or technology prior to an acquisition, including the identification and assessment of liabilities, claims or other circumstances that could result in litigation or regulatory exposure, unfavorable accounting treatment, unexpected tax implications and other adverse effects on our business;
- The maintenance of acceptable standards, controls, procedures and policies;
- The potential disruption of our ongoing business and distraction of management;
- The impairment of relationships with our employees and customers as a result of any integration of new management and other personnel;
- The inability to maintain relationships with customers of the acquired business;
- Cultural challenges associated with integrating employees from the acquired company into our organization;
- The potential loss of key employees of the acquired business;

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- Challenges in maintaining good and effective relations with existing business partners or of those of the acquired business, including as a result of the changes in the competitive landscape effected by the acquisition;
- The difficulty and expense of incorporating and further developing acquired technology and rights into our products and services and of maintaining quality standards consistent with our brand;
- The potential failure to achieve the expected benefits of the combination or acquisition;

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- Expenses related to the acquisition;
- Claims and liabilities we may assume from the acquired business or technology, or that are otherwise related to the acquisition;
- Operating expenses related to the acquired business or technology;
- The risk of entering new markets in which we have little or no experience;
- Potential impairment of tangible assets and intangible assets and goodwill acquired in acquisitions;
- For foreign transactions, additional risks related to the integration of operations across different cultures and languages, and the economic, political, and regulatory risks associated with specific countries; and
- The dilutive impact on our current stockholders' percentage of ownership as a result of issuing shares of our common stock in connection with an acquisition or business combination.

There can be no assurance that we will manage these challenges and risks successfully. Moreover, if we are not successful in completing acquisitions that we have pursued or may pursue, our business may be adversely affected, and we may incur substantial expenses and divert significant management time and resources. In addition, in pursuing such acquisitions, we could use substantial portions of our available cash as all or a portion of the purchase price. We could also issue additional securities as consideration for these acquisitions, which could cause our stockholders to suffer significant dilution, or we may incur substantial debt. Any acquisition may not generate additional revenue or profit for us, which may adversely affect our operating results.

If we fail to effectively manage our growth, our operations and financial results could be adversely affected.

We have expanded our operations rapidly in recent years. For example, our total revenue increased from \$748.2 million for the fiscal year ended February 28, 2010 to \$909.3 million for the fiscal year ended February 28, 2011. Moreover, the total number of our employees increased from over 3,200 as of February 28, 2010 to over 3,700 as of February 28, 2011 and is expected to generally increase in the foreseeable future. In addition, we continue to explore ways to extend our product and service offerings and geographic reach. Our growth has placed and will likely continue to place a strain on our management systems, information systems, resources and internal controls. Our ability to successfully offer products and services and implement our business plan requires adequate information systems and resources and oversight from our senior management.

As we expand in international markets, these challenges increase as a result of the need to support a growing business in an environment of multiple languages, cultures, customs, legal systems, dispute resolution systems, regulatory systems and commercial practices. As we grow, we must also continue to hire, train, supervise and manage new employees. We may not be able to adequately screen and hire or adequately train, supervise and manage sufficient personnel or develop management, or effectively manage and develop our controls and oversight functions and information systems to adequately manage our expansion effectively. If we are unable to adequately manage our growth and expansion, our business, operating results and financial condition could be materially adversely affected.

We include software licensed from other parties in our enterprise technology offerings, the loss of which could increase our costs and delay software shipments.

We utilize various types of software licensed from unaffiliated third parties in our enterprise technology offerings. Aspects of our business could be disrupted if any of the software we license from others or functional equivalents of this software were no longer available to us, no longer offered to us on commercially reasonable terms or changed in ways or included defects that made the third-party software unsuitable for our use. In these cases, we would be required to either redesign our products to function with software available from other parties, develop these components ourselves or eliminate the functionality, which could result in increased costs, the need to mitigate customer issues, delays in our product shipments and the release of new product offerings and limit the features available in our current or future products.

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We may not be able to continue to attract and retain capable management.

Our future success depends on the continued services and effectiveness of a number of key management personnel. Our ability to retain key management personnel or hire capable new management personnel as we grow may be challenged to the extent the technology sector performs well and/or if companies with more generous compensation packages or greater perceived growth opportunities compete for the same personnel. In addition, historically we have used share-based compensation as a key component of our compensation packages. Changes in the accounting for share-based compensation could adversely affect our earnings or force us to use more cash compensation to attract and retain capable personnel. If the price of our common stock falls, the value of our share-based awards to the recipient is reduced. Such events, or if we are unable to secure shareholder approval for increases in the number of shares eligible for share-based compensation grants, could adversely affect our ability to successfully attract and retain key management personnel. Effective succession planning is also important to our long-term success. Failure to ensure effective transfer of knowledge and smooth transitions involving key management personnel could hinder our strategic planning and execution.

We depend on our key non-management employees, the loss of which could adversely affect our business or stock price and diminish the Red Hat brand.

Competition in our industry for qualified employees, especially technical employees, is intense and from time to time our competitors directly target our employees. The loss of the technical knowledge and industry expertise of any of these individuals could seriously impede our success. Moreover, the loss of these individuals, particularly to a competitor, some of which may be in a position to offer greater compensation, and any resulting loss of customers could reduce our market share and diminish the Red Hat brand and adversely affect our business or stock price. We have from time to time in the past experienced, and we may experience in the future, difficulty in hiring and retaining highly skilled employees with appropriate qualifications.

