

RED HAT INC
Form 10-K
April 24, 2014
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

x **Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the fiscal year ended February 28, 2014

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 of Incorporation)

06-1364380

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

100 East Davie Street, Raleigh, North Carolina 27601

(Address of principal executive offices, including zip code)

(919) 754-3700

(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, \$0.0001 par value	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large accelerated filer <input checked="" type="checkbox"/>	Accelerated filer <input type="checkbox"/>
Non-accelerated filer <input type="checkbox"/>	Smaller reporting company <input type="checkbox"/>

(Do not check if a smaller reporting company)

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

The aggregate market value of the common equity held by non-affiliates of the registrant as of August 30, 2013 was approximately \$8.0 billion based on the closing price of \$50.52 of our common stock as reported by the New York Stock Exchange on August 30, 2013. For purposes of the immediately preceding sentence, the term affiliate consists of each director, executive officer and greater than 10% stockholder of the registrant. There were 189,344,281 shares of common stock outstanding as of April 16, 2014.

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DOCUMENTS INCORPORATED BY REFERENCE

Portions of Red Hat, Inc.'s Definitive Proxy Statement to be filed with the Securities and Exchange Commission and delivered to stockholders in connection with its annual meeting of stockholders to be held on August 7, 2014 are incorporated by reference into Part III of this Form 10-K. With the exception of the portions of the Proxy Statement expressly incorporated into this Annual Report on Form 10-K by reference, such document shall not be deemed filed as part of this Annual Report on Form 10-K.

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CAUTIONARY NOTE ON FORWARD-LOOKING STATEMENTS

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 any statement that is not strictly a historical statement could be deemed to be a forward-looking 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, Inc. together with its subsidiaries (Red Hat) and its partners). Words such as anticipate, believe, estimate, expect, intend, plan, project, will, and similar expressions, may also identify such forward-looking statements. Red Hat may also make forward-looking statements in other filings made with the Securities and Exchange Commission (SEC), press releases, materials delivered to stockholders and oral statements made by management. Investors are cautioned that these forward-looking statements are inherently uncertain, 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 in Item 1A, Risk Factors and elsewhere in this report as well as in Red Hat's other filings with the 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. Moreover, Red Hat operates in a rapidly changing and highly competitive environment. It is impossible to predict all risks and uncertainties or assess the impact of any new risk or uncertainty on our business or any forward-looking statement. 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.

ITEM 1. BUSINESS

OVERVIEW

Red Hat is a leading global provider of open source software solutions, using a community-powered approach to develop and offer reliable and high-performing operating system, virtualization, middleware, storage and cloud technologies.

Our business model

Development. Red Hat employs an open source software development model that uses the collective input, resources and knowledge of a global community of contributors who collaborate to develop, maintain and enhance software. We believe this model offers advantages to Red Hat because we are able to offer our software more quickly and with lower development cost than is typical of many software vendors who use a proprietary model to develop their products. Our open source development model also benefits our customers, who are able to take advantage of the quality and value of open source software that we help to develop, aggregate, integrate, test, certify, deliver, maintain, enhance and support.

Licensing. We typically distribute our software offerings under open source licenses that permit access to the software's human-readable source code. These licenses also provide relatively broad rights for recipients of the software to use, copy, modify and redistribute the software. These broad rights afford significant latitude for our customers to inspect, suggest changes, customize and enhance the software if they so choose.

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Subscriptions. We provide our software offerings primarily under annual or multi-year subscriptions. A subscription generally entitles a customer to, among other things, a specified level of support, as well as new versions of the software, security updates, fixes, functionality enhancements and upgrades to the technology, if and when available, and compatibility with an ecosystem of certified hardware and software.

Our offerings

Our software offerings are designed to provide customers with high-performing, scalable, flexible, reliable, secure and stable technologies that meet the information technology (IT) infrastructure needs of enterprises. These offerings include:

- *Red Hat Enterprise Linux* an operating system that runs on a broad range of hardware, including mainframes, servers and work stations.
- *Red Hat Enterprise Virtualization* software that allows customers to manage a common hardware infrastructure to run multiple operating systems and applications. Our virtualization offerings are designed to permit customers to optimize resource allocation and operational flexibility in their IT environments.
- *Red Hat JBoss Middleware* a family of offerings and technologies used for developing, deploying and managing enterprise applications.
- *Red Hat Storage Server* software that enables enterprises to treat physical storage as a scalable, standardized, centrally managed pool of virtual storage.
- *Red Hat cloud offerings* enterprise technologies that enable customers to take advantage of the benefits of cloud computing. Cloud computing is a term used to refer to an IT infrastructure that allows multiple users to access a shared pool of computing resources (such as networks, processors, storage platforms, operating systems and applications). In a cloud environment, computing resources may be deployed more rapidly and efficiently, and usage may be increased or decreased as needed.

We also offer a wide range of services that are designed to help customers derive additional value from Red Hat enterprise technologies. Our consulting services assist customers to enable infrastructure, application integration, middleware and cloud solutions. Our support services provide customers with technical support to assist with implementing, configuring and using Red Hat enterprise technologies. Our training services help populate customers and partners with skilled Red Hat certified professionals.

Red Hat, Inc. was incorporated in Connecticut in March 1993 as ACC Corp., Inc., which subsequently changed its name to Red Hat Software, Inc. Red Hat Software, Inc. reincorporated in Delaware in September 1998 and changed its name to Red Hat, Inc. in June 1999. Except as otherwise indicated, all references in this report to we , us , our , the Company , the registrant , or Red Hat refer to Red Hat, Inc. and its subsidiaries. Our fiscal year ends on the last day of February, and we identify our fiscal years by the calendar years in which they end. For example, we refer to the fiscal year ended February 28, 2014 as fiscal 2014.

OUR BUSINESS

We use the open source software development and licensing model to provide our enterprise offerings to customers primarily on a subscription basis. Subscriptions for our offerings are marketed and sold to customers directly and through channel partners.

Development and licensing of Red Hat s open source offerings

The open source software development model allows us to use the collective input, resources and knowledge of global communities of contributors who collaborate to develop, maintain and enhance software.

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We develop our enterprise offerings by working with these open source development communities, often in a leadership role. Red Hat sponsors a number of open source communities, including the Fedora Project, GlusterFS, the JBoss community projects and OpenShift Origin. We are also an active participant in other communities such as OpenStack. Our role helps us to benefit from the efforts of these communities, which we believe allows us to reduce both development cost and time and enhance acceptance and support of our offerings and technologies. Additionally, the open and transparent nature of these communities provides our customers and potential customers with access and insights into, and the ability to influence, the future direction of our enterprise offerings.

Under the open source licensing model, a software developer distributes the human-readable source code version of the software under an open source license, such as the GNU General Public License (GPL) or GNU Lesser General Public License. Open source licenses provide relatively broad rights for recipients of the software to use, copy, modify and redistribute the software. These rights afford significant latitude for recipients to inspect, suggest changes, customize or enhance the software.

The open source model provides an inherent level of transparency and choice that contrasts with the proprietary software model. Under the proprietary software model, a software vendor generally develops the software itself or acquires components from other vendors, without the input from a wider community of participants. The vendor generally licenses to the user only the machine-readable binary (or object) code version of the software, with no or limited rights to copy, modify or redistribute the software, and does not make the underlying source code available to the user or other developers. Moreover, peer review and collaborative enhancements are more difficult because of the lack of access to the source code.

The growth of the Internet has greatly increased the scale and efficiency of open source software development through the availability of collaborative technologies, such as email lists, code repositories and websites. These technologies have enabled a global community of developers to collaborate on more complex open source projects, many of which are commercially funded.

We believe that open source software is a viable and arguably superior alternative to traditional proprietary software for the enterprise customer. Open source software, as compared to proprietary software, offers a number of benefits, including:

- enabling an enterprise customer s in-house development team to collaborate and innovate with a global community of independent developers and testers;
- providing an enterprise customer s in-house development team access to both binary and source code, and broader rights to copy, modify and redistribute the software;
- offering an enterprise customer greater flexibility through open rather than proprietary protocols and formats;
- permitting an enterprise customer ongoing access to improvements made to the software that are distributed by others; and
- allowing an enterprise customer to inspect and help diagnose problems more easily and customize the software to suit its particular needs.

Subscription business model

We provide our software offerings to our customers primarily under annual or multi-year subscriptions. Our subscription business model is designed to provide customers with a comprehensive technology solution for the duration of their subscription. A subscription generally entitles a customer to, among other things, a specified level of support, as well as new versions of the software, security updates, fixes, functionality enhancements and upgrades to the technology, if and when available, and compatibility with an ecosystem of certified hardware and

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software applications. We offer customers subscription options that have varying levels of customer support to which the customer is entitled. In addition, our customers are eligible to participate in Red Hat's Open Source Assurance program, which provides certain protections in the event there is an intellectual property infringement issue with our enterprise offerings.

Our subscription business model contrasts with the typical proprietary software license model from a revenue recognition perspective. Under a proprietary software license model, the vendor typically recognizes license revenue in the period that the software is initially licensed. In contrast, under our subscription model, we generally defer revenue when we bill the customer and recognize revenue over the life of the subscription term.

Distribution of Red Hat enterprise offerings

We make Red Hat enterprise offerings available directly to customers and indirectly through various channels of distribution. Our direct sales channels include our sales force and our web store. Our indirect sales channels include cloud computing providers, distributors, independent software vendors (ISVs), systems integrators (SIs), and value added resellers (VARs). In addition, hardware original equipment manufacturers (OEMs) pre-load and support Red Hat enterprise offerings on their hardware products and also sell their hardware together with Red Hat enterprise offerings as part of pre-configured solutions. Red Hat Enterprise Linux and Red Hat JBoss Middleware enterprise offerings also have gained widespread support from leading ISVs, independent hardware vendors (IHVs), and SIs. With the support and tools we make available, many of these companies have engineered and certified that their technologies run on or with Red Hat enterprise offerings, and, in some cases, IHVs and ISVs have built their products and solutions using our enterprise offerings. We believe widespread support from these companies helps to increase the level of market acceptance and adoption of our enterprise offerings.

Support by leading technology providers

To facilitate the widespread deployment of Red Hat offerings, we have focused on gaining broad support for our offerings from technology providers that are critical to enterprises. For example, leading ISVs with applications that run on, or with, our enterprise technologies include BMC Software, Inc. (BMC), CA, Inc. (CA), EMC Corporation (EMC), Hewlett-Packard Company (HP), International Business Machines Corporation (IBM), Microsoft Corporation (Microsoft), Oracle Corporation (Oracle), SAP AG (SAP), SAS Institute Inc. (SAS), Symantec Corporation (Symantec) and VMware, Inc. (VMware). In addition, we have certification and pre-load arrangements with leading hardware vendors including Cisco Systems, Inc. (Cisco), Dell Inc. (Dell), Fujitsu Limited (Fujitsu), HP, Hitachi, Ltd (Hitachi), IBM, Lenovo Group Limited (Lenovo), and NEC Corporation (NEC). We also have certification agreements with leading networking and storage companies including Cisco, EMC, Ericsson Inc., HP, NetApp, Inc. (NetApp), Nokia Corporation, and Nokia Siemens Networks. We also have strategic relationships with leading semiconductor and technology companies, such as Advanced Micro Devices, Inc., ARM Holdings plc, and Intel Corporation, and cloud providers, such as Amazon.com, Inc. (Amazon), Fujitsu, Google Inc. (Google), IBM and Rackspace Hosting, Inc. (Rackspace).

Factors influencing our success

We believe our success is influenced by:

- the extent to which we can expand the breadth and depth of our enterprise offerings;
- our ability to enhance the value of Red Hat enterprise offerings through frequent and continuing innovation while maintaining stable platforms over multi-year periods;
- our ability to generate increasing revenue from channel partner and other strategic relationships, including cloud computing providers, distributors, IHVs, ISVs, OEMs, SIs, and VARs;

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- our ability to generate new and recurring revenue for Red Hat enterprise offerings;
- the widespread and increasing deployment of open source technologies by enterprises and similar institutions, such as government agencies and universities; and
- our ability to provide customers with consulting and training services that generate additional revenue.

Geographic areas and segment reporting

As of February 28, 2014, Red Hat had more than 80 locations around the world, including offices in North America, South America, Europe, Asia and Australia. Red Hat has three geographic operating segments: the Americas (U.S., Canada and Latin America), EMEA (Europe, Middle East and Africa) and Asia Pacific. These segments are aggregated into one reportable segment due to the similarity in the nature of offerings, 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). See NOTE 2 Summary of Significant Accounting Policies and NOTE 20 Segment Reporting to our Consolidated Financial Statements for further discussion of our operating segments. See Item 1A, Risk Factors, for a discussion of some of the risks attendant to our operations, including foreign operations.

Subscription revenue by product group

Subscription revenue for our Infrastructure-related offerings (Red Hat Enterprise Linux, Red Hat Enterprise Virtualization and related offerings) as a percentage of our total revenue were 76.3%, 77.4% and 76.8% for fiscal 2014, fiscal 2013 and fiscal 2012, respectively. Subscription revenue for our Application Development-related offerings (Red Hat JBoss Middleware) and other emerging technology offerings (including Red Hat Storage Server and our cloud offerings) as a percentage of our total revenue were 10.8%, 9.1% and 8.4% for fiscal 2014, fiscal 2013 and fiscal 2012, respectively. For additional financial information about our products and services, see NOTE 20 Segment Reporting to our Consolidated Financial Statements.

