

RED HAT INC
Form 10-Q
October 05, 2012
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended August 31, 2012

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)

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Delaware
(State or other jurisdiction of

06-1364380
(I.R.S. Employer

incorporation or organization)

Identification No.)

1801 Varsity Drive, Raleigh, North Carolina 27606

(Address of principal executive offices, including zip code)

(919) 754-3700

(Registrant's telephone number, including area code)

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

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

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

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

As of October 1, 2012, there were 193,324,891 shares of common stock outstanding.

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

	August 31, 2012 (Unaudited)	February 29, 2012 (1)
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 571,576	\$ 549,217
Investments in debt and equity securities, short-term	297,876	264,298
Accounts receivable, net of allowances for doubtful accounts of \$1,929 and \$1,877, respectively	215,433	255,180
Deferred tax assets, net	72,007	69,765
Prepaid expenses	85,642	81,266
Other current assets	2,135	1,629
Total current assets	\$ 1,244,669	\$ 1,221,355
Property and equipment, net of accumulated depreciation and amortization of \$172,924 and \$163,892, respectively	113,092	92,065
Goodwill	595,430	591,563
Identifiable intangibles, net	122,709	100,638
Investments in debt securities, long-term	490,168	446,838
Other assets, net	39,573	38,640
Total assets	\$ 2,605,641	\$ 2,491,099
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable and accrued expenses	\$ 139,060	\$ 114,078
Deferred revenue	704,573	711,408
Other current obligations	963	819
Total current liabilities	\$ 844,596	\$ 826,305
Long-term deferred revenue	239,827	235,328
Other long-term obligations	37,535	30,649
Commitments and contingencies (NOTE 12 and NOTE 13)		
Stockholders' equity:		
Preferred stock, 5,000,000 shares authorized, none outstanding		
Common stock, \$0.0001 per share par value, 300,000,000 shares authorized, 227,721,987 and 226,553,435 shares issued, and 193,211,928 and 192,654,636 shares outstanding at August 31, 2012 and February 29, 2012, respectively	23	23
Additional paid-in capital	1,761,524	1,709,082
Retained earnings	464,142	391,676
Treasury stock at cost, 34,510,059 and 33,898,799 shares at August 31, 2012 and February 29, 2012, respectively	(728,894)	(696,012)
Accumulated other comprehensive loss	(13,112)	(5,952)
Total stockholders' equity	\$ 1,483,683	\$ 1,398,817
Total liabilities and stockholders' equity	\$ 2,605,641	\$ 2,491,099

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(1) Derived from audited financial statements.

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

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

	Three Months Ended		Six Months Ended	
	August 31, 2012	August 31, 2011	August 31, 2012	August 31, 2011
Revenue:				
Subscriptions	\$ 278,800	\$ 238,337	\$ 551,371	\$ 463,870
Training and services	43,795	42,983	85,956	82,196
Total subscription and training and services revenue	322,595	281,320	637,327	546,066
Cost of subscription and training and services revenue:				
Cost of subscriptions	18,846	16,596	36,786	31,835
Cost of training and services	29,012	30,043	57,092	57,251
Total cost of subscription and training and services revenue	47,858	46,639	93,878	89,086
Gross profit	274,737	234,681	543,449	456,980
Operating expense:				
Sales and marketing	123,578	99,730	244,449	197,056
Research and development	63,366	51,488	123,246	99,776
General and administrative	37,813	30,985	71,724	62,311
Facility exit costs (NOTE 12)	0	0	3,142	0
Total operating expense	224,757	182,203	442,561	359,143
Income from operations	49,980	52,478	100,888	97,837
Interest income	2,154	2,127	4,448	4,063
Other income (expense), net	(656)	326	1,232	59
Income before provision for income taxes	51,478	54,931	106,568	101,959
Provision for income taxes	16,473	14,963	34,102	29,542
Net income	\$ 35,005	\$ 39,968	\$ 72,466	\$ 72,417
Basic net income per common share	\$ 0.18	\$ 0.21	\$ 0.38	\$ 0.38
Diluted net income per common share	\$ 0.18	\$ 0.20	\$ 0.37	\$ 0.37
Weighted average shares outstanding				
Basic	193,064	192,937	193,005	193,046
Diluted	195,795	196,171	195,929	196,428