A number of our key employees have become, or will soon become, vested in a significant amount of their equity compensation awards. Employees may be more likely to leave us after a significant portion of their equity compensation awards fully vest, especially if the shares underlying the equity awards have significantly appreciated in value. If we do not succeed in retaining and motivating our key employees and attracting new key personnel, our business, its financial performance and our stock price may decline.

Our corporate culture has contributed to our success, and if we cannot maintain this culture as we grow, we could lose the innovation, creativity and teamwork fostered by our culture, and our business may be harmed.

We believe that a critical contributor to our success has been our corporate culture, which we believe fosters innovation, creativity and teamwork. As our organization grows, and we are required to implement more complex organizational management structures, we may find it increasingly difficult to maintain beneficial aspects of our corporate culture. If we are unable to maintain our corporate culture, we may find it difficult to attract and retain motivated employees.

Our subscription-based contract model may encounter customer resistance or we may experience a decline in the demand for our products.

We provide Red Hat enterprise technologies under annual or multi-year subscriptions. Through the life of a subscription, a customer is entitled to specified levels of support as well as security updates, bug fixes, functionality enhancements and upgrades to the technology, when and if available, via the Red Hat Customer Portal. While we believe this practice complies with the requirements of the GNU General Public License, and while we have reviewed this practice with the Free Software Foundation, the organization that maintains and provides interpretations of the GNU General Public License, we may still encounter customer resistance to this distribution model or customers may fail to honor the terms of our subscription agreements. To the extent we are

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unsuccessful in promoting or defending this distribution model, our business and operating results could be materially and adversely affected. In addition, our customers generally undertake a significant evaluation process that may result in a lengthy sales cycle. We spend substantial time, effort, and money on our sales efforts without any assurance that our efforts will produce any sales. As technologies and the markets for our enterprise offerings change, our subscription-based contract model may no longer meet the needs of our customers. If we are unable to adapt our contract model to changes in the marketplace, our business and operating results could be adversely impacted.

If our current and future customers do not renew their subscription agreements with us, our operating results may be adversely impacted.

Our customers may not renew their subscriptions for our services after the expiration of their subscription agreements and in fact, some customers elect not to do so. In addition, our customers may opt for a lower-priced edition of our offerings or for fewer subscriptions. We have limited historical data with respect to rates of customer subscription renewals, so we cannot accurately predict customer renewal rates. Our customers' renewal rates may decline or fluctuate as a result of a number of factors, including their level of satisfaction with our services and their ability to continue their operations and spending levels. Government contracts could be subject to future funding that may affect the extension or termination of programs and generally are subject to the right of the government to terminate for convenience or non-appropriation. If we experience a decline in the renewal rates for our customers or they opt for lower-priced editions of our offerings or fewer subscriptions, our operating results may be adversely impacted.

If open source software programmers, most of whom we do not employ, do not continue to develop and enhance open source technologies, we may be unable to develop new products, adequately enhance our existing products or meet customer requirements for innovation, quality and price.

We rely to a significant degree on a number of largely informal communities of independent open source software programmers to develop and enhance our products. For example, Linus Torvalds, a prominent open source software developer, and a relatively small group of software engineers, many of whom are not employed by us, are primarily responsible for the development and evolution of the Linux kernel, which is the heart of the Red Hat Enterprise Linux operating system. If these groups of programmers fail to adequately further develop and enhance open source technologies, we would have to rely on other parties to develop and enhance our products or we would need to develop and enhance our products with our own resources. We cannot predict whether further developments and enhancements to these technologies would be available from reliable alternative sources. In either event, our development expenses could be increased and our product release and upgrade schedules could be delayed. Moreover, if third-party software programmers fail to adequately further develop and enhance open source technologies, the development and adoption of these technologies could be stifled and our products could become less competitive. Delays in developing, completing or shipping new or enhanced products could result in delayed or reduced revenue for those products and could also adversely affect customer acceptance of those offerings.

If third-party enterprise hardware and software providers do not continue to make offerings compatible with our offerings, our software may cease to be competitive and our business and financial performance may be adversely affected.

The competitive position of our offerings is dependent on their compatibility with offerings of third-party enterprise hardware and software companies. To the extent that a software or hardware vendor might have or develop products that compete with ours, the vendor may have an incentive to seek to limit the performance, functionality or compatibility of our offerings when used with one or more of the vendor's offerings. In addition, these vendors may fail to support or issue statements of compatibility or certification of our offerings when used with their offerings. We intend to encourage the development of additional applications that operate on both current and new versions of our offerings by, among other means, attracting third-party developers to Red Hat

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Enterprise Linux and JBoss Enterprise middleware technologies, providing open source tools to create these applications and maintaining our existing developer relationships through marketing and technical support. We intend to encourage the compatibility of our software with various third-party hardware and software offerings by maintaining and expanding our relationships, both business and technical, with relevant independent hardware and software vendors. If we are not successful in achieving these goals, however, our products may not be competitive and our business and financial performance may be adversely affected.

We may be unable to predict the future course of open source technology development, which could reduce the market appeal of our products and damage our reputation.

We do not exercise control over many aspects of the development of open source technology. Different groups of open source software programmers compete with one another to develop new technology. Typically, the technology developed by one group will become more widely used than that developed by others. If we acquire or adopt new technology and incorporate it into our products but competing technology becomes more widely used or accepted, the market appeal of our products may be reduced and that could harm our reputation, diminish the Red Hat brand and result in decreased revenue.