Backlog

The total value of all non-cancellable subscription and service agreements at February 28, 2014 included deferred revenue classified as a current liability of \$966.8 million, long-term deferred revenue of \$322.4 million and backlog (the value of customer contracts to be billed in the future) not reflected in our financial statements in excess of \$270.0 million. The total value of all non-cancellable subscription and service agreements at February 28, 2013 included deferred revenue classified as a current liability of \$830.5 million, long-term deferred revenue of \$259.5 million and backlog not reflected in our financial statements in excess of \$280.0 million. The amount of backlog at February 28, 2014 that we expect to be billed during the fiscal year ending February 28, 2015 is in excess of \$190.0 million.

We report our off-balance sheet backlog as a conservative approximation, often describing the amount as in excess of , primarily because the value of underlying contracts is derived from data not yet subjected to the complete application of our revenue recognition policies. We endeavor to derive the value of our off-balance sheet backlog in a consistent manner year over year and therefore believe the amounts are comparable.

Seasonality

Our fourth fiscal quarter has historically been our strongest quarter for billing both new business and renewals. For a more detailed discussion, see Part II, Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations. We also have historically experienced a seasonal decline in our services revenue during our fiscal fourth quarter as compared to our fiscal third quarter.

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BUSINESS STRATEGY

Our business strategy is to (i) promote the widespread adoption of Red Hat enterprise offerings by enterprise customers globally, (ii) expand our virtualization, storage, cloud and other enterprise offerings, (iii) invest in the development of open source technologies, (iv) increase revenue from our existing customer base, (v) increase revenue by promoting a range of services to help our customers derive additional value, (vi) expand routes to market, (vii) grow our presence in international markets and (viii) pursue strategic acquisitions and alliances.

Promote the widespread adoption of Red Hat enterprise offerings by enterprise customers globally

Many of our customers use Red Hat Enterprise Linux and Red Hat JBoss Middleware for mission-critical areas of their IT infrastructure. In addition, we see increasing interest and usage among customers for our virtualization, storage and cloud offerings. We seek to promote further adoption of our enterprise offerings by enhancing the value of our offerings through frequent and continuing innovations to these offerings while maintaining stable platforms over multi-year periods. We believe that our low-cost, high-value offerings are a catalyst for change in the IT industry, enabling new deployments and migrations, which encourage a larger ecosystem of compatible hardware and software solutions. We also seek to encourage users of free versions of our enterprise technologies to become paying customers by helping these users understand the value of our subscription offerings.

Expand our virtualization, storage, cloud and other enterprise offerings

We intend to continue to expand our enterprise virtualization suite of server, client and management offerings to enable customers to increase their deployments of virtualization in enterprise environments. We also expect to continue to invest resources to further develop and market our storage and high-performance distributed computing offerings. Moreover, we intend to continue to leverage and build upon our technologies that seek to optimize resource allocation and enhance performance and flexibility in cloud computing environments.

Invest in the development of open source technologies

We intend to continue to invest significant resources in the development of open source technologies, capitalizing on our substantial experience working with open source development communities. We expect this continued investment to take the form of expenditures on internal development efforts, as well as continued funding of third-party open source projects and the expansion of our developer services.

Increase revenue from our existing customer base

We seek to build upon the relationships we have with our current customers in an effort to generate additional revenue by renewing and increasing existing subscriptions and promoting our other enterprise technology offerings.

Increase revenue by promoting a range of services to help our customers derive additional value

We seek to increase revenue by providing additional consulting and other targeted services. We also enable our partners to provide services that promote growth in our subscription revenue. These services are designed to help customers derive additional value from Red Hat enterprise offerings.

Expand routes to market

We intend to continue to grow our direct sales channel as well as our cloud computing providers, distributors, IHVs, ISVs, OEMs, VARs and other channel partner networks on a global basis. In addition, we are

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enhancing our relationships with SIs in order to expand our reach to customers who traditionally rely on SIs for advice and recommendations regarding their technology purchases.

Grow our presence in international markets

We have operations in a number of countries in the Americas, EMEA and Asia Pacific, with over 80 locations worldwide. We expect to continue to expand our operations geographically. See NOTE 20 Segment Reporting to our Consolidated Financial Statements for a discussion of our revenue by geographic area.

Pursue strategic acquisitions and alliances

We expect to continue to pursue a selective acquisition strategy as opportunities arise to complement and expand our enterprise technology offerings and service capabilities. We also intend to create and extend our strategic alliances where it is beneficial to our business. To facilitate the widespread deployment of Red Hat offerings, we will continue efforts to build broader and deeper relationships with providers of hardware, software, cloud computing and SI services critical to enterprises.

PRODUCTS AND SERVICES

Red Hat's software offerings are designed to provide enterprises with high-performing, scalable, flexible, reliable, secure and stable technologies that meet customers' IT needs, both on-premise (i.e., running on computers located within an enterprise's premises) and in a cloud. Our service offerings, principally directed toward our enterprise customers and the leading hardware providers with whom we have strategic or channel partner relationships, include consulting, support, and training.

Infrastructure-related offerings

Red Hat Enterprise Linux technologies. Red Hat Enterprise Linux is an operating system built with various open source software components, including the Linux kernel, and is designed expressly for enterprise computing. An operating system is the software that allows a computer and its various hardware and software components to interact. A worldwide community of developers collaborates to improve Linux software components, and we believe we are able to integrate the best of those improvements into our stable, yet innovative and high-performing Red Hat Enterprise Linux platform. Moreover, Red Hat Enterprise Linux enjoys the support of major OEMs, IHVs, ISVs and other technology partners, increasing the interest of developers in adding further enhancements to the Linux kernel.

Red Hat Enterprise Linux delivers features required for enterprise deployments, including support for a wide range of ISV applications from vendors, such as BMC, CA, EMC, HP, IBM, Microsoft, Oracle, SAP, SAS, Symantec, and VMware; certification on multiple architectures and leading OEM platforms, including platforms offered by Cisco, Dell, Fujitsu, HP, Hitachi, IBM, Lenovo, and NEC; and comprehensive technical support, with up to 24x7, one-hour response, available from both Red Hat and selected ISV and OEM partners.

In addition, Red Hat offers a portfolio of add-ons that extends the features of Red Hat Enterprise Linux. These add-ons, which are designed to tailor a customer's computing environment to suit its specific requirements, include:

- *High Availability* provides failover services between nodes within a cluster intended to make applications more resistant to downtime.
- *Resilient Storage* enables a shared storage or clustered file system to access the same storage device over a network.

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- *Network Load Balancer* provides redundancy for web servers, databases, networking and storage, intended to maximize throughput, decrease response time, and increase reliability and uptime.
- *Smart Management* includes Red Hat Network Satellite management and provisioning modules that allow a customer to provision, patch, configure and control Red Hat Enterprise Linux development, test and production systems.
- *Extended Lifecycle Support* provides software security updates, fixes and support after Red Hat's published end of life date for certain versions of Red Hat Enterprise Linux.
- *Extended Update Support* extends the support period of a Red Hat Enterprise Linux update for up to 24 months to give enterprise customers more flexibility with their resource and deployment cycles.

We believe that these add-ons provide customers with increased features, flexibility and choice.

Red Hat Enterprise Virtualization. Red Hat Enterprise Virtualization includes standalone virtualization functionality and management tools for both server and desktop deployments. Virtualization allows a single computer system to function as multiple virtual systems by abstracting operating systems and application software from the underlying hardware infrastructure, thereby allowing customers to use a common hardware infrastructure to run multiple operating systems and applications. Virtualization is intended to enhance the capital and operational efficiencies of enterprises by increasing server utilization and deployment flexibility.

Red Hat Enterprise Virtualization combines the Kernel-based Virtual Machine (KVM) hypervisor included in the Linux kernel with the oVirt open source virtualization management system to offer enterprises a platform for large-scale virtualization initiatives and private cloud deployments. Red Hat Enterprise Virtualization is designed to support virtual machines running Red Hat Enterprise Linux and its wide ecosystem of certified hardware systems and software applications, as well as Microsoft Windows operating systems and application servers supported under Microsoft Windows Server Virtualization Validation Program (SVVP).

Application Development-related and other emerging technology offerings

Red Hat JBoss Middleware. Red Hat JBoss Middleware is a family of middleware offerings for developing, deploying, and managing applications that are accessible via the Internet, enterprise intranets, extranets, clouds and virtual private networks. Middleware generally refers to the software that enables the development, operation and integration of applications and other software. Red Hat JBoss Middleware integrates, tests, and refines enterprise-ready features from JBoss and other community projects into supported, stable, enterprise-class middleware distributions.

Red Hat JBoss Middleware offerings consist of a number of deployment platforms and tools, including:

- *Red Hat JBoss Enterprise Application Platform* provides an environment for building, hosting and deploying applications and services. It includes Red Hat JBoss Application Server, Red Hat JBoss Cache, Red Hat JBoss Transactions, Red Hat JBoss Messaging and Red Hat JBoss Web Services.
- *Red Hat JBoss Web Server* provides an enterprise-class web server solution for large-scale websites and lightweight web applications that utilize Apache Tomcat and Apache Web Server.
- *Red Hat JBoss Fuse Service Works* provides an environment for deploying and integrating service-oriented architecture services and business processes.
- *Red Hat JBoss Portal* provides a platform for deploying standards-based portals.

- *Red Hat JBoss BRMS* provides a platform for business rules management and complex event processing.
- *Red Hat JBoss BPM Suite* provides a business process management platform that combines business rules management and complex event processing with a business process management system to help

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customers model and encode business processes, policies and rules and measure the results of business activities.

- *Red Hat JBoss Developer Studio* provides an integrated development environment for developing, testing and deploying rich web applications, enterprise applications and service-oriented architecture services.
- *Red Hat JBoss Data Virtualization* provides a solution for integration of distributed data sources.
- *Red Hat JBoss Data Grid* provides a scalable, distributed in-memory data grid that permits cost-effective scaling of big data tiers.
- *Red Hat JBoss Fuse and Red Hat JBoss A-MQ* provide customers messaging and integration tools for distributed applications.
- *Red Hat JBoss Operations Network* provides built-in management and monitoring capabilities to administer JBoss application environments.

Red Hat Storage Server. Red Hat Storage Server is a software-defined storage platform that enables users to treat storage as a virtualized resource, and is available for deployment on-premise, in cloud computing environments or in hybrid environments. Red Hat Storage Server aggregates disk and memory resources of multiple physical storage resources into a unified storage pool and abstracts physical hardware from users and applications, offering enterprises the ability to treat physical storage as a scalable, standardized, centrally-managed pool of virtual storage.

Red Hat cloud offerings. Cloud computing is a term used to refer to an IT infrastructure that enables the use of a shared pool of computing resources (such as networks, processors, storage platforms, operating systems, and applications) by multiple users. In a cloud environment, computing resources may be deployed rapidly and efficiently, and usage may be increased or decreased as needed.

Cloud computing can be implemented in different ways. In a public cloud, computing resources are made available to the general public by an entity that controls and operates these resources. In a private cloud, computing resources are operated solely for the benefit of a particular entity. A hybrid cloud blends the public and private cloud models and enables interoperability between public and private cloud computing environments.

Red Hat provides a number of offerings to assist users in creating cloud computing environments:

- *Red Hat CloudForms* an open hybrid cloud management solution that allows users to deploy, monitor and manage services across cloud providers and virtualization solutions.
- *Red Hat Enterprise Linux OpenStack Platform* an infrastructure-as-a-service offering that provides an enterprise-ready cloud foundation built on OpenStack technologies optimized for and integrated with Red Hat Enterprise Linux.
- *Red Hat Cloud Infrastructure* an offering that combines and integrates Red Hat Enterprise Virtualization, Red Hat CloudForms and Red Hat Enterprise Linux OpenStack Platform. Red Hat Cloud Infrastructure allows users to build and manage a private or hybrid infrastructure-as-a-service cloud.
- *OpenShift by Red Hat* a cloud application platform (also called platform-as-a-service) that automates the hosting, configuration, deployment and administration of application stacks in an elastic cloud environment. OpenShift gives application developers self-service access so they can more easily deploy applications on demand. Customers can use OpenShift Enterprise in a private cloud environment or OpenShift Online, a public version of OpenShift hosted by Red Hat. Customers can also use Red Hat JBoss Enterprise

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Application Platform for OpenShift to enable enterprise application development and capability with OpenShift.

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Red Hat's standalone offerings, such as Red Hat Enterprise Linux, Red Hat Enterprise Virtualization, Red Hat JBoss Middleware, and Red Hat Storage Server, can also be combined to enable public, private and hybrid cloud deployments.

Additional Red Hat enterprise offerings. Red Hat enterprise offerings also include other technologies, such as for high-performance distributed computing, directory services and user authentication. These offerings broaden customer choice and are components of our open source architecture vision for the enterprise.

Red Hat consulting, support, and training services

Red Hat offers a range of services that are designed to help our customers derive additional value from Red Hat enterprise offerings.

Consulting. We offer the services of experienced consultants focused on our offerings to assist with the technology and strategic infrastructure needs of our customers. Our offerings include assessments, implementations, upgrade planning, platform migrations, solution integration and application development.