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

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

	Three Months Ended		Six Months Ended	
	August 31, 2012	August 31, 2011	August 31, 2012	August 31, 2011
Net income	\$ 35,005	\$ 39,968	\$ 72,466	\$ 72,417
Other comprehensive income (loss), net of tax:				
Foreign currency translation adjustment	1,242	(9)	(8,078)	2,615
Unrealized gain (loss) on securities during period	1,252	(1,968)	1,297	(477)
Reclassification for gain recognized during period	(15)	(666)	(379)	(1,326)
Total other comprehensive income (loss), net of tax	2,479	(2,643)	(7,160)	812
Comprehensive income	\$ 37,484	\$ 37,325	\$ 65,306	\$ 73,229

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

	Three Months Ended		Six Months Ended	
	August 31, 2012	August 31, 2011	August 31, 2012	August 31, 2011
Cash flows from operating activities:				
Net income	\$ 35,005	\$ 39,968	\$ 72,466	\$ 72,417
Adjustments to reconcile net income to net cash provided by operating activities:				
Depreciation and amortization	14,568	13,147	28,647	25,886
Share-based compensation expense	23,859	18,753	46,065	34,940
Deferred income taxes	13,036	8,155	23,063	19,210
Excess tax benefits from share-based payment arrangements	(9,600)	(8,112)	(19,800)	(16,672)
Other	529	(240)	(1,840)	(317)
Changes in operating assets and liabilities net of effects of acquisitions:				
Accounts receivable	(18,735)	(20,457)	35,825	11,585
Prepaid expenses	833	65	(6,966)	(3,228)
Accounts payable and accrued expenses	15,250	3,328	26,348	(611)
Deferred revenue	26,430	22,851	21,308	24,121
Other	2,678	(357)	3,141	(19)
Net cash provided by operating activities	103,853	77,101	228,257	167,312
Cash flows from investing activities:				
Purchase of investment in debt securities available for sale	(185,028)	(220,436)	(507,769)	(401,286)
Proceeds from sales and maturities of investment in debt securities available for sale	190,094	208,693	417,779	381,276
Acquisition of business, net of cash acquired	(10,051)	0	(10,051)	0
Purchase of other intangible assets	(24,341)	(1,059)	(26,863)	(3,602)
Purchase of property and equipment	(20,344)	(11,523)	(36,243)	(20,179)
Other	0	(319)	330	346
Net cash used in investing activities	(49,670)	(24,644)	(162,817)	(43,445)
Cash flows from financing activities:				
Excess tax benefits from share-based payment arrangements	9,600	8,112	19,800	16,672
Proceeds from exercise of common stock options	2,626	3,370	6,516	8,413
Payments related to net settlement of share-based compensation awards	(3,856)	(2,952)	(22,688)	(11,985)
Purchase of treasury stock	(2,871)	(38,006)	(32,882)	(56,952)
Payments on other borrowings	(213)	(94)	(477)	(688)
Net cash provided by (used in) financing activities	5,286	(29,570)	(29,731)	(44,540)
Effect of foreign currency exchange rates on cash and cash equivalents	3,491	4,348	(13,350)	15,501

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Net increase in cash and cash equivalents	62,960	27,235	22,359	94,828
Cash and cash equivalents at beginning of the period	508,616	710,223	549,217	642,630
Cash and cash equivalents at end of the period	\$ 571,576	\$ 737,458	\$ 571,576	\$ 737,458

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

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RED HAT, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