Because of the characteristics of open source software, there are few technology barriers to entry in the open source market by new competitors and it may be relatively easy for competitors, some of which may have greater resources than we have, to enter our markets and compete with us.

One of the characteristics of open source software is that anyone can modify and redistribute the existing open source software and use it to compete with us. Such competition can develop without the degree of overhead and lead time required by traditional proprietary software companies. It is possible for new competitors with greater resources than ours to develop their own open source solutions, potentially reducing the demand for, and putting price pressure on, our solutions. For example, Oracle Corporation (Oracle) has developed its own version of the Linux operating system and sells support both for its version of the Linux operating system and for Red Hat Enterprise Linux. In addition, some competitors make their open source software available for free download and use on an ad hoc basis or may position their open source software as a loss leader. We cannot guarantee that we will be able to compete successfully against current and future competitors or that competitive pressure and/or the availability of open source software will not result in price reductions, reduced operating margins and loss of market share, any one of which could seriously harm our business.

Industry consolidation may lead to increased competition and may harm our operating results.

There has been a trend in industry consolidation in our markets for several years. We expect this trend to continue as companies attempt to strengthen or hold their market positions in an evolving industry and as companies are acquired or are unable to continue operations. For example, in early 2010, Oracle completed its acquisition of Sun Microsystems, Inc. (Sun). Oracle's acquisition of Sun creates a large, integrated supplier of enterprise software that also provides hardware optimized for these software products. We believe that industry consolidation may result in stronger competitors that are better able to compete as sole-source vendors for customers. This could have a material adverse effect on our business, financial condition and results of operations.

Our continued success depends on our ability to adapt to a rapidly changing industry. Investment in new business strategies and initiatives could disrupt our ongoing business and may present risks not originally contemplated.

We operate in highly competitive markets that are characterized by rapid technological change and frequent new product and service announcements. We must continue to invest significant resources in research and development in order to enhance our existing products and services and introduce new high-quality products and services. If we are unable to ensure that our users and customers have a high-quality experience with our

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products and services, then they may become dissatisfied and move to competitors' products and services. In addition, if we are unable to predict user preferences or industry changes, or if we are unable to modify our products and services on a timely basis, we may lose customers. Technological changes, such as the adoption of virtualization and cloud-based technology solutions, may reduce demand for some of our existing product offerings.

Our future success will depend on our ability to adapt to rapidly changing technologies, to adapt our services to evolving industry standards and to improve the performance and reliability of our services. Our failure to adapt to such changes could harm our business. In addition, the widespread adoption of other technological changes could require substantial expenditures to modify or adapt our services or infrastructure.

Delays in developing, completing or shipping new or enhanced offerings and technologies could result in delayed or reduced revenue for those offerings and could also adversely affect customer acceptance of those offerings and technologies. The success of new and enhanced offering introductions depends on several factors, including our ability to develop and complete new products in a timely manner, successfully promote the offerings, manage the risks associated with the offerings, make sufficient resources available to support them and address any quality or other defects in the early stages of introduction.

Moreover, we believe that our continued success depends on our investing in new business strategies or initiatives that complement our strategic direction and product road map. Such endeavors may involve significant risks and uncertainties, including distraction of management's attention away from other business operations, and insufficient revenue generation to offset liabilities and expenses undertaken with such strategies and initiatives. Because these endeavors may be inherently risky, no assurance can be given that such endeavors will not materially adversely affect our business, operating results or financial condition.

Our continued success depends on our ability to maintain and enhance a strong brand.

We believe that the brand identity that we have developed has contributed significantly to the success of our business. We also believe that maintaining and enhancing the Red Hat brand is important to expanding our customer base and attracting talented employees. In order to maintain and enhance our brand, we may be required to make substantial investments that may not be successful. If we fail to promote and maintain our brand, or if we incur excessive costs in doing so, our business, operating results and financial condition may be materially and adversely affected. Maintaining our brand will depend in part on our ability to remain a leader in open source technology and our ability to continue to provide high-quality products and services.

Our Red Hat Enterprise Virtualization and cloud computing offerings are based on emerging technologies, and the potential market for these offerings remains uncertain.

Our Red Hat Enterprise Virtualization and cloud computing product offerings and related services are based on emerging technologies, the success of which will depend on the perceived technological and operational benefits and cost savings associated with the adoption of these technologies. The market for these products and services remains uncertain. In addition, we may make errors in predicting and reacting to relevant business trends. To the extent that the adoption of virtualization and cloud computing offerings occurs more slowly or less pervasively than we expect, the revenue growth associated with these products and services may be slower than currently expected, which could adversely affect our business, operating results and financial condition.

If our growth rate slows, our stock price could be adversely impacted.

As the markets for our products mature and the scale of our business increases, the rate of growth in our product sales will likely be lower than those we have experienced in earlier periods. In addition, to the extent that the adoption of our products and services occurs more slowly or is less pervasive than we expect, our revenue growth rates may slow materially or our revenue may decline substantially, which could adversely affect our stock price.

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Security and privacy breaches may expose us to liability and harm our reputation and business.