Support. Our Red Hat subscriptions generally include varying levels of technical support to assist customers with implementing, configuring and using Red Hat enterprise technologies. In addition, Red Hat's Customer Portal provides an online method for customers to obtain certified software, access a knowledge base and software update alerts and advisories, as well as interact with our technical support engineers. We also offer a technical account management service for customers who require a more personalized support relationship. The technical account management service is designed to offer a highly skilled, proactive support engineer who understands a customer's IT infrastructure and serves as a primary point of contact for technical support that is tailored to the customer's business.

Training. Our training services consist of an array of interactive courses designed to meet the diverse needs of our customers. We deliver courses worldwide in classroom, corporate on-site and online settings. These courses span topics such as system administration, deployment, management and security, and enterprise application development and integration. Certifications include Red Hat Certified Architect, Red Hat Certified Engineer, Red Hat Certified Datacenter Specialist, Red Hat Certified JBoss Administrator, Red Hat Certified JBoss Developer, Red Hat Certified Security Specialist, Red Hat Certified System Administrator, Red Hat Certified System Administrator in Red Hat OpenStack, Red Hat Certified Virtualization Administrator and Red Hat Certificates of Expertise in a variety of specialties.

By providing consulting and support services that help to enable infrastructure, application integration and middleware solutions both on-premise or in a cloud, we facilitate further adoption and use of our technologies in the enterprise. In addition, our training services help populate customers and partners with skilled Red Hat certified professionals who often serve as internal open source advocates, increasing opportunities for successful adoption and use of our enterprise technologies. Our service capabilities promote and reinforce the use of open source technologies as well as our Red Hat brands.

COMPETITION

We compete with a number of large and well-established companies that have significantly greater financial resources, larger development staffs and more extensive marketing and distribution capabilities. No assurance can be given that our efforts to compete effectively will be sufficient.

We believe that the major factors affecting the competitive landscape for our offerings include:

- the name and reputation of the vendor or competitive offering;
- the product price, performance, reliability, security and functionality;

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- the alliances of the vendor with major industry hardware and/or software providers;
- the ability to adapt development, sales, marketing and support to the open source software model;
- the financial and value relationship of subscription services;
- the channel strength and number of channel partners of the vendor;
- the quality of consulting and support services;
- the number of Global 2000 company reference accounts;
- the number of cloud computing partners and reference accounts;
- the availability of third-party enterprise applications that are compatible with the technology;
- the breadth of hardware and software ecosystem compatibility;
- the management framework for administering the software technologies;
- the ability of the vendor to quickly diagnose software issues and provide patches and other solutions; and
- the strength of the vendor's relationships and reputation in the open source community.

With respect to our operating system offerings, our competitors include Microsoft, which offers a hardware-independent, multi-user operating system that competes with Red Hat's offerings. Moreover, we also compete with HP, IBM, Oracle and Unisys Corporation, each of which offer the UNIX operating system. Many of these competitors bundle competitive operating systems, such as UNIX, with their own hardware and additional software offerings, thereby making it more difficult for us to penetrate their customer bases. With respect to Linux operating systems, our competitors include The Attachmate Group, Inc. (Attachmate), with its SUSE brand of Linux, and Oracle's Linux offering. We also compete with freely available Linux distributions, such as CentOS, Debian, Fedora, openSUSE, and Ubuntu.

With respect to our virtualization offerings, our competitors include Attachmate, Citrix Systems, Inc. (Citrix), Microsoft, Oracle and VMware. Microsoft and VMware offer virtualization technologies that are certified and supported with Red Hat Enterprise Linux operating system offerings, and Microsoft supports its server operating systems and application servers running on our virtualization offerings.

With respect to our middleware offerings, our competitors include IBM, Microsoft, Oracle and Pivotal Software, Inc. (Pivotal). All of these vendors offer the majority of their middleware products under a typical proprietary software license model. IBM and Oracle often bundle hardware and software for their customers, making it more difficult for us to penetrate their customer bases. Our middleware offering is heavily dependent on the Java programming language, which is controlled by Oracle.

With respect to our storage offerings, we compete with companies that provide software-based storage products, such as EMC and NetApp. Public cloud providers, such as Amazon and Rackspace, also offer storage capabilities.

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With respect to our cloud technologies, we compete with companies that provide tools for enterprises to create private clouds, such as Citrix, Microsoft, Pivotal, and VMware, as well as with companies that provide public clouds and that allow users to consume computing resources as a service without the need to purchase equipment or software, such as Amazon, Google, Microsoft and Rackspace.

With respect to our service offerings, we face competition in the markets for services related to the development, deployment and integration of enterprise technologies. Our competitors in these markets include Accenture plc, HP, IBM, and Tata Consultancy Services Limited, as well as other technology consulting companies.

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Due to the nature of open source technology, the open source software model is not characterized by the traditional barriers to entry that are found in the proprietary software model. For example, the financial and legal barriers to creating a new Linux distribution are relatively low because the software components typically included in Linux distributions are publicly available under open source licenses that permit copying, modification and redistribution. Anyone can use, copy, modify and redistribute Red Hat Enterprise Linux, Red Hat JBoss Middleware and our other open source offerings. However, they are not permitted to refer to these products as Red Hat or Red Hat JBoss products unless they have a formal business relationship with us that allows for such references. Moreover, our customers agree that during their support relationship with Red Hat, they will purchase a support subscription for each computer system, core, socket or other unit on which they deploy Red Hat's software. In addition, the primary means by which customers can receive a certified version of Red Hat enterprise software, as well as new versions of the software, security updates, fixes, functionality enhancements and upgrades to the technology, if and when available, is to purchase and maintain a current subscription directly from us or our partners with whom we have agreements.

Although we believe that we generally compete on par or favorably with many of our competitors in a number of respects, we believe that a number of our key competitors currently have superior marketing and distribution capabilities. In addition, there are significantly more enterprise infrastructure applications available for competing operating systems technologies, such as Windows, than there are for Red Hat Enterprise Linux. An integral part of our strategy has been to help address these shortcomings by, among other methods, strengthening our existing strategic and channel partner relationships and entering into new ones to expand our marketing and distribution capabilities and by attracting more attention to the open source movement. Also, increasing the adoption of Red Hat enterprise technologies should create additional opportunities and incentives for software developers to write more applications that are compatible with Red Hat enterprise technologies.

SOFTWARE ENGINEERING AND DEVELOPMENT

We have invested, and intend to continue to invest, significant resources in research and development. We expended \$317.3 million, \$263.2 million and \$208.7 million, in our fiscal years ended February 28, 2014, February 28, 2013 and February 29, 2012, respectively, in research and development costs. We focus and modify our research and development efforts based on the needs of users and changes in the marketplace. Our development efforts are currently focused on adding new or improved functionality to our offerings that is needed by enterprise customers or that supports the expansion of our third-party hardware and software ecosystem. However, any upgrades and enhancements are offered on an when-and-if-available basis. Our software engineers collaborate with open source software development teams working through open source communities, such as the Fedora Project, GlusterFS, JBoss community projects, OpenShift Origin and OpenStack. This involvement enables us to remain abreast of, and in some instances lead, certain technical advances, plans for development of new features and timing of releases, as well as other information related to the management of open source projects.

Our software engineers make development contributions to many components comprising Red Hat software offerings, such as Red Hat Enterprise Linux, Red Hat Enterprise Virtualization, Red Hat JBoss Middleware, Red Hat Storage Server, Red Hat Cloud Infrastructure and Red Hat OpenShift, and provide leadership within the various open source communities across many of the core components. Our software engineers also perform extensive testing of Red Hat enterprise technologies. We use various industry methods of quality assurance testing to help ensure that our enterprise technologies are ready for use by our customers when delivered. We also work closely with leading hardware and software vendors to help ensure that their hardware and applications will operate effectively with Red Hat enterprise platforms.

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INTELLECTUAL PROPERTY

Most of our offerings, such as Red Hat Enterprise Linux and Red Hat JBoss Middleware, are built primarily from software components licensed to the general public under various open source licenses. While some components are developed by our own employees, Red Hat obtains many components from software developed and released by contributors to independent open source software development projects. Open source licenses grant licensees broad permissions to use, copy, modify and redistribute the software. Certain open source licenses, such as the GPL, impose significant limits on a distributor's ability to license derivative works under more restrictive terms and generally require the distributor to disclose the source code of such works. The inclusion of software components governed by such licenses in our offerings limits our ability to use traditional proprietary software licensing models for those offerings. As a result, while we have substantial copyright interests in our software technologies, open source development and licensing practices may have the effect of limiting the value of our software copyright assets. Consequently, our trademarks may represent our most valuable intellectual property.

We pursue registration of some of our trademarks in the U.S. and in other countries. We have registered the Red Hat and JBoss trademarks and the Red Hat Shadowman logo in countries in North America, South America, Europe, Asia and Africa as well as in Australia.

Despite our efforts to protect our trademark rights, unauthorized third parties have, in the past, attempted and, in the future, may attempt, to misappropriate our trademark rights. We cannot be certain that we will succeed in preventing such misappropriation of our trade names and trademarks. The laws of some foreign countries do not protect or deter misappropriation of our trademark rights to the same extent as do the laws of the U.S. In addition, while we engage in certain enforcement activity, policing unauthorized use of our trademark rights is difficult, expensive and time consuming, and our efforts may be inadequate. The loss of any material trademark or trade name could have a material adverse effect on our business, operating results and financial condition.

Red Hat also seeks patent protection of some of the innovative ideas of our software developers and other employees. Some of these inventions are applicable to our current technologies, while others provide protection to new and other technologies. Moreover, our principal objectives in seeking patent protection are to provide a measure of deterrence against the potential patent infringement claims of third parties and to a more limited extent to help ensure that new technologies and innovations covered by our patents remain open. As part of Red Hat's commitment to the open source community, we provide our Patent Promise, an undertaking, subject to certain limitations, not to enforce our patent rights against users of open source software covered by certain open source licenses. This permits the development and distribution of open source applications by third parties that could otherwise infringe on our patents. For these reasons, it is unlikely that our patents will, of themselves, provide us substantial revenue. We are also a founding member and active participant, along with other industry leaders (including IBM, Philips, Sony and Google) in the Open Invention Network, LLC, which acquires patents with the goal of promoting innovation in open source for the Linux platform. For discussion of our investment in Open Invention Network, LLC, see NOTE 7 Other Assets, Net to our Consolidated Financial Statements.

Third parties have, in the past, asserted and, in the future, may assert, infringement claims against us which may result in costly litigation or require us to obtain a license to third-party intellectual property rights. See Item 3, Legal Proceedings. There can be no assurance that such licenses will be available on reasonable terms or at all, which could have a material adverse effect on our business, operating results and financial condition. Red Hat regularly commits to its subscription customers that if portions of our enterprise offerings are found to infringe third-party intellectual property rights we will, at our expense and option: (i) obtain the right for the customer to continue to use the offering consistent with their subscription agreement with us; (ii) modify the offering so that its use is non-infringing; or (iii) replace the infringing component with a non-infringing component, and indemnify them against specific types of infringement claims. Although we cannot predict whether we will need to satisfy these commitments and often have limitations on these commitments, satisfying these commitments could be costly and time-consuming and could materially and adversely affect our business, operating results, financial condition and cash flows.

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We also generally enter into confidentiality and nondisclosure agreements with our employees and consultants and seek to control access to and distribution of our confidential documentation and other proprietary information.

EMPLOYEES

As of February 28, 2014, Red Hat had approximately 6,300 employees.

AVAILABLE INFORMATION

We maintain a website at www.redhat.com. We make available, free of charge on our website, our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended (the "Securities Exchange Act"), as soon as reasonably practicable after we electronically file those reports with, or furnish them to, the Securities and Exchange Commission (the "SEC"). We also similarly make available, free of charge on our website, the reports filed with the SEC by our executive officers, directors and 10% stockholders pursuant to Section 16 under the Securities Exchange Act as soon as reasonably practicable after copies of those filings are provided to us by those persons. We are not including the information contained at www.redhat.com, or at any other Internet address, as part of, or incorporating it by reference into, this Annual Report on Form 10-K.

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ITEM 1A. RISK FACTORS

Set forth below are certain risks and cautionary statements, which supplement other disclosures in this report. Please carefully consider the following risks and cautionary statements. If any of the following risks occur, our business, financial condition, operating results and cash flows could be materially adversely affected.

RISKS RELATED TO BUSINESS UNCERTAINTY

We face intense competition.

The enterprise software industry is rapidly evolving and intensely competitive, and is subject to changing technologies, shifting customer needs, and frequent introductions of new products and services. We compete based on our ability to provide our customers with enterprise software offerings that best meet their needs at a compelling price. We expect that competition will continue to be intense, and there is a risk that our competitors' products may provide better performance or include additional features when compared to our offerings. Competitive pressures could also affect the prices we may charge or the demand for our offerings, resulting in reduced profit margins and loss of market share.

Our current and potential competitors range from large and well-established companies to emerging start-ups. Some of our competitors have significantly greater financial resources and name recognition, larger development and sales staffs and more extensive marketing and distribution capabilities. Certain competitors also bundle hardware and software offerings, making it more difficult for us to penetrate their customer bases. As the enterprise software industry evolves, the competitive pressure for the Company to innovate encompasses a wider range of products and services, including new offerings, that require different expertise than our current offerings. Some competitors may be able to innovate and provide products and services faster than we can.