Our security and testing measures may not prevent security breaches that could harm our business. Advances in computer capabilities, new discoveries in the field of cryptography, inadequate technology or facility security measures or other factors may result in a compromise or breach of our systems and the data we process. Our security measures may be breached as a result of actions by third parties or employee error or malfeasance. Any compromise of our systems or the data we process could harm our reputation or financial condition and, therefore, our business. In addition, a party who is able to circumvent our security measures or exploit inadequacies in our security measures, could, among other effects, misappropriate proprietary information, cause interruptions in our operations or expose customers to computer viruses or other disruptions or vulnerabilities. Actual or perceived vulnerabilities may lead to claims against us by customers, partners or other third parties, which could be material. While our customer agreements typically contain provisions that seek to limit our liability, there is no assurance these provisions will be enforceable and effective under applicable law. In addition, the cost and operational consequences of implementing further data protection measures could be significant.

We are vulnerable to system failures, which could harm our reputation and business.

We rely on our technology infrastructure for many functions, including selling our products and services, supporting our partners, fulfilling orders and billing, collecting and making payments. Our systems are vulnerable to damage or interruption from natural disasters, power loss, telecommunication failures, terrorist attacks, computer intrusions and viruses, software errors, computer denial-of-service attacks and other events. A significant number of our systems are not redundant, and our disaster recovery planning is not sufficient for every eventuality. Our systems are also subject to break-ins, sabotage and intentional acts of vandalism by internal employees, contractors and third parties. Despite any precautions we may take, such problems could result in, among other consequences, interruptions in our services, which could harm our reputation, business and financial condition. We do not carry business interruption insurance sufficient to protect us from all losses that may result from interruptions in our services as a result of system failures or to cover all contingencies. Any interruption in the availability of our websites and on-line interactions with customers and partners would create a large volume of user questions and complaints that would need to be addressed by our support personnel. If our support personnel cannot meet this demand, customer and partner satisfaction levels may fall, which in turn could cause additional claims, reduced revenue or loss of customers.

A decline in or reprioritization of funding in the U.S. government budget or delays in the budget process could adversely affect our business and future financial performance.

We derive, and expect to continue to derive, a portion of our revenue from U.S. government agencies. Concerns about increased deficit spending, along with continued economic challenges, continue to place pressure on U.S. government spending. The termination of, or delayed or reduced funding for, programs or contracts from which we derive revenue could adversely affect our business and financial performance.

If we fail to comply with our customer contracts or government contracting regulations, our business could suffer.

Our contracts with our customers may include unique and specialized performance requirements. In particular, our contracts with federal, state, provincial and local governmental customers are subject to various procurements regulations, contract provisions and other requirements relating to their formation, administration and performance. Any failure by us to comply with the specific provisions in our customer contracts or any violation of government contracting regulations could result in the imposition of various civil and criminal penalties, which may include termination of contracts, forfeiture of profits, suspension of payments and, in the case of our government contracts, fines and suspension from future government contracting. In addition, we may be subject to *qui tam* litigation, the process by which a private individual sues or prosecutes on behalf of the

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government relating to government contracts and shares in the proceeds of any successful litigation or settlement, which could include claims for up to treble damages. Further, any negative publicity related to our customer contracts or any proceedings surrounding them, regardless of its accuracy, may damage our business and affect our ability to compete for new contracts. There is increased pressure for governments and their agencies, both domestically and internationally, to reduce spending. If our customer contracts are terminated, if we are suspended from government work, or if our ability to compete for new contracts is adversely affected, we could suffer an adverse effect on our business, operating results or financial condition.

RISKS RELATED TO LEGAL UNCERTAINTY

If our products are found or alleged to infringe third-party intellectual property rights, we could be required to redesign our products, replace components of our products, enter into license agreements with third parties and provide infringement indemnification.

We regularly commit to our subscription customers that if portions of our enterprise products are found to infringe any third-party intellectual property rights we will, at our expense and option: (i) obtain the right for the customer to continue to use the product consistent with their subscription agreement with us; (ii) modify the product so that it is non-infringing; or (iii) replace the infringing component with a non-infringing component, and indemnify them against specified infringement claims. Although we cannot predict whether we will need to satisfy these commitments and often have limitations on these commitments, satisfying the commitments could be costly and time consuming and could materially and adversely affect our operating results and financial condition. In addition, our insurance policies would likely not adequately cover our exposure to this type of claim.

We are vulnerable to claims that our products infringe third-party intellectual property rights because our products are comprised of software components, many of which are developed by numerous independent parties, and an adverse legal decision affecting our intellectual property could materially harm our business.

We are vulnerable to claims that our products infringe third-party intellectual property rights, including patent, copyright and trade secrets because our products are comprised of software components, many of which are developed by numerous independent parties. Moreover, because the scope of software patent protection is often not well defined or readily determinable, patent applications in the United States are not publicly disclosed at the time of filing, and the number of software patents that are issued each year is significant and growing, we may be unable to assess the relevance of patents to our products, or take appropriate responsive action, in a timely or economic manner. These risks have been amplified by the increase in third parties whose sole or primary business is to assert such claims. In the past, our products have been subject to intellectual property infringement claims. We expect these claims to increase as the size of our business and market share grow, the number of products and competitors in our industry segment grows and the functionality of products in different industry segments overlaps. Defending patent infringement, copyright infringement and/or trade secret claims, even claims without significant merit, can be time consuming, expensive and divert the attention of technical and management personnel.

An adverse legal decision regarding the intellectual property in and to our technology and other offerings could harm our business and may do so materially. See Legal Proceedings .

Our activities, or the activities of our partners, may violate anticorruption laws and regulations that apply to us.