Industry consolidation may affect competition by creating larger and potentially stronger competitors in the markets in which we compete. We also compete in certain areas with our partners and potential partners, and this may adversely impact our relationship with an individual partner or a number of partners.

Our efforts to compete effectively may not be sufficient, which may adversely affect our business, financial condition, operating results and cash flows.

Our continued success depends on our ability to adapt to a rapidly changing industry. Investment in new offerings, 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. Our continued success will depend on our ability to adapt to rapidly changing technologies, to adapt our offerings to evolving industry standards, to predict user preferences and industry changes and to improve the performance and reliability of our offerings. Our failure to adapt to such changes could harm our business. In addition, the widespread adoption of other technological changes could require substantial expenditures on our part to modify or adapt our offerings or infrastructure. Delays in developing, completing or delivering 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 invest significant resources in research and development in order to enhance our existing offerings and introduce new offerings in a timely manner, successfully promote the offerings, manage the risks associated with the offerings, make sufficient resources available to support the offerings 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 technology road map. Such endeavors may involve

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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 adversely affect our business, financial condition, operating results and cash flows.

If we fail to continue to establish and maintain strategic 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 relationships with industry-leading cloud providers, enterprise solution providers, hardware manufacturers, and software vendors, such as Amazon.com, Inc., Cisco Systems, Inc., Dell Inc., Fujitsu Limited, Hewlett-Packard Co., International Business Machines Corporation, NEC Corporation, Oracle Corporation, SAP AG and others. Many of these strategic partners have engineered and certified that their products and services run on or with our offerings, and in some cases have built their products using our offerings. We may not be able to maintain these relationships or replace them on attractive terms in the future. Some of our strategic 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 offerings, 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 offerings effectively or continue to devote the resources necessary to provide us with effective sales, marketing and technical support. As our agreements with strategic partners terminate or expire, we may be unable to renew or replace these agreements on comparable terms, or at all.

We rely, to a significant degree, on indirect sales channels for the distribution of our offerings, and disruption within these channels could adversely affect our business, financial condition, operating results and cash flows.

We use a variety of different indirect distribution methods for our offerings, including channel partners, such as certified cloud providers, distributors, hardware original equipment manufacturers (OEMs), and resellers. A number of these partners in turn distribute via their own networks of channel partners with whom we have no direct relationship. These relationships allow us to offer our technologies to a much larger customer base than we would otherwise be able through our direct sales and marketing efforts.

We rely, to a significant degree, on each of our channel partners to select, screen and maintain relationships with its distribution network and to distribute our offerings in a manner that is consistent with applicable regulatory requirements and Red Hat's quality standards. Our channel partners may offer their own products and services that are competitive with our offerings or may not distribute and market our offerings effectively. Moreover, our existing channel partner relationships do not, and any future channel partner relationships may not, afford us any exclusive marketing or distribution rights. In addition, if a channel partner is acquired by a competitor or its business units are reorganized or divested, our revenue derived from that partner may be adversely impacted.

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 business 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 technologies, thereby making it more difficult for us to establish brand awareness, ensure proper delivery and installation of our software, 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 offerings 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.

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The duration and extent of economic downturns, regional financial instability, and economic and market conditions generally could adversely affect our business, financial condition, operating results and cash flows.

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 customer segments and geographic regions in which we operate, which may result in reduced demand and increased price competition for our offerings. Our operating results in one or more geographic regions or customer segments may also be affected by uncertain or changing economic conditions within that region or segment. 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 operating results. Also, these conditions may make it more difficult to forecast operating results. If global economic conditions, or economic conditions in the U.S., Europe, Asia or in other key geographic regions or customer segments, remain uncertain or persist, spread or deteriorate further, current and prospective customers may delay or reduce their IT spending, which could adversely affect our business, financial condition, operating results and cash flows.

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 business, financial condition, operating results and cash flows 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. These types of transactions can increase the expense of running our business and present significant challenges and risks, including:

- Integrating the acquired business' accounting, financial reporting, management, information and information security, human resource and other administrative systems to permit effective management and reporting, and the lack of control if such integration is delayed or not implemented;
- Gathering full information regarding a business or technology prior to a transaction, 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;
- Increased operating expenses related to the acquired business or technology;
- Maintaining or establishing acceptable standards, controls, procedures and policies;
- Disruption of our ongoing business and distraction of management;
- Impairment of relationships with our employees, partners or customers as a result of any integration of new management and other personnel, products or technology or as a result of the changes in the competitive landscape affected by the transaction;
- Maintaining good relationships with customers or business partners of the acquired business;
- Effective evaluation of talent at an acquired business or cultural challenges associated with integrating employees from the acquired business into our organization;

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- Loss of key employees of the acquired business;
- Incorporating and further developing acquired products or technology into our offerings and maintaining quality standards consistent with our brands;

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- Achieving the expected benefits of the transaction;
- Expenses related to the transaction;
- Claims and liabilities we may assume from the acquired business or technology, or that are otherwise related to the transaction;
- Entering into new markets in which we have little or no experience or in which competitors may have stronger market positions;
- Impairment of intangible assets and goodwill acquired in transactions; and
- For foreign transactions, additional risks related to the integration of operations across different cultures and languages, and the economic, political, compliance and regulatory risks associated with specific countries.

There can be no assurance that we will manage these challenges and risks successfully. Moreover, if we are not successful in completing transactions 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 and completing such transactions, we could use substantial portions of our available cash as all or a portion of the purchase price for these transactions or as retention incentives to employees of the acquired business, or we may incur substantial debt. We could also issue additional securities as all or a portion of the purchase price for these transactions or as retention incentives to employees of the acquired business, which could cause our stockholders to suffer significant dilution. Any transaction may not generate additional revenue or profit for us, or may take longer to do so than expected, which may adversely affect our business, financial condition, operating results and cash flows.

If we fail to effectively manage our growth, our business, financial condition, operating results and cash flows could be adversely affected.

We have expanded our operations rapidly in recent years. For example, our total revenue increased from \$1.33 billion for the fiscal year ended February 28, 2013 to \$1.53 billion for the fiscal year ended February 28, 2014. Moreover, the total number of our employees increased from over 5,600 as of February 28, 2013 to approximately 6,300 as of February 28, 2014. In addition, we continue to explore ways to extend our 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 provide our offerings and implement our business plan requires adequate information systems and resources, internal controls 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, (i) we may not be able to adequately screen and hire or adequately train, supervise, manage or develop sufficient personnel, and (ii) we may not be able to develop or effectively manage our controls, oversight functions or information systems. If we are unable to effectively manage our growth, our business, financial condition, operating results and cash flows could be adversely affected.

Industry consolidation may lead to increased competition and may adversely affect our business, financial condition, operating results and cash flows.

There has been a trend of consolidation in the technology industry. We expect this trend to continue as companies attempt to strengthen or hold their market positions in an evolving industry. For example, as the computing, networking, storage, and software technologies that comprise the enterprise data center converge, many companies seek to position themselves as key or single-source vendors providing end-to-end technology solutions for the data center. Also, some of our current and potential competitors have made acquisitions or

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announced new strategic alliances designed to position them as a key or single-source vendor. As a result of these developments, we face greater competition, including competition from entities that are among our key business partners. This increased competition could adversely affect our business, financial condition, operating results and cash flows.

Because of the characteristics of open source software, there are few technology barriers to entry into 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 may 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 competitors with greater resources than ours to develop their own open source solutions, potentially reducing the demand for, and putting price pressure on, our offerings. 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 adversely affect our business, financial condition, operating results and cash flows.

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, including our CEO. The loss of these individuals, particularly to a competitor, some of which may be in a position to offer greater compensation, could adversely affect our business or stock price.

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 make it more beneficial for 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 recipients 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, and our inability to attract and retain such employees could adversely affect our business or diminish our brands.

Competition in our industry for qualified employees, especially technical employees, is intense and our competitors directly target our employees. Our inability to attract and retain key employees could hinder our influence in open source projects and 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 our brands. 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 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

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appreciated in value. Additionally, as we grow, there may be less equity compensation to award per employee. If we do not succeed in attracting and retaining key personnel, our business, financial performance, operating results and cash flows may be adversely affected.

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 collaboration fostered by our culture, and our business may be adversely affected.

We believe that a critical contributor to our success has been our corporate culture, which we believe fosters innovation, creativity and collaboration. As our organization grows, and we are required to implement more complex organizational management structures, we may find it increasingly difficult to maintain these 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 business model may encounter customer resistance or we may experience a decline in the demand for our offerings.

We provide Red Hat enterprise technologies primarily under annual or multi-year subscriptions. A subscription generally entitles a customer to, among other things, a specified level of support, as well as new versions of the software, security updates, fixes, functionality enhancements and upgrades to the technology, if and when available, and compatibility with an ecosystem of certified hardware and software applications. 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 unsuccessful in promoting or defending this distribution model, our business, financial condition, operating results and cash flows could be adversely affected.

Demand for our offerings depends substantially on the general demand for enterprise software, which fluctuates based on numerous factors, including the spending levels and growth of our current and prospective customers, and general economic conditions. 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, including developing and implementing appropriate go-to-market strategies and training our sales force and channel partners in order to effectively market new offerings, without any assurance that our efforts will produce any sales. The purchase of our offerings may be discretionary and can involve significant expenditures. If our current and prospective customers cut costs, then they may significantly reduce their enterprise software expenditures.

As technologies and the markets for our enterprise offerings change, our subscription-based business model may no longer meet the needs of our customers. For example, a business model based on annual or multi-year subscriptions may no longer be competitive in an environment where disruptive technologies (such as virtualization and cloud) enable customers to consume computing resources on an hourly basis or for free. We also develop and offer disruptive technologies, which may have an effect on the demand for our subscription-based offerings.

An increased focus on developing and providing virtualization, storage and cloud computing offerings may require a greater focus on marketing more holistic solutions, rather than individual offerings. Consequently, we may need to develop appropriate marketing and pricing strategies for our offerings, our customers' purchasing decisions may become more complex and require additional levels of approval and the duration of sales cycles for our offerings may increase.

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If we are unable to adapt our business model to changes in the marketplace or if demand for our offerings declines, our business, financial condition, operating results and cash flows could be adversely affected.

If our customers do not renew their subscription agreements with us, or if they renew on less favorable terms, our business, financial results, operating results and cash flows may be adversely affected.

Our customers may not renew their subscriptions 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 business, financial condition, operating results and cash flows may be adversely affected.

If third-party enterprise hardware and software providers do not continue to make their products and services compatible with our offerings, our software may cease to be competitive and our business, financial condition, operating results and cash flows may be adversely affected.

The competitive position of our offerings is dependent on their compatibility with products and services of third-party enterprise hardware and software companies. To the extent that a software or hardware vendor might have or develop products and services 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 our offerings, 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 offerings may not be competitive and our business, financial condition, operating results and cash flows may be adversely affected.

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 technologies, adequately enhance our existing technologies 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 enterprise technologies. 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 offerings or we would need to develop and enhance our offerings 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 technology 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 offerings could become less competitive. Delays in developing, completing or delivering new or enhanced offerings could result in delayed or reduced revenue for those offerings and could also adversely affect customer acceptance of those offerings.

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

Despite our testing procedures, errors have been and may continue to be found in our offerings after deployment. This risk is increased by the fact that much of the code in our offerings 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 we may not be able to successfully do so in a timely manner or at all. Errors and failures in our offerings could result in a loss of, or delay in, market acceptance of our enterprise technologies, loss of existing or potential customers and delayed or lost revenue and could damage our reputation and our ability to convince enterprise users of the benefits of our technologies.

In addition, errors in our technologies could cause system failures, loss of data or other adverse effects 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. While we seek to insure against these types of claims, our insurance policies may not adequately limit our exposure to such claims. These claims, even if unsuccessful, could be costly and time consuming to defend and could adversely affect our business, financial conditions, operating results and cash flows.

Our virtualization, storage and cloud computing offerings are based on emerging technologies and business models, and the potential market for these offerings remains uncertain.

Our virtualization, storage and cloud computing offerings are based on emerging technologies and business models, the success of which will depend on the perceived technological and operational benefits and cost savings associated with the adoption of these technologies. Virtualization, storage and cloud computing technologies are rapidly evolving, and their development is a complex and uncertain process requiring high levels of innovation and investment as well as the accurate anticipation of technology trends, market demand and customer needs. We expect competition to remain intense and, as with many emerging IT sectors, these technologies may be subject to a first mover effect pursuant to which certain product offerings rapidly capture a significant portion of market share and developer attention. Moreover, we may make errors in reacting to relevant business trends and predicting which technologies are successful or otherwise develop into industry standards.

Adoption of virtualization, storage and cloud computing offerings may occur more slowly or less pervasively than we expect and the revenue growth associated with these offerings may be slower than currently expected. Moreover, even if virtualization, storage and cloud computing are adopted widely by enterprises, our offerings in these areas may not attract a sufficient number of users or generate attractive financial results. We incur expenses associated with these offerings in advance of our ability to generate associated revenue. Demand for our virtualization, storage and cloud computing offerings may unfavorably impact demand for our other offerings, including software subscriptions and related professional services. If the market for our virtualization, storage and cloud computing offerings fails to develop adequately, it could have an adverse affect on our business, financial condition, operating results and cash flows.

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

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

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

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

Security breaches and data loss may expose us to liability, harm our reputation and adversely affect our business.

Our business involves the production and distribution of enterprise software technologies, as well as hosting applications. As part of our business, we (or third parties with whom we contract) receive, store and process our data, as well as our customers' and partners' data. While we take security and testing measures relating to our offerings and operations, those measures may not prevent security breaches and data loss that could harm our business or the businesses of our customers and partners. Advances in computer capabilities, new discoveries in the field of cryptography, inadequate technology or facility security measures or other factors may result in data loss or a compromise or breach of our systems and the data we receive, store and process (or systems and the data received, stored and processed by third parties with whom we contract). These security measures may be breached or data lost as a result of actions by third parties or employee error or malfeasance. A party who is able to circumvent security measures or exploit inadequacies in security measures, could, among other things, misappropriate proprietary information (including information about our employees, customers and partners and our customers' information), cause the loss or disclosure of some or all of this information, cause interruptions in our or our customers' operations, cause delays in development efforts or expose customers (and their customers) to computer viruses or other disruptions or vulnerabilities. A compromise to these systems could remain undetected for an extended period of time, exacerbating the impact of that compromise. These risks may increase as we continue to grow our cloud and services offerings and as we receive, store and process more of our customers' data. Actual or perceived vulnerabilities may lead to regulatory investigations, claims against us by customers, partners or other third parties, or costs, such as those related to providing customer notifications and fraud monitoring. 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. Any loss of data or compromise of our systems or the data we receive, store or process (or systems and the data received, stored and processed by third parties with whom we contract) could result in a loss of confidence in the security of our offerings, damage our reputation, lead to legal liability and adversely affect our business, financial condition, operating results and cash flows.

We are vulnerable to technology infrastructure failures, which could harm our reputation and adversely affect our business.

We rely on our technology infrastructure, and the technology infrastructure of third parties, for many functions, including selling our offerings, supporting our partners, fulfilling orders and billing, collecting and making payments. This technology infrastructure may be 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 the systems making up this infrastructure are not redundant, and our disaster recovery planning may not be sufficient for every eventuality. This technology infrastructure may fail or be vulnerable to damage or interruption because of actions by third parties or employee error or malfeasance. We may not carry business interruption insurance sufficient to protect us from all losses that may result from interruptions in our services as a result of technology infrastructure failures or to cover all contingencies. Any interruption in the availability of our websites and on-line interactions with customers or partners may cause a reduction in customer or partner satisfaction levels, which in turn could cause additional claims, reduced revenue or loss of customers or partners. Despite any precautions we may take, such problems could result in, among other consequences, a loss of data, loss of confidence in the stability and

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reliability of our offerings, damage to our reputation, legal liability, all of which may adversely affect our business, financial condition, operating results and cash flows interruptions.

A decline in or reprioritization of funding in the U.S. government budget or delays in the budget process could adversely affect our business, financial condition, operating results and cash flows.

We derive, and expect to continue to derive, a portion of our revenue from U.S. government agencies. Government deficit reduction and austerity measures, along with continued economic challenges, continue to place pressure on U.S. government spending. The termination of, or delayed or reduced funding for, government-sponsored programs and contracts from which we derive revenue could adversely affect our business, financial condition, operating results and cash flows.

We may be unable to predict the future course of open source technology development, which could reduce the market appeal of our offerings, damage our reputation and adversely affect our business, financial condition, operating results and cash flows.

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 offerings but competing technology becomes more widely used or accepted, the market appeal of our offerings may be reduced and that could harm our reputation, diminish our brands and adversely affect our business, financial condition, operating results and cash flows.

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

We utilize various types of software licensed from unaffiliated third parties in our 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 technologies 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 delivery of our offerings and the release of new offerings and limit the features available in our current or future offerings.

RISKS RELATED TO LEGAL UNCERTAINTY

If our technologies are found or alleged to infringe third-party intellectual property rights, we may be required to take costly and time consuming actions to meet our commitments to customers.

We regularly commit to our subscription customers that if portions of our offerings 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 technology consistent with their subscription agreement with us; (ii) modify the technology 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 we often have limitations on these commitments, satisfying the commitments could be costly, be time consuming, divert the attention of technical and management personnel, and adversely affect our business, financial condition, operating results and cash flows. In addition, our insurance policies would likely not adequately cover our exposure to this type of claim.

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We are vulnerable to claims that our technologies infringe third-party intellectual property rights and an unfavorable legal decision affecting our intellectual property could adversely affect our business.

We are vulnerable to claims that our technologies infringe third-party intellectual property rights, including patent, copyright and trade secrets, because our technologies are comprised of software components, many of which are developed by numerous independent parties. We are also unlikely to be able to assess adequately the relevance of patents to our technologies, and may be unable to take appropriate responsive action, in a timely or economic manner because, among other reasons, the scope of software patent protection is often not well defined or readily determinable, patent applications in the U.S. are not publicly disclosed at the time of filing, and the number of software patents that are issued each year is significant and growing. Our exposure to risks associated with the use of intellectual property may increase as a result of acquisitions. In addition, third parties may make infringement and similar or related claims after we have acquired technology that had not been asserted prior to our acquisition of such technology.

In the past, our technologies have been subject to intellectual property infringement claims. Some of these claims have been brought by entities that do not design, manufacture, or distribute products or services or that acquire intellectual property like patents for the sole purpose of monetizing their acquired intellectual property through asserting claims of infringement. As these entities do not have operating businesses of their own and therefore have limited risk of counterclaims for damages or injunctive relief, it may be difficult to deter them from bringing intellectual property infringement claims. We expect to face the possibility of more intellectual property infringement claims as our prominence increases, business activities expand, market share and revenue grow, the number of products and competitors in our industry grows and the functionality of products in different portions of the industry overlap. We may not be able to accurately assess the risk related to these suits, and we may be unable to accurately assess our level of exposure.

Defending patent and other intellectual property claims, even claims without significant merit, can be time consuming, costly and can divert the attention of technical and management personnel. We may receive unfavorable preliminary or interim rulings in the course of litigation, and there can be no assurances that favorable final outcomes will be obtained in all cases. We may decide to settle certain lawsuits and disputes on terms that are unfavorable to us. Similarly, if any litigation to which we are a party is resolved adversely, we may be subject to an unfavorable judgment that may not be reversed upon appeal. The terms of such a settlement or judgment may require us to cease offering certain of our technologies or pay substantial amounts to the other party. In addition, we may have to seek a license to continue offering technologies found to be in violation of a third party's rights, which may not be available on reasonable terms, or at all, and may significantly increase our operating costs and expenses. As a result, we may also be required to develop alternative non-infringing technology or practices or discontinue the practices. The development of alternative non-infringing technology or practices could require significant effort and expense or may not be feasible.

An unfavorable legal decision regarding the intellectual property in and to our technology and other offerings could adversely affect our business, financial condition, operating results and cash flows. See Item 3, **Legal Proceedings** for additional information.

Our activities, or the activities of our partners, may violate anti-corruption 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 help promote compliance with these laws, our employees, contractors, partners and agents, as well as those companies to which we outsource certain of our business operations, may take actions in violation of our policies and procedures. Any violation of these laws and regulations could result in fines, criminal sanctions against us, our officers, or our employees, prohibitions on the conduct of our business, and damage to our reputation.

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We could be prevented from selling or developing our software if the GNU General Public License and similar licenses under which our technologies 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 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 offerings. 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 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 may 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 distribute our offerings. 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 one or more of our brands 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.

Efforts to assert intellectual property ownership rights in our technologies could impact our standing in the open source community, which could limit our technology 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. This 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 technologies 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 adversely affect our business.

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 adversely affect our business, financial condition, operating results and cash flows. See Item 3, Legal Proceedings for additional information.

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

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Internet commerce continues to evolve, increasing regulation by federal, state or foreign agencies becomes more likely. The introduction of new offerings by us may cause new and different regulations to apply to our business. New or increased laws and regulations applying to the solicitation, collection, processing, protection, use or other treatment of information could affect our ability to use and share data, or the adoption of our cloud offerings by customers.

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 could require that we change our data practices. 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.

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 or a requirement to change our data practices could have an adverse affect on our business, financial condition, operating results and cash flows.

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

Our contracts with our customers may include 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 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, financial condition, operating results and cash flows.

We may be subject to legal liability associated with providing online services or content.

We provide offerings, such as OpenShift, that enable users to exchange information, advertise products and services, conduct business, and engage in various online activities. The law relating to the liability of providers of these online offerings for activities of their users is relatively unsettled and still developing both in the U.S. and internationally and may be significantly different from jurisdiction to jurisdiction. Claims could be brought against us for breaches of contract, defamation, fraud, libel, negligence, patent, copyright or trademark infringement, tort, unfair competition, unlawful activity, or other theories based on the nature and content of information that we publish or to which we provide links or that may be posted online or generated by us or by third parties, including our customers. In addition, we could be subject to domestic or international actions alleging that certain content we have generated or third-party content that we have made available within our services violates applicable law.

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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 IT 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 offerings 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 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 not be able to meet the financial and operational challenges that we will encounter as our international operations, which represented approximately 44.7% of our total revenue for the fiscal year ended February 28, 2014, continue to expand.

Our international operations accounted for approximately 44.7% of total revenue for the fiscal year ended February 28, 2014. 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 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 offerings for a significant number of international markets, which may adversely affect our operating results. Additional challenges associated with the conduct of our business overseas that may adversely affect our operating results include:

- Fluctuations in exchange rates;
- Pricing environments;
- Longer payment cycles and less financial stability of customers;
- Economic, political, compliance and regulatory risks associated with specific countries;
- Laws and policies of the U.S. and other jurisdictions affecting trade, foreign investment, loans, and taxes;

- Difficulty selecting and monitoring channel partners outside of the U.S.;

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- 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;
- Different employee/employer relationships and the existence of works councils and labor unions;
- Difficulty maintaining quality standards consistent with the our brands;
- Export and import laws and regulations could prevent us from delivering our offerings into and from certain countries;
- 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 that could affect the competitive pricing of our offerings and reduce our market share in some countries; and
- Economic or political instability or terrorist acts in some international markets that could adversely affect our business in those markets or 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.

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

A substantial portion of our revenue is derived from our Red Hat Enterprise Linux platform.

During our fiscal year ended February 28, 2014, a substantial portion of our subscription revenue was derived from our Red Hat Enterprise Linux technologies. Although we are continuing to develop other offerings, we expect that revenue from Red Hat Enterprise Linux will constitute a majority of our revenue for the foreseeable future. Declines and variability in demand for Red Hat Enterprise Linux could occur as a result of:

- competitive products and pricing;
- failure to release new or enhanced versions of Red Hat Enterprise Linux on a timely basis, or at all;
- technological change that we are unable to address with Red Hat Enterprise Linux; or

- future economic conditions.

Additionally, as more customers and potential customers virtualize their data centers and move computing projects to cloud environments, demand for operating systems such as Red Hat Enterprise Linux may decline. Due to the concentration of our revenue from Red Hat Enterprise Linux, our business, financial condition, operating results and cash flows could be adversely affected by a decline in demand for Red Hat Enterprise Linux.

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

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different from our historical income tax provisions and accruals. Economic and political pressures to increase tax revenue in various jurisdictions may make resolving tax disputes more difficult. The results of an audit or litigation could adversely affect 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 are taxed on foreign earnings. Although we cannot predict whether or in what form this proposed legislation may pass, if enacted it could adversely affect our tax expense and cash flows.

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 operating results 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, which could adversely affect our operating results.

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 offerings, 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 condition of our business could be adversely affected; current and potential future shareholders could lose confidence in us and/or

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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 Securities and Exchange Commission and various bodies formed to 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 of, 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, 2014 consisted primarily of money market funds, U.S. government and agency securities, German sovereign and agency securities, certificates of deposit, and corporate 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.

A significant part of our investment portfolio consists of U.S. government and agency securities. If global credit and equity markets experience prolonged periods of decline, or if there is a default or downgrade of U.S. government or agency debt, our investment portfolio may be adversely impacted and we could determine that some of our investments have experienced an other-than-temporary decline in fair value, requiring impairment charges that could adversely affect our financial condition and operating results.

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 financial condition and operating results. For information regarding the sensitivity of and risks associated with the market value of portfolio investments and interest rates, see Part II, Item 7A, 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 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

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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 Part II, Item 7A, Quantitative and Qualitative Disclosures About Market Risk .

Epidemics, geo-political events, Internet and power outages or natural disasters could adversely affect our business, financial condition, operating results and cash flows.

The occurrence of one or more epidemics, geo-political events (such as civil unrest or terrorist attacks), Internet and power outages or natural disasters in a country in which we operate or in which technology industry suppliers or our customers are located, could adversely affect our business, financial condition, operating results and cash flows. 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 customers to access our offerings, 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, or disruption in our communications with our customers.

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ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

Our headquarters is currently located in a subleased facility at 100 E. Davie Street, Raleigh, North Carolina. The building includes approximately 380,000 square feet of office and retail space and an integrated parking deck. We entered into an agreement to sublease this building on December 27, 2011, and the sublease will expire on August 23, 2035. The rental payments under the sublease are approximately \$4.6 million annually until December 31, 2020 and approximately \$3.8 million annually thereafter until the end of the sublease. We are also responsible for payment of taxes and all operating expenses relating to the subleased building (other than certain expenses relating to the operation of the integrated parking deck and the retail portions of the building, which are the responsibility of the tenants of those portions of the building). Over the term of the sublease agreement, we also receive certain rent credits and improvement allowances.