In many foreign countries, particularly in certain developing economies, it is not uncommon to engage in business practices that are prohibited by regulations that may apply to us, such as the U.S. Foreign Corrupt Practices Act and similar laws. Although we have policies and procedures designed to promote compliance with these laws, our employees, contractors, partners and agents, as well as those companies to which we outsource

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certain of our business operations, may take actions in violation of our policies and procedures. Any violation of our policies and procedures could result in a violation of applicable law and adversely affect our business and financial performance.

We could be prevented from selling or developing our software if the GNU General Public License and similar licenses under which our products are developed and licensed are not enforceable or are modified so as to become incompatible with other open source licenses.

A number of our offerings, including Red Hat Enterprise Linux, have been developed and licensed under the GNU General Public License and similar open source licenses. These licenses state that any program licensed under them may be liberally copied, modified and distributed. It is possible that a court would hold these licenses to be unenforceable or that someone could assert a claim for proprietary rights in a program developed and distributed under them. Any ruling by a court that these licenses are not enforceable, or that open source components of our product offerings may not be liberally copied, modified or distributed, may have the effect of preventing us from distributing or developing all or a portion of our products. In addition, licensors of open source software employed in our offerings may, from time to time, modify the terms of their license agreements in such a manner that those license terms may no longer be compatible with other open source licenses in our offerings or our end user license agreement, and thus could, among other consequences, prevent us from continuing to distribute the software code subject to the modified license.

Our products may contain defects that may be costly to correct, delay market acceptance of our products and expose us to claims and litigation.

Despite our testing procedures, errors have been and will continue to be found in our products after commencement of commercial shipments. This risk is exacerbated by the fact that much of the code in our products is developed by independent parties over whom we exercise no supervision or control. If errors are discovered, we may have to make significant expenditures of capital and devote significant technical resources to analyze, correct, eliminate or work around them and may not be able to successfully do so in a timely manner or at all. Errors and failures in our products could result in a loss of, or delay in, market acceptance of our products, loss of existing or potential customers and delayed or lost revenue and could damage our reputation and our ability to convince commercial users of the benefits of Linux-based operating systems and other open source software products.

In addition, failures in our products could cause system or other failures for our customers who may assert warranty and other claims for substantial damages against us. Although our agreements with our customers often contain provisions which seek to limit our exposure to potential product liability claims, it is possible that these provisions may not be effective or enforceable under the laws of some jurisdictions. In addition, our insurance policies may not adequately limit our exposure to this type of claim. These claims, even if unsuccessful, could be costly and time consuming to defend and could materially harm our business.

Our efforts to protect our trademarks may not be adequate to prevent third parties from misappropriating our intellectual property rights in our trademarks.

Our collection of trademarks is valuable and important to our business. The protective steps we have taken in the past have been, and may in the future continue to be, inadequate to protect and deter misappropriation of our trademark rights. We may be unable to detect the unauthorized use of, or take appropriate steps to enforce, our trademark rights in a timely manner. We have registered some of our trademarks in countries in North America, South America, Europe, Asia, Africa and Australia and have other trademark applications pending in various countries around the world. Effective trademark protection may not be available in every country in which we offer or intend to offer our products and services. We may be unable to prevent third parties from acquiring domain names that are similar to, infringe upon, or diminish the value of our trademarks and other proprietary rights. Failure to adequately protect our trademark rights could damage or even destroy the Red Hat brand and impair our ability to compete effectively. Furthermore, defending or enforcing our trademark rights could result in the expenditure of significant financial and managerial resources.

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Efforts to assert intellectual property ownership rights in our products could impact our standing in the open source community, which could limit our product innovation capabilities and adversely affect our business.

When we undertake actions to protect and maintain ownership and control over our intellectual property, including patents, copyrights and trademark rights, our standing in the open source community could be adversely affected, which in turn could limit our ability to continue to rely on this community, upon which we are dependent, as a resource to help develop and improve our products and further our research and development efforts, and could adversely affect our business.

We are, and may become, involved in disputes and lawsuits that could have a material adverse effect on our performance or stock price.

Lawsuits or legal proceedings may be commenced against us. These disputes and proceedings may involve significant expense and divert the attention of management and other employees. If we do not prevail in these matters, we could be required to pay substantial damages or settlement costs, which could have a material adverse effect on our financial condition or results of operations. See [Legal Proceedings](#) for additional information on this and other certain matters that may affect our performance or stock price.

Our business is subject to a variety of U.S. and international laws regarding data protection.

Our business is subject to federal, state and international laws regarding privacy and protection of user data. We post, on our website, our privacy policies and practices concerning the use and disclosure of user data. Any failure by us to comply with our posted privacy policies or other federal, state or international privacy-related or data protection laws and regulations could result in proceedings against us by governmental entities or others which could have a material adverse effect on our business, results of operations and financial condition.

It is possible that these laws may be interpreted and applied in a manner that is inconsistent with our data practices. If so, in addition to the possibility of fines and penalties, a governmental order requiring that we change our data practices could result, which in turn could have a material adverse effect on our business. Compliance with these regulations may involve significant costs or require changes in business practices that result in reduced revenue. Noncompliance could result in penalties being imposed on us or orders that we cease conducting the noncompliant activity.

RISKS RELATED TO FINANCIAL UNCERTAINTY

Our quarterly and annual operating results may not be a reliable indicator of our future financial performance.

Due to the unpredictability of the technology spending environment, among other reasons, our revenue and operating results have fluctuated and may continue to fluctuate. We base our current and projected future expense levels, in part, on our estimates of future revenue. Our expenses are, to a large extent, fixed in the short term. Accordingly, we may not be able to adjust our spending quickly enough to protect our projected operating results for a quarter if our revenue in that quarter falls short of our expectations. If, among other considerations, our future financial performance falls below the expectations of securities analysts or investors or we are unable to increase or maintain profitability, the market price of our common stock may decline.

Our stock price has been volatile historically and may continue to be volatile. Further, the sale of our common stock by significant stockholders may cause the price of our common stock to decrease.

The trading price of our common stock has been and may continue to be subject to wide fluctuations. Our stock price may fluctuate in response to a number of events and factors, such as quarterly variations in operating results, announcements of technological innovations or new products by us or our competitors, announcements relating to strategic decisions, announcements related to key personnel, customer purchase delays, service disruptions, changes in financial estimates and recommendations by securities analysts, the operating and

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stock price performance of other companies that investors may deem comparable to us, news reports relating to trends in our markets, general economic conditions and other risks listed herein.

In addition, several of our stockholders own significant portions of our common stock. If these stockholders were to sell all or a portion of their holdings of our common stock, then the market price of our common stock could be negatively impacted. The effect of such sales, or of significant portions of our stock being offered or made available for sale, could result in strong downward pressure on our stock price. Investors should be aware that they could experience significant short-term volatility in our stock if such stockholders decide to sell all or a portion of their holdings of our common stock at once or within a short period of time.

We may lack the financial and operational resources needed to increase our market share and compete effectively.

In the market for operating systems, we face significant competition from larger companies with greater financial, operational and technical resources and name recognition than we have. Competitors, which offer hardware-independent multi-user operating systems for Intel platforms and/or Linux and UNIX-based operating systems, include Microsoft Corporation (Microsoft), Oracle, IBM and HP.

In the market for middleware offerings, we face significant competition from larger companies with greater financial, operational and technical resources and name recognition than we have. These competitors include, but are not limited to, IBM, Microsoft and Oracle, all of which offer broad portfolios of enterprise Java and non-Java middleware products. IBM and Oracle bundle hardware and software for their customers, making it more difficult to penetrate these customer bases.

In the market for virtualization and cloud offerings, we face significant competition from larger companies with greater financial, operational and technical resources and name recognition than we have. These competitors include, but are not limited to, VMware, Microsoft, Citrix Systems, Inc. and Oracle.

In the market for services offerings, we face significant competition from larger companies with greater financial, operational and technical resources and name recognition than we have, including those that currently provide service and training related to the Linux operating system as well as other operating systems, particularly UNIX-based operating systems, due to the fact that Linux-and UNIX-based operating systems share many common features. These larger companies, including IBM, Oracle and HP, may be able to leverage their existing service organizations and provide higher levels of consulting and training on a more cost-effective basis than we can.

We may lack the resources needed to compete successfully with our current competitors as well as potential new competitors. Moreover, we compete in certain areas with our strategic partners and potential strategic partners, and this may adversely impact our relationship with an individual partner or a number of partners. Competitive pressures could affect prices or demand for our products and services, resulting in reduced profit margins and loss of market opportunity. We may have to lower the prices of our products and services to stay competitive, which could affect our margins and financial condition. In addition, if our pricing and other factors are not sufficiently competitive, we may lose market share. Industry consolidation may also effect competition by creating larger and potentially stronger competitors in the markets in which we compete, which may have an adverse effect on our business.

We may not be able to meet the financial and operational challenges that we will encounter as our international operations, which represented approximately 43.7% of our total revenue for the fiscal year ended February 28, 2011, continue to expand.

Our international operations accounted for approximately 43.7% of total revenue for the fiscal year ended February 28, 2011. As we expand our international operations, we may have difficulty managing and administering a globally dispersed business and we may need to expend additional funds to, among other

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activities, reorganize our sales force and technical support services team, outsource or supplement general and administrative functions, staff key management positions, obtain additional information technology infrastructure and successfully localize software products for a significant number of international markets, which may negatively affect our operating results.

Additional challenges associated with the conduct of our business overseas that may negatively affect our operating results include:

- Fluctuations in exchange rates;
- Different pricing environments;
- Longer payment cycles and less financial stability of customers;
- Compliance with a wide variety of foreign laws;
- Difficulty selecting and monitoring channel partners outside of the United States;
- Lower levels of availability or use of the internet, through which our software is often delivered;
- Difficulty protecting our intellectual property rights overseas due to, among other reasons, the uncertainty of laws and enforcement in certain countries relating to the protection of intellectual property rights;
- Difficulty in staffing, developing and managing foreign operations as a result of distance, language, legal, cultural and other differences;
- Difficulty maintaining quality standards consistent with the Red Hat brand;
- Export control regulations could prevent us from shipping our products into and out of certain markets;
- Public health risks and natural disasters, particularly in areas in which we have significant operations;
- Limitations on the repatriation and investment of funds and foreign currency exchange restrictions;
- Changes in import/export duties, quotas or other trade barriers could affect the competitive pricing of our products and services and reduce our market share in some countries; and
- Economic or political instability or terrorist acts in some international markets could result in the loss or forfeiture of some foreign assets and the loss of sums spent developing and marketing those assets and the revenue associated with them.

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Any failure by us to effectively manage the challenges associated with the international expansion of our operations could adversely affect our business, operating results and financial condition.

We may be subject to greater tax liabilities.