In addition to our headquarters, we have leased office facilities in over 35 countries and more than 80 locations. Significant locations in North America include Atlanta, Georgia; Chicago, Illinois; Dallas, Texas; McLean, Virginia; Mountain View, California; Toronto, Canada and Westford, Massachusetts. Significant locations in Latin America include Buenos Aires, Argentina; Mexico City, Mexico; Santiago, Chile and Sao Paulo, Brazil. Significant locations in EMEA include Amsterdam, Netherlands; Barcelona, Spain; Brno, Czech Republic; Cork, Ireland; Dubai, United Arab Emirates; Farnborough, United Kingdom; Frankfurt, Germany; Madrid, Spain; Munich, Germany; Puteaux, France; Ra'anana, Israel; Rome, Italy; Stockholm, Sweden and Stuttgart, Germany. Significant locations in Asia Pacific include Bangalore, India; Beijing, China; Brisbane, Australia; Melbourne, Australia; Mumbai, India; New Delhi, India; Pune, India; Seoul, South Korea; Singapore; Sydney, Australia and Tokyo, Japan. We believe that in all material respects our properties have been satisfactorily maintained, are in good condition and are suitable for our operations.

ITEM 3. LEGAL PROCEEDINGS

The Company 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 condition, results of operations or cash flows.

ITEM 4. MINE SAFETY DISCLOSURES

This Item is not applicable.

Table of Contents**PART II****ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES****Market Information**

Our common stock trades on the New York Stock Exchange under the symbol RHT. The chart below sets forth the high and low sales information for each of the quarters of the fiscal years ended February 28, 2014 and February 28, 2013.

Quarter	FY 2014		FY 2013	
	High	Low	High	Low
First	\$ 55.59	\$ 46.75	\$ 62.75	\$ 48.25
Second	\$ 53.72	\$ 44.92	\$ 59.49	\$ 49.45
Third	\$ 54.38	\$ 41.89	\$ 60.00	\$ 46.76
Fourth	\$ 60.19	\$ 45.45	\$ 57.10	\$ 46.34

 Holders

As of April 16, 2014, we estimate that there were 1,391 registered stockholders of record of our common stock.

Dividends

We have never declared or paid any cash dividends on our common stock. We anticipate that our future earnings will be retained for the operation and expansion of our business and do not anticipate paying cash dividends in the foreseeable future.

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The following graph shows a comparison of cumulative total return (equal to dividends plus stock appreciation) during the period from February 28, 2009 through February 28, 2014 for:

- Red Hat, Inc.;
- a peer group consisting of Adobe Systems Incorporated, Akamai Technologies, Inc., Ansys, Inc., Autodesk, Inc., Cadence Design Systems, Inc., Citrix, Informatica Corporation, Intuit Inc., Jack Henry & Associates, Inc., Micros Systems, Inc., NetApp, Nuance Communications, Inc., Salesforce.com, Inc., Synopsys, Inc., TIBCO Software, Inc., Verisign, Inc. and VMware (the Stock Performance Peer Group); and
- the S&P 500 Index.

We are required to provide a line-graph presentation comparing cumulative, five-year stockholder returns on an indexed basis with a broad equity market index and either a published industry index or an index of peer companies selected by Red Hat. In our index of peer group companies, we have selected peer companies considered to be peers for purposes of benchmarking executive compensation during the fiscal year ended February 28, 2014.

COMPARISON OF FIVE-YEAR CUMULATIVE**TOTAL RETURN AMONG RED HAT,****STOCK PERFORMANCE PEER GROUP AND S&P 500 INDEX**

	2/28/2009	2/28/2010	2/28/2011	2/29/2012	2/28/2013	2/28/2014
RED HAT, INC.	\$ 100.00	\$ 204.89	\$ 301.53	\$ 361.29	\$ 371.15	\$ 430.90
PEER GROUP	\$ 100.00	\$ 189.93	\$ 291.10	\$ 309.72	\$ 296.81	\$ 388.10
S&P 500 INDEX	\$ 100.00	\$ 153.55	\$ 188.25	\$ 197.84	\$ 224.44	\$ 281.34

Notes:

- Assumes initial investment of \$100.00 on February 28, 2009. Total return includes reinvestment of dividends.
- The lines represent annual index levels derived from compounded daily returns that include all dividends.

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- If the annual interval, based on the fiscal year-end, ends on a day that is not a trading day, the preceding trading day is used.
- The information included under the heading "Stock Performance Graph" in Item 5 of this Annual Report on Form 10-K is furnished and not filed and shall not be deemed to be soliciting material or subject to Rule 14A, shall not be deemed filed for purposes of Section 18 of the Securities Exchange Act or otherwise subject to the limitations of that section, and shall not be deemed incorporated by reference in any filing of the Company under the Securities Act of 1933, as amended, or the Securities Exchange Act, whether made before or after the date of this report and irrespective of any general incorporation by reference language in any such filing.
- The stock price performance shown in the graph is not necessarily indicative of future price performance.

Issuer Purchases of Equity Securities

The table below sets forth information regarding the Company's purchases of its common stock during its fourth fiscal quarter ended February 28, 2014:

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)
December 1, 2013 – December 31, 2013		\$		\$ 240.0 million
January 1, 2014 – January 31, 2014	72,515	\$ 59.02		\$ 240.0 million
February 1, 2014 – February 28, 2014		\$		\$ 240.0 million
Total	72,515	\$ 59.02		

- (1) During the three months ended February 28, 2014, the Company withheld an aggregate of 72,515 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 April 15, 2013, the Company announced that its Board of Directors has authorized the repurchase of up to \$300.0 million of Red Hat's common stock from time to time on the open market or in privately negotiated transactions. The program commenced on April 16, 2013, and will expire on the earlier of (i) March 31, 2015, or (ii) a determination by the Board, Chief Executive Officer or Chief Financial Officer to discontinue the program.

Table of Contents**ITEM 6. SELECTED FINANCIAL DATA**

The following table sets forth selected financial data for each of the Company's fiscal years in the five-year period ended February 28, 2014. The selected balance sheet data as of February 28, 2014 and February 28, 2013 and the selected statement of operations data for the fiscal years ended February 28, 2014, February 28, 2013 and February 29, 2012 are derived from our Consolidated Financial Statements contained in this Annual Report on Form 10-K and should be read in conjunction with the Consolidated Financial Statements, related notes and other financial information included herein. The selected statement of operations data for the fiscal years ended February 28, 2011 and February 28, 2010 and the selected balance sheet data as of February 29, 2012, February 28, 2011 and February 28, 2010, are derived from our Consolidated Financial Statements contained in the Annual Reports on Form 10-K for the years ended February 29, 2012 and February 28, 2011.

	February 28, 2014	February 28, 2013	Year Ended February 29, 2012	February 28, 2011	February 28, 2010
(in thousands, except per share data)					
SELECTED STATEMENT OF OPERATIONS DATA					
Revenue:					
Subscriptions	\$ 1,336,771	\$ 1,148,341	\$ 965,575	\$ 773,404	\$ 638,654
Training and services	197,844	180,476	167,528	135,873	109,582
Total subscription and training and services revenue	\$ 1,534,615	\$ 1,328,817	\$ 1,133,103	\$ 909,277	\$ 748,236
Gross profit	\$ 1,302,015	\$ 1,128,217	\$ 954,555	\$ 758,990	\$ 634,391
Income from operations	\$ 232,289	\$ 201,038	\$ 199,913	\$ 145,676	\$ 100,349
Interest income	\$ 6,645	\$ 8,245	\$ 8,418	\$ 6,743	\$ 10,381
Other income (expense), net	\$ 614	\$ 469	\$ (322)	\$ 1,275	\$ 10,772
Net income	\$ 178,292	\$ 150,204	\$ 146,626	\$ 107,278	\$ 87,253
Basic net income per common share	\$ 0.94	\$ 0.78	\$ 0.76	\$ 0.56	\$ 0.46
Diluted net income per common share	\$ 0.93	\$ 0.77	\$ 0.75	\$ 0.55	\$ 0.45
Weighted average shares outstanding					
Basic	189,920	193,147	193,151	190,294	187,845
Diluted	192,036	195,804	196,451	196,353	193,546

	February 28, 2014	February 28, 2013	As of February 29, 2012	February 28, 2011	February 28, 2010
(in thousands)					
SELECTED BALANCE SHEET DATA					
Total cash and investments in debt and equity securities (available-for-sale, current and long-term)					
	\$ 1,487,429	\$ 1,318,373	\$ 1,260,353	\$ 1,192,391	\$ 970,185
Working capital	\$ 423,096	\$ 383,037	\$ 395,050	\$ 504,757	\$ 436,852
Total assets	\$ 3,106,619	\$ 2,813,660	\$ 2,491,099	\$ 2,199,322	\$ 1,870,872
Total deferred revenue (current and long-term)	\$ 1,289,197	\$ 1,089,952	\$ 946,736	\$ 772,254	\$ 645,860
Stockholders' equity	\$ 1,551,165	\$ 1,520,161	\$ 1,398,817	\$ 1,290,699	\$ 1,111,052

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**ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS
OVERVIEW**

We are a leading global provider of open source software solutions, using a community-powered approach to develop and offer reliable and high-performing operating system, virtualization, middleware, storage and cloud 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 use 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 development, aggregation, integration, testing, certification, delivery, maintenance, enhancement and support of our Red Hat enterprise technologies, and by providing a level of performance, reliability, scalability, flexibility, stability and security 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 primarily provide our enterprise offerings in the form of annual or multi-year subscriptions, and we recognize revenue over the period of the subscription agreements with our customers. We market our offerings primarily to enterprise customers.

We have focused on introducing and gaining acceptance for Red Hat enterprise technologies that comprise our open source architecture. Red Hat Enterprise Linux and Red Hat JBoss Middleware offerings have gained widespread ISV and IHV support. We have continued to build our open source architecture by expanding our enterprise operating system and middleware offerings and introducing virtualization, storage, cloud and other offerings.

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 Estimates** and in NOTE 2 **Summary of Significant Accounting Policies** to our Consolidated Financial Statements.

In our fiscal year ended February 28, 2014, we focused on and expect in our fiscal year ending February 28, 2015 to continue to focus on, among other things, (i) promoting the widespread adoption of Red Hat enterprise offerings by enterprise customers globally, (ii) expanding our virtualization, storage, cloud and other enterprise offerings, (iii) investing in the development of open source technologies, (iv) increasing revenue from our existing customer base, (v) increasing revenue by promoting a range of services to help our customers derive additional value, (vi) expanding routes to market, (vii) growing our presence in international markets, and (viii) pursuing strategic acquisitions and alliances.

Revenue

For the year ended February 28, 2014, total revenue increased 15.5%, or \$205.8 million, to \$1.53 billion from \$1.33 billion for the year ended February 28, 2013. Subscription revenue increased 16.4%, or \$188.4

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million, driven primarily by additional subscriptions related to our principal Red Hat Enterprise Linux and Red Hat JBoss Middleware offerings, which continue to gain broader market acceptance in mission-critical areas of computing, and our expansion of sales channels and our 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 9.6%, or \$17.4 million, for the year ended February 28, 2014 as compared to the year ended February 28, 2013. The increase is driven primarily by customer interest in new products and increased demand for our open source solutions.

We believe our success is influenced by:

- the extent to which we can expand the breadth and depth of our enterprise offerings;
- our ability to enhance the value of Red Hat enterprise offerings through frequent and continuing innovation while maintaining stable platforms over multi-year periods;
- our ability to generate increasing revenue from channel partner and other strategic relationships, including cloud computing providers, distributors, IHVs, ISVs, OEMs, SIs, and VARs;
- our ability to generate new and recurring revenue for Red Hat enterprise offerings;
- the widespread and increasing deployment of open source technologies by enterprises and similar institutions, such as government agencies and universities; and
- our ability to provide customers with consulting and training services that generate additional revenue.

Deferred revenue, billings proxy, seasonality and backlog

Deferred revenue

Our deferred revenue, current and long-term, balance at February 28, 2014 was \$1.29 billion. Because of our subscription model and revenue recognition policies, deferred revenue improves predictability of future revenue. For example, current deferred revenue provides a baseline for revenue to be recognized over the next twelve months. Similarly, long-term deferred revenue provides a baseline for revenue to be recognized beyond twelve months. Total deferred revenue at February 28, 2014 increased 18.3%, or \$199.2 million, as compared to the balance at February 28, 2013 of \$1.09 billion.

The change in deferred revenue reported on our Consolidated Balance Sheets of \$199.2 million differs from the \$205.4 million change in deferred revenue we reported on our Consolidated Statements of Cash Flows for the year ended February 28, 2014 due to changes in foreign currency exchange rates used to translate deferred revenue balances from our foreign subsidiaries' functional currency into U.S. dollars.

Billings proxy

We approximate our annual billings by adding revenue recognized on our Consolidated Statements of Operations to the change in total deferred revenue reported on our Consolidated Statements of Cash Flows. We use the change in deferred revenue as reported on our Consolidated Statements of Cash Flows because the amount has been adjusted for the impact of changes in foreign currency exchange rates used to translate deferred revenue balances from our foreign subsidiaries' functional currencies into U.S. dollars.

Our billings proxy increased by 16.7%, or \$248.6 million, to \$1.74 billion for the year ended February 28, 2014 from \$1.49 billion for the year ended February 28, 2013.

Seasonality

Our fourth fiscal quarter has historically been our strongest quarter for new billings and renewals. This pattern has become more pronounced over time as the number of customers with renewal dates occurring in the last half of our fiscal year has continued to increase. Furthermore, our quarterly sales cycles are frequently

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weighted toward the end of the quarter, with an increased volume of sales completed in the last few weeks of each quarter. The year-over-year compounding effect of this seasonality in billing patterns and overall new business and renewal activity causes the value of invoices making up our billings that we generate in the last half of our fiscal year to continually increase in proportion to the value of our invoices making up our billings in the first half of our fiscal year. Below is a summary of our billings (approximated as described above by adding revenue for the period with the change in deferred revenue as reported on our Consolidated Statements of Cash Flows for the same period) by quarter for fiscal 2014, fiscal 2013, fiscal 2012, fiscal 2011 and fiscal 2010 (in thousands):

	First quarter		Second quarter		Third quarter		Fourth quarter	
	Billings proxy	% of fiscal year total	Billings proxy	% of fiscal year total	Billings proxy	% of fiscal year total	Billings proxy	% of fiscal year total
Year ended February 28, 2014	\$ 346,359	19.9%	\$ 376,303	21.6%	\$ 452,555	26.0%	\$ 564,755	32.5%
Year ended February 28, 2013	\$ 309,609	20.8%	\$ 349,025	23.4%	\$ 378,813	25.4%	\$ 453,944	30.4%
Year ended February 29, 2012	\$ 266,016	20.3%	\$ 304,171	23.2%	\$ 322,072	24.6%	\$ 417,699	31.9%
Year ended February 28, 2011	\$ 208,086	20.4%	\$ 233,200	22.8%	\$ 262,379	25.7%	\$ 318,336	31.1%
Year ended February 28, 2010	\$ 176,749	21.3%	\$ 193,788	23.3%	\$ 217,792	26.2%	\$ 242,532	29.2%

We also have historically experienced a seasonal decline in our services revenue during our fiscal fourth quarter as compared to our fiscal third quarter.

Backlog

Our backlog as of February 28, 2014 totaled approximately \$1.56 billion and includes amounts billed to customers and recognized as current and long-term deferred revenue on our Consolidated Balance Sheet of \$966.8 million and \$322.4 million, respectively, plus the value of non-cancellable subscription and services agreements to be billed in the future and not reflected in our financial results, which was in excess of \$270.0 million. Our total backlog as of February 28, 2013 was approximately \$1.37 billion and included off-balance sheet backlog in excess of \$280.0 million. The increase in backlog from approximately \$1.37 billion as of February 28, 2013 to \$1.56 billion as of February 28, 2014 demonstrates increased customer commitment to our open source technologies.

We report our off-balance sheet backlog as a conservative approximation, often describing the amount as in excess of , primarily because the value of underlying contracts is derived from data not yet subjected to the complete application of our revenue recognition policies. We endeavor to derive the value of our off-balance sheet backlog in a consistent manner year over year and therefore believe the amounts are comparable.

Subscription revenue

Our enterprise technologies are sold primarily under subscription agreements. These agreements typically have a one- or three-year subscription period. A subscription generally entitles a customer to, among other things, a specified level of support, as well as new versions of the software, security updates, fixes, functionality enhancements and upgrades to the technology, if and when available, and compatibility with an ecosystem of certified hardware and software applications. Subscription revenue increased sequentially for each quarter of fiscal 2014, fiscal 2013 and fiscal 2012 and is being driven primarily by the increased use of our offerings by the enterprise and our expansion of sales channels and geographic footprint during these periods.

Revenue by geography

In the year ended February 28, 2014, approximately 44.7%, or \$686.6 million, of our revenue was generated outside the U.S. compared to approximately 43.3%, or \$574.9 million, for the year ended February 28, 2013. 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 outside the U.S. or expand our presence in existing international locations. As of February 28, 2014, we had offices in more than 80 locations throughout the world.

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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 Australia, China, India, Japan, Singapore and South Korea). Revenue generated by the Americas, EMEA and Asia Pacific for fiscal 2014, fiscal 2013 and fiscal 2012 was as follows (in thousands):

	Americas	EMEA	Asia Pacific	Total
Year ended February 28, 2014	\$ 974,655	\$ 352,935	\$ 207,025	\$ 1,534,615
Year ended February 28, 2013	\$ 855,214	\$ 284,922	\$ 188,681	\$ 1,328,817
Year ended February 29, 2012	\$ 716,033	\$ 257,603	\$ 159,467	\$ 1,133,103

Year-over-year revenue growth rates in U.S. dollars for our three geographical regions were as follows for fiscal 2014, fiscal 2013 and fiscal 2012:

	Americas	EMEA	Asia Pacific	Total
Year ended February 28, 2014	14.0%	23.9%	9.7%	15.5%
Year ended February 28, 2013	19.4%	10.6%	18.3%	17.3%
Year ended February 29, 2012	22.7%	29.0%	26.7%	24.6%

Excluding the impact of changes in foreign currency exchange rates, revenue from the Americas, EMEA and Asia Pacific grew approximately 14.7%, 19.7% and 23.9%, respectively, for the year ended February 28, 2014. Excluding the impact of changes in foreign currency exchange rates, total revenue grew by 17.1% for the year ended February 28, 2014.

As we expand further within each region, we anticipate revenue growth rates in local currencies to become more similar among our geographic regions due to the similarity of products and services offered and the similarity in customer types or classes.

Gross profit margin

Gross profit margin decreased slightly to 84.8% for the year ended February 28, 2014 from 84.9% for the year ended February 28, 2013 as a result of increased amortization related to the prior fiscal year's complementary middleware and cloud-management technology acquisitions and increased staffing to support our emerging cloud offerings, such as OpenStack and OpenShift. These incremental amortization and staffing costs were partially offset by a slight product mix shift from services to subscriptions due to the higher gross profit margins for subscriptions.

Gross profit margin by geography

Gross profit margins by geographic region for fiscal 2014, fiscal 2013 and fiscal 2012 were as follows:

	Americas	EMEA	Asia Pacific	Total
Year ended February 28, 2014	85.0%	88.8%	83.2%	84.8%
Year ended February 28, 2013	84.9%	88.9%	83.9%	84.9%
Year ended February 29, 2012	84.4%	87.7%	82.7%	84.2%

Regional year-over-year variations in gross profit margins are primarily due to slight product mix shifts between subscriptions and services.

As we continue to expand our sales and support services within our geographic regions, we expect gross profit margins across geographic regions 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. These geographic profit margins exclude the impact of share-based compensation expense, which was not allocated to our geographic regions.

Table of Contents**Income from operations**

Operating income was 15.1% of total revenue for each of the years ended February 28, 2014 and February 28, 2013. Operating expenses as a percent of revenue decreased to 69.7% for the year ended February 28, 2014 from 69.8% for the year ended February 28, 2013 as savings realized from our general and administrative functions offset the increase in costs from investments made in our sales and marketing and research and development functions.

Income from operations by geography

Operating income as a percentage of revenue generated by our geographic regions for fiscal 2014, fiscal 2013 and fiscal 2012 was as follows:

	Americas	EMEA	Asia Pacific	Total (1)
Year ended February 28, 2014	20.4%	26.9%	25.1%	15.1%
Year ended February 28, 2013	21.2%	25.4%	24.5%	15.1%
Year ended February 29, 2012	23.1%	29.0%	24.7%	17.6%

- (1) Total operating income as a percentage of revenue includes corporate (non-allocated) share-based compensation expense for the years ended February 28, 2014, February 28, 2013 and February 29, 2012 of \$113.8 million, \$98.7 million and \$79.3 million, respectively. For additional information, see NOTE 20 Segment Reporting to our Consolidated Financial Statements.

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 February 28, 2014 totaled \$1.49 billion. Cash generated from operating activities for the year ended February 28, 2014 totaled \$540.6 million, which represents an increase of 16.2% in operating cash flow as compared to the year ended February 28, 2013. This increase is due to an increase in subscription and services revenues, billings and collections during the same period.

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

Foreign currency exchange rates impact on results of operations

Approximately 44.7% of our revenue for the year ended February 28, 2014 came from sales outside the U.S. 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. 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 our prior fiscal year ended February 28, 2013, our revenue and operating expenses from non-U.S. operations for the fiscal year ended February 28, 2014 would have been higher than we reported by approximately \$21.4 million and \$12.1 million, respectively, which would have resulted in income from operations being higher by \$9.3 million.

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Business combinations

During the year ended February 28, 2013, we completed the acquisition of ManageIQ, Inc. (*ManageIQ*) for approximately \$104.5 million in cash. ManageIQ is a provider of enterprise cloud management and automation solutions that enable organizations to deploy, manage and optimize private clouds, public clouds and virtualized infrastructures. As a result of the acquisition of ManageIQ, operating expenses increased by approximately \$3.0 million for the year ended February 28, 2013.

Also during the year ended February 28, 2013, we acquired two businesses operating in the middleware space. These acquisitions include technologies that are complementary to our Red Hat JBoss Middleware technology. One acquisition, which included certain assets and related operations acquired from Polymita Technologies S.L. (*Polymita*), closed on August 28, 2012. The second acquisition closed on September 7, 2012 and included certain assets and related operations acquired from FuseSource, a division of Progress Software Corporation (*FuseSource*). Transaction fees related to these two acquisitions totaled approximately \$1.0 million for the year ended February 28, 2013 and are included in general and administrative expense on our Consolidated Statement of Operations for the year ended February 28, 2013. As a result of these two acquisitions, operating expenses increased by approximately \$8.0 million for the year ended February 28, 2013.

During the year ended February 29, 2012, 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 \$137.2 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.

For further discussion related to our acquisitions, see NOTE 3 Business Combinations to our Consolidated Financial Statements.

Facility exit costs

In December 2011, we entered into an agreement to sublease a building located in downtown Raleigh, North Carolina in which our headquarters is currently located. In connection with the transition to our new headquarters, we have subleased or entered into agreements to assign our existing leases related to the two facilities that previously constituted our headquarters in Raleigh, North Carolina.

In May 2012, we entered into a sublease agreement with an unrelated third-party to lease one of the two facilities that previously constituted our headquarters. As a result, we recognized a loss of \$3.1 million for the year ended February 28, 2013, which represented the excess of our remaining obligation on the space over the agreed sublease income.

We ceased using the remaining facility in June 2013 and, as a result, recognized a loss of \$2.2 million which represented the remaining costs associated with our exit from the facility. In August 2013, we agreed to assign our lease related to the remaining facility to an unrelated third party effective September 2014.

Table of Contents**CRITICAL ACCOUNTING ESTIMATES**

We prepare our consolidated financial statements in accordance with accounting principles generally accepted in the U.S. (U.S. GAAP). Our significant accounting policies are disclosed in NOTE 2 Summary of Significant Accounting Policies to our Consolidated Financial Statements and describe our methods for applying U.S. GAAP in areas such as revenue recognition, deferred selling costs, fair value measurements, and foreign currency translation among other areas deemed significant. In applying certain significant accounting policies, we have to make estimates and assumptions that affect our reported amounts of assets, liabilities, revenue, and expenses, as well as related disclosure of contingent assets and liabilities. In some cases, changes in the accounting estimates are reasonably likely to occur from period to period. Accordingly, actual results could differ materially from our estimates. To the extent that there are material differences between these estimates and actual results, our financial condition, results of operations or cash flows could be adversely affected. We base our estimates on past experience and other assumptions that we believe are reasonable under the circumstances, and we evaluate these estimates on an ongoing basis. We refer to accounting estimates of this type as critical accounting estimates, which we discuss further below. Critical accounting estimates are applied in the following areas:

- Revenue recognition;
- Goodwill and other long-lived assets;
- Share-based compensation;
- Income taxes; and
- Loss contingencies.

Revenue recognition

Application of accounting principles related to the measurement and recognition of revenue requires judgment. For example, in transactions that include multiple elements, we must exercise judgment in determining whether adequate vendor-specific objective evidence (VSOE) of fair value exists for each undelivered element. Changes to the elements in a transaction, the ability to identify VSOE for those elements, and changes in the fair value of the respective elements could materially impact the amount of earned and unearned revenue.

In addition, complex arrangements with nonstandard terms and conditions may require significant contract interpretation to determine appropriate accounting, including whether the deliverables specified in a multiple element transaction should be treated as separate units of accounting.

Goodwill and other long-lived assets

We make judgments about the recoverability of goodwill, identifiable intangible assets and other long-lived assets, including capitalized software purchased or developed for internal use. The assumptions and estimates used to determine recoverability of goodwill, identifiable intangible assets and other long-lived assets are complex and subjective. They can be affected by various factors, including external factors, such as industry and economic trends, and internal factors, such as changes in our business strategy and our internal, multi-year forecasts for our subscription and services offerings, which often include emerging technologies. Changes in any of these various factors could materially impact our financial condition and results of operations.

Share-based compensation

We are required to make estimates and assumptions with regards to the number of share-based awards that we expect will ultimately vest and the amount of tax benefits we expect will ultimately be realized, among other things.