We are subject to income and other taxes in the U.S. and in numerous foreign jurisdictions. Our domestic and foreign tax liabilities are subject to the allocation of revenue and expenses in different jurisdictions. Additionally, the amount of taxes paid is subject to our interpretation of applicable tax laws in the jurisdictions in which we operate. Significant judgment is required in determining our worldwide provision for income taxes. In the ordinary course of our business, there are many transactions and calculations where the ultimate tax determination is uncertain. We are regularly subject to audits by tax authorities. Although we believe our tax estimates are reasonable, the final determination of tax audits and any related litigation could be materially different from our historical income tax provisions and accruals. The results of an audit or litigation could have a material effect on our financial statements in the period or periods for which that determination is made.

We earn a significant amount of our operating income from outside the U.S., and any repatriation of funds currently held in foreign jurisdictions may result in higher effective tax rates for the company. In addition, there have been proposals to change U.S. tax laws that would significantly impact how U.S. multinational corporations

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are taxed on foreign earnings. Although we cannot predict whether or in what form this proposed legislation will pass, if enacted it could have a material adverse impact on our tax expense and cash flow.

Because we recognize revenue from subscriptions for our service over the term of the subscription, downturns or upturns in sales may not be immediately reflected in our operating results.

We generally recognize subscription revenue from customers ratably over the term of their subscription agreements, which are generally 12 to 36 months. As a result, much of the revenue we report in each quarter is deferred revenue from subscription agreements entered into during previous quarters. Consequently, a decline in subscriptions in any one quarter will not necessarily be fully reflected in the revenue in that quarter and will negatively affect our revenue in future quarters. In addition, we may be unable to adjust our cost structure to reflect this reduced revenue. Accordingly, the effect of significant downturns in sales and market acceptance of our service, and potential changes in our rate of renewals, may not be fully reflected in our results of operations until future periods. Our subscription model also makes it difficult for us to rapidly increase our revenue through additional sales in any period, as revenue from new customers must be recognized over the applicable subscription term.

If our goodwill or amortizable intangible assets become impaired, we may be required to record a significant charge to earnings.

Under generally accepted accounting principles, we review our amortizable intangible assets for impairment when events or changes in circumstances indicate the carrying value may not be recoverable. Goodwill is required to be tested for impairment at least annually. Factors that may be considered a change in circumstances indicating that the carrying value of our goodwill or amortizable intangible assets may not be recoverable include a decline in stock price and market capitalization, reduced future cash flow estimates and slower growth rates in our industry. We may be required to record a significant charge to earnings in our financial statements during the period in which any impairment of our goodwill or amortizable intangible assets is determined resulting in an adverse impact on our results of operations.

We may be exposed to potential risks if we do not have an effective system of disclosure controls or internal controls.

We must comply, on an on-going basis, with the requirements of the Sarbanes-Oxley Act of 2002, including those provisions that establish the requirements for both management and auditors of public companies with respect to reporting on internal control over financial reporting. We cannot be certain that measures we have taken, and will take, will be sufficient or timely completed to meet these requirements on an on-going basis, or that we will be able to implement and maintain adequate disclosure controls and controls over our financial processes and reporting in the future, particularly in light of our rapid growth, international expansion and changes in our products and services, which are expected to result in on-going changes to our control systems and areas of potential risk.

If we fail to maintain an effective system of disclosure controls or internal control over financial reporting, including satisfaction of the requirements of the Sarbanes-Oxley Act, we may not be able to accurately or timely report on our financial results or adequately identify and reduce fraud. As a result, the financial position of our business could be harmed; current and potential future shareholders could lose confidence in us and/or our reported financial results, which may cause a negative effect on our trading price; and we could be exposed to litigation or regulatory proceedings, which may be costly or divert management attention.

Changes in accounting principles and guidance, or their interpretation, could result in unfavorable accounting charges or effects, including changes to previously filed financial statements, which could cause our stock to decline.

We prepare our consolidated financial statements in accordance with accounting principles generally accepted in the U.S. These principles are subject to interpretation by the SEC and various bodies formed to

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interpret and create appropriate accounting principles and guidance. A change in these principles or guidance, or in their interpretations, may have a significant effect on our reported results and may retroactively affect previously reported results.

Our investment portfolio is subject to credit and illiquidity risks and fluctuations in the market value of our investments and interest rates. These risks may result in an impairment in or the loss of all or a portion of the value of our investments, an inability to sell our investments or a decline in interest income.

We maintain an investment portfolio of various holdings, types and maturities. Our portfolio as of February 28, 2011 consisted primarily of money market funds, U.S. government securities, certificates of deposit, agency securities, corporate securities and equity securities. Although we follow an established investment policy and seek to minimize the risks associated with our investments by investing primarily in investment grade, highly liquid securities and by limiting the amounts invested with any one institution, type of security or issuer, we cannot give assurances that the assets in our investment portfolio will not lose value or become impaired, or that our interest income will not decline.

We may be required to record impairment charges for other-than-temporary declines in fair market value in our investments. Future fluctuations in economic and market conditions could adversely affect the market value of our investments, and we could record additional impairment charges and lose some or all of the principal value of investments in our portfolio. A total loss of an investment or a significant decline in the value of our investment portfolio could adversely affect our operating results and financial condition. For information regarding the sensitivity of and risks associated with the market value of portfolio investments and interest rates, see [Quantitative and Qualitative Disclosures About Market Risk](#) .

Our investments in private companies are subject to risk of loss of investment capital. Some of these investments may have been made to further our strategic objectives and support our key business initiatives. Our investments in private companies are inherently risky because the markets for the technologies they have under development are typically in the early stages and may never materialize. We could lose the value of our entire investment in these companies.

We are subject to risks of currency fluctuations and related hedging operations.

A portion of our business is conducted in currencies other than the U.S. dollar. Changes in exchange rates among other currencies and the U.S. dollar will affect our net revenue, operating expenses and operating margins. We cannot predict the impact of future exchange rate fluctuations. As we expand international operations, our exposure to exchange rate fluctuations increases. We use financial instruments, primarily forward purchase contracts, to economically hedge U.S. dollar and other currency commitments arising from trade accounts receivable, trade accounts payable and fixed purchase obligations. If these hedging activities are not successful or we change or reduce these hedging activities in the future, we may experience significant unexpected expenses from fluctuations in exchange rates. For information regarding our hedging activity, see [Quantitative and Qualitative Disclosures About Market Risk](#) .

Natural disasters and geo-political events could adversely affect our financial performance.

The occurrence of one or more epidemics or natural disasters, such as the recent earthquakes in Japan and related events, or geo-political events, such as civil unrest or terrorist attacks in a country in which we operate or in which our suppliers or our customers are located, could disrupt and adversely affect our operations and financial performance. Such events could result in physical damage to, or the complete loss of, one or more of our facilities, the lack of an adequate work force in a market, the inability of our associates to reach or have transportation to our facilities directly affected by such events, the evacuation of the populace from areas in which our facilities are located, changes in the purchasing patterns of our customers, the temporary or long-term disruption in the supply of computer hardware and related components, the disruption or delay in the manufacture and transport of goods overseas, the disruption of utility services to our facilities or to suppliers, partners or customers, and disruption in our communications with our customers.

Table of Contents**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS****Issuer Purchases of Equity Securities**

The table below sets forth information regarding the Company's purchases of its common stock during its third fiscal quarter ended November 30, 2011:

Issuer Purchases of Equity Securities

Period	Total Number of Shares Purchased (1)	Weighted Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (2)	Maximum Number (or Approximate Dollar Value) of Shares that May Yet Be Purchased Under the Plans or Programs (2)
September 1, 2011 - September 30, 2011	0	\$ 0.00	0	\$ 162.8 million
October 1, 2011 - October 31, 2011	433,980	\$ 46.36	0	\$ 162.8 million
November 1, 2011 - November 30, 2011	0	\$ 0.00	0	\$ 162.8 million
Total	433,980	\$ 46.36	0	\$ 162.8 million

- (1) During the three months ended November 30, 2011, the Company withheld an aggregate of 433,980 shares of common stock from employees to satisfy minimum tax withholding obligations relating to the vesting of restricted share awards. These shares were not withheld pursuant to the program described in Note 2 below.
- (2) On March 24, 2010, the Company announced that its Board of Directors had authorized the repurchase of up to an aggregate of \$300.0 million of the Company's common stock from time to time in open market or privately negotiated transactions, as applicable. The program will expire on the earlier of (i) March 31, 2012 or (ii) a determination by the Board of Directors, Chief Executive Officer or Chief Financial Officer to discontinue the program. See NOTE 10 to the Consolidated Financial Statements for information regarding the Company's \$300.0 million stock repurchase program announced on March 24, 2010. See NOTE 15 to the Consolidated Financial Statements for a discussion of shares repurchased under the program subsequent to November 30, 2011.

ITEM 6. EXHIBITS

(a) List of Exhibits

Exhibit No.	Exhibit
2.1+	Agreement and Plan of Merger, dated as of October 3, 2011, among Red Hat, Inc., a Delaware corporation, Gluster, Inc., a Delaware corporation, Matte Acquisition Corporation, a Delaware corporation and wholly-owned subsidiary of Red Hat, Inc., and Fortis Advisors LLC, as the Holder Agent (incorporated by reference to Exhibit 2.1 to the registrant's Current Report on Form 8-K filed with the SEC on October 4, 2011 (File No. 001-33162)).
31.1	Certification of the registrant's Chief Executive Officer pursuant to Rule 13a-14(a)/Rule 15(d)-14(a) under the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of the registrant's Chief Financial Officer pursuant to Rule 13a-14(a)/Rule 15(d)-14(a) under the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification of the registrant's principal executive officer and principal financial officer pursuant to 18 U.S.C. Section 1350

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101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema
101.CAL	XBRL Taxonomy Extension Calculation Linkbase

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Exhibit No.	Exhibit
101.DEF	XBRL Taxonomy Extension Definition Linkbase
101.LAB	XBRL Taxonomy Extension Label Linkbase
101.PRE	XBRL Taxonomy Extension Presentation Linkbase

- * Indicates a management contract or compensatory plan, contract or arrangement.
- + Previously filed.

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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.

RED HAT, INC.

Date: January 9, 2012

By: */s/* JAMES M. WHITEHURST
James M. Whitehurst

President and Chief Executive Officer

(Duly Authorized Officer on Behalf of the Registrant)

RED HAT, INC.

Date: January 9, 2012

By: */s/* CHARLES E. PETERS, JR.
Charles E. Peters, Jr.

Executive Vice President and Chief Financial Officer

(Principal Financial Officer)

RED HAT, INC.

Date: January 9, 2012

By: */s/* MARK E. COOK
Mark E. Cook

Vice President and Controller

(Principal Accounting Officer)