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Share-based awards expected to vest

We currently apply an estimated annual forfeiture rate of 10% to the service-based share awards we grant to our employees. Our estimated forfeiture rate is based on recent historical experience as well as qualitative considerations about management's expectations for attrition rates over the vesting periods. Actual attrition rates could vary significantly from our expectations resulting in material quarterly adjustments to our financial results. During the year ended February 28, 2014 we granted service-based share awards with a total fair value of \$120.9 million to which we applied an estimated annual forfeiture rate of 10%.

With respect to performance-based awards that we grant to certain executive officers and senior management, we estimate the number of shares expected to vest based primarily on our most current reported financial results relative to a defined peer group's most recent reported financial results. Because past or current financial trends may not be predictive of future financial performance, our estimate of the number of shares expected to vest may differ materially from the number of shares that actually vest. The maximum number of potential performance-based shares available to vest as of February 28, 2014 totaled 1.7 million, of which approximately 1.1 million shares are expected to vest. If all of the potential performance-based shares were to vest, we would be required to recognize additional expense of approximately \$6.0 million. See NOTE 13 Share-based Awards to our Consolidated Financial Statements for further discussion related to awards outstanding and expected to vest.

Income tax benefits related to share-based awards

We recognize share-based compensation expense based on an award's grant date fair value over the requisite service period. Because we do not know the actual amount of tax benefits an award will generate until such award is exercised (or vested), we assume that the amount ultimately recognized for tax purposes will be the same amount we recognized in our operating results, that is for book purposes. Consequently, our deferred tax asset related to share-based compensation expense, which totaled \$32.5 million as of February 28, 2014, is based on each qualifying award's grant date fair value rather than the award's to-be-determined exercise date intrinsic value (or vesting date fair value).

Historically, the difference between the grant date fair value and the exercise date intrinsic value has been significant. As a result of such differences, for the years ended February 28, 2014, February 28, 2013 and February 29, 2012, we realized excess tax benefits related to share-based awards totaling \$12.8 million, \$34.2 million and \$29.9 million, respectively.

If the share price for our common stock were to depreciate for a sustained period of time we could be required to recognize a tax benefit shortfall. Such shortfalls could have a material adverse effect on our cash flows and to the extent such shortfalls accumulate in excess of approximately \$170.0 million (the amount of our accumulated pool of windfall tax benefits available to offset future shortfalls) could materially adversely impact our results of operations. For further discussion, see NOTE 2 Summary of Significant Accounting Policies, NOTE 11 Income Taxes and NOTE 13 Share-based Awards to our Consolidated Financial Statements.

Income taxes

As described in NOTE 2 Summary of Significant Accounting Policies to our Consolidated Financial Statements, we account for income taxes using the liability method in which deferred tax assets or liabilities are recognized for the temporary differences between financial reporting and tax bases of our assets and liabilities and for tax carryforwards at enacted statutory tax rates in effect for the years in which the differences are expected to reverse.

We continue to assess the realizability of our deferred tax assets, which primarily consist of share-based compensation expense deductions (described above), tax credit carryforwards and deferred revenue. In assessing the realizability of these deferred tax assets, management considers whether it is more likely than not that some

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portion or all of the deferred tax assets will be realized. As of February 28, 2014, deferred tax assets totaled \$137.9 million, of which \$0.7 million was offset by a valuation allowance. For further discussion regarding deferred income taxes see NOTE 2 Summary of Significant Accounting Policies and NOTE 11 Income Taxes to our Consolidated Financial Statements.

Because tax laws are complex and subject to different interpretations, significant judgment is required. As a result, we make certain estimates and assumptions in (i) calculating our income tax expense, deferred tax assets and deferred tax liabilities, (ii) determining any valuation allowance recorded against deferred tax assets and (iii) evaluating the amount of unrecognized tax benefits, as well as the interest and penalties related to such uncertain tax positions. Our estimates and assumptions may differ significantly from tax benefits ultimately realized. For further discussion regarding uncertain tax positions see NOTE 11 Income Taxes to our Consolidated Financial Statements.

Loss contingencies

We are subject to the possibility of various losses arising in the course of conducting our business, including losses related to legal proceedings and claims brought against us. We consider the likelihood of loss or impairment of an asset or the incurrence of a liability, as well as our ability to reasonably estimate the amount of loss, in determining loss contingencies. An estimated loss contingency is accrued when it is probable that an asset has been impaired or a liability has been incurred and the amount of loss can be reasonably estimated.

Significant judgment is required in evaluating both the likelihood and the estimated amount of a potential loss. Until the final resolution of a matter, there may be an exposure to loss in excess of the amount recorded, and such amount could be material. Should any of our estimates or assumptions change or prove to have been incorrect, it could materially adversely impact on our business, financial condition, operating results or cash flows.

Table of Contents**RESULTS OF OPERATIONS****Years ended February 28, 2014 and February 28, 2013**

The following table is a summary of our results of operations for the years ended February 28, 2014 and February 28, 2013 (in thousands):

	Year Ended		\$ Change	% Change
	February 28, 2014	February 28, 2013		
Revenue:				
Subscriptions	\$ 1,336,771	\$ 1,148,341	\$ 188,430	16.4%
Training and services	197,844	180,476	17,368	9.6
Total subscription and training and services revenue	\$ 1,534,615	\$ 1,328,817	\$ 205,798	15.5%
Cost of subscription and training and services revenue:				
Cost of subscriptions	97,100	80,340	16,760	20.9
As a % of subscription revenue	7.3%	7.0%		
Cost of training and services	135,500	120,260	15,240	12.7
As a % of training and services revenue	68.5%	66.6%		
Total cost of subscription and training and services revenue	\$ 232,600	\$ 200,600	\$ 32,000	16.0%
As a % of total revenue	15.2%	15.1%		
Total gross profit	\$ 1,302,015	\$ 1,128,217	\$ 173,798	15.4%
Operating expense:				
Sales and marketing	597,885	514,554	83,331	16.2
Research and development	317,263	263,150	54,113	20.6
General and administrative	152,407	146,333	6,074	4.2
Facility exit costs	2,171	3,142	(971)	(30.9)
Total operating expense	\$ 1,069,726	\$ 927,179	\$ 142,547	15.4%
Income from operations	232,289	201,038	31,251	15.5
Interest income	6,645	8,245	(1,600)	(19.4)
Other income (expense), net	614	469	145	30.9
Income before provision for income taxes	\$ 239,548	\$ 209,752	\$ 29,796	14.2%
Provision for income taxes	61,256	59,548	1,708	2.9
Net income	\$ 178,292	\$ 150,204	\$ 28,088	18.7%
Gross profit margin subscriptions	92.7%	93.0%		
Gross profit margin training and services	31.5%	33.4%		
Gross profit margin	84.8%	84.9%		
As a % of total revenue:				
Subscription revenue	87.1%	86.4%		
Training and services revenue	12.9%	13.6%		
Sales and marketing expense	39.0%	38.7%		
Research and development expense	20.7%	19.8%		
General and administrative expense	9.9%	11.0%		
Facility exit costs	0.1%	0.2%		

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Total operating expenses	69.7%	69.8%
Income from operations	15.1%	15.1%
Income before provision for income taxes	15.6%	15.8%
Net income	11.6%	11.3%
Effective income tax rate	25.6%	28.4%

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

Subscription revenue, which is primarily comprised of direct and indirect sales of Red Hat enterprise offerings, increased by 16.4%, or \$188.4 million, to \$1.34 billion for the year ended February 28, 2014 from \$1.15 billion for the year ended February 28, 2013.

Revenue derived from the sale of subscriptions supporting our Infrastructure-related offerings increased by 13.9%, or \$143.1 million, to \$1.17 billion for the year ended February 28, 2014 from \$1.03 billion for the year ended February 28, 2013 and is primarily due to increases in volumes sold, including additional subscriptions attributable to geographic expansion and the continued migration of enterprises to our open source Linux platform from proprietary Unix platforms.

Revenue derived from the sale of subscriptions supporting our Application Development-related and other emerging technology offerings increased by 37.6%, or \$45.3 million, to \$165.7 million for the year ended February 28, 2014 from \$120.4 million for the year ended February 28, 2013. The increase is primarily due to additional subscriptions for Red Hat JBoss Middleware offerings. We expect the growth rate of revenue derived from our Application Development-related and other emerging technology offerings to exceed the growth rate of revenue derived from our Infrastructure-related offerings as our Application Development-related and other emerging technology offerings continue to gain broader market acceptance in the enterprise IT environment.

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 9.6%, or \$17.4 million, to \$197.8 million for the year ended February 28, 2014 from \$180.5 million for the year ended February 28, 2013. Training revenue increased 3.0%, or \$1.5 million. Our services revenue increased by 12.2%, or \$15.8 million, as a result of an increase in consulting engagements driven by increased demand for our open source solutions. We expect services revenue to continue growing, though at a slower pace than subscription revenue as we continue to expand our reach by enabling our channel partners to provide consulting services on our behalf. Combined training and services revenue as a percentage of total revenue was 12.9% and 13.6% for the year ended February 28, 2014 and February 28, 2013, respectively.

Cost of revenue*Cost of subscription revenue*

The cost of subscription revenue primarily consists of expenses we incur to support, distribute, and package Red Hat enterprise offerings. These costs include labor-related cost to provide technical support, security updates and fixes, as well as costs for fulfillment, physical media, literature, packaging and shipping. Cost of subscription revenue increased by 20.9%, or \$16.8 million, to \$97.1 million for the year ended February 28, 2014 from \$80.3 million for the year ended February 28, 2013. Employee-related expenses increased \$11.7 million for the year ended February 28, 2014 as compared to the year ended February 28, 2013, due to the expansion of our technical staff in order to meet the demands of our growing subscriber base for support, security updates and fixes. The remaining increase relates to increased amortization expense of \$5.3 million related to technologies acquired either directly or as part of businesses acquired during the year ended February 28, 2013. As the number of open source technology subscriptions continues to increase, we expect associated support cost will continue to increase, although we anticipate this will occur at an overall slower rate than that of subscription revenue growth due to economies of scale. Gross profit margin on subscriptions was 92.7% and 93.0% for the year ended February 28, 2014 and February 28, 2013, respectively.

Table of Contents*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 12.7%, or \$15.2 million, to \$135.5 million for the year ended February 28, 2014 from \$120.3 million for the year ended February 28, 2013. Costs to deliver our services revenue increased by 15.7%, or \$14.5 million, to \$107.3 million for the year ended February 28, 2014. The increase in costs to deliver services includes \$8.1 million and \$6.3 million of increased outside contractor fees and employee compensation expenses, respectively. The increase in both contractor fees and employee compensation expense is due to the necessary expansion of our professional consulting teams needed to provide services related to our emerging technology offerings. As a result of such investment in staffing, profit margin from professional services decreased to 26.1% for the year ended February 28, 2014 from 28.3% for the year ended February 28, 2013. Total costs to deliver training and services as a percentage of training and services revenue increased to 68.5% for the year ended February 28, 2014 from 66.6% for the year ended February 28, 2013.

Gross profit

Gross profit margin decreased slightly to 84.8% for the year ended February 28, 2014 from 84.9% for the year ended February 28, 2013 as a result of both increased amortization expense related to the prior fiscal year's middleware and cloud-management technology acquisitions and increased staffing to support our emerging cloud offerings. These incremental amortization and staffing costs were partially offset by a slight product mix shift from services to subscriptions.

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 16.2%, or \$83.3 million, to \$597.9 million for the year ended February 28, 2014 from \$514.6 million for the year ended February 28, 2013. Selling costs increased 16.1%, or \$62.6 million, for the year ended February 28, 2014 as compared to the year ended February 28, 2013 and includes \$56.3 million of additional employee- and travel-related expenses, the majority of which is attributable to the expansion of our sales force from the prior year. Marketing costs grew 16.5%, or \$20.7 million, for the year ended February 28, 2014 as compared to the year ended February 28, 2013. The increase in marketing costs includes \$10.9 million of employee compensation expense related to increased headcount and incremental advertising costs of \$10.0 million to support our marketing efforts. The remaining increase in sales and marketing costs primarily relates to facility and technology infrastructure enhancements, which increased \$4.6 million for the year ended February 28, 2014 as compared to the year ended February 28, 2013. As a result of continued investments made to expand the breadth of our global sales coverage and depth of our product sales coverage, sales and marketing expense as a percentage of revenue increased to 39.0% for the year ended February 28, 2014 from 38.7% for the year ended February 28, 2013.

Research and development

Research and development expense consists primarily of personnel and related costs for development of software technologies. Research and development expense increased by 20.6%, or \$54.1 million, to \$317.3 million for the year ended February 28, 2014 from \$263.2 million for the year ended February 28, 2013. Employee compensation increased by \$41.9 million primarily from the expansion of our engineering group through both direct hires and business acquisitions. The remaining increase in research and development costs relates primarily to process and technology infrastructure enhancements, which increased \$7.4 million. Research and development expense was 20.7% and 19.8% of total revenue for the year ended February 28, 2014 and February 28, 2013, respectively.

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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 4.2%, or \$6.1 million, to \$152.4 million for the year ended February 28, 2014 from \$146.3 million for the year ended February 28, 2013. The increase in general and administrative expenses results from increased employee compensation expenses of \$10.3 million, primarily related to additional headcount, and increased facilities and information systems costs of \$3.2 million. Partially offsetting employee compensation, facilities and information systems costs were outside professional services and