NOTE 1 Company

Red Hat, Inc., incorporated in Delaware, together with its subsidiaries (Red Hat or the Company) is a global leader in providing open source software solutions to the enterprise. The Company is also the market leader in providing enterprise-ready open source operating system platforms. The Company applies its technology leadership to create its: enterprise operating platform, Red Hat Enterprise Linux; enterprise middleware platform, Red Hat JBoss Middleware; virtualization solutions and other infrastructure technology solutions, based on open source technology. The Company's enterprise solutions are intended to meet the functionality requirements and performance demands of the enterprise and third-party computer hardware and software applications that are critical to the enterprise. The Company provides these solutions through content distribution and management services, Red Hat Network, Red Hat Network Satellite and Red Hat JBoss Operations Network, which allow various Red Hat enterprise technologies to be updated and configured and the performance of these and other technologies to be monitored in an automated fashion. These solutions reflect the Company's continuing commitment to provide an enterprise-wide infrastructure platform and developer solutions based on open source technology. The Company derives its revenue and generates its cash from customers primarily from two sources: (i) subscriptions for its enterprise technologies and (ii) training and services revenue, as further described below in NOTE 2 Summary of Significant Accounting Policies contained in the Company's Annual report on Form 10-K for the year ended February 29, 2012.

NOTE 2 Summary of Significant Accounting Policies

Unaudited Interim Financial Information

The unaudited interim consolidated financial statements as of and for the three months and six months ended August 31, 2012 have been prepared by the Company pursuant to the rules and regulations of the Securities and Exchange Commission (the SEC) for interim financial reporting. These consolidated statements are unaudited and, in the opinion of management, include all adjustments (consisting of normal recurring adjustments and accruals) necessary to present fairly the consolidated balance sheets, consolidated operating results and consolidated cash flows for the periods presented in accordance with accounting principles generally accepted in the United States of America. Operating results for the three months and six months ended August 31, 2012 are not necessarily indicative of the results that may be expected for the fiscal year ending February 28, 2013. Certain information and footnote disclosures normally included in annual financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been omitted in accordance with the SEC's rules and regulations for interim reporting. For further information, see the Company's Consolidated Financial Statements, including notes thereto, included in the Company's Annual Report on Form 10-K for the fiscal year ended February 29, 2012.

Principles of Consolidation

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

Use of Estimates

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

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

There have been no changes to the Company's significant accounting policies from those described in NOTE 2 Summary of Significant Accounting Policies to the Consolidated Financial Statements contained in the Company's Annual Report on Form 10-K for the year ended February 29, 2012. These unaudited financial statements should be read in conjunction with such Annual Report on Form 10-K.

Recent Accounting Pronouncements

In July 2012, the FASB issued Accounting Standards Update No. 2012-02, *Intangibles - Goodwill and Other (Topic 350) Testing Indefinite-Lived Intangible Assets for Impairment* (ASU 2012-02), to simplify how entities test intangibles with indefinite lives for impairment. ASU 2012-02 gives entities the option to first assess qualitative factors to determine whether it is more likely than not that the fair value of an intangible asset is less than its carrying amount. If a greater than 50 percent likelihood exists that the fair value is less than the carrying amount then a quantitative impairment test as described in Subtopic 350-30 must be performed. ASU 2012-02 is effective for the Company in its first quarter of fiscal 2014 but is eligible for early adoption. The Company does not believe that this updated standard will have a significant impact on its consolidated financial statements.

In December 2011, the FASB issued Accounting Standards Update No. 2011-11, *Balance Sheet (Topic 210) Disclosures about Offsetting Assets and Liabilities* (ASU 2011-11), to require entities to disclose information about offsetting and related arrangements of financial instruments and derivative instruments. ASU 2011-11 is effective for the Company in the first quarter of its fiscal year ending February 28, 2014 (fiscal 2014). The Company does not believe that this updated standard will have a significant impact on its consolidated financial statements.

NOTE 3 Changes in Equity

The following table summarizes the changes in the Company's stockholders' equity, including other comprehensive income, during the three months ended August 31, 2012 (in thousands):

	Common Stock	Additional Paid-In Capital	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income (Loss)	Total Stockholders Equity
Balance at May 31, 2012	\$ 23	\$ 1,728,175	\$ 429,137	\$ (726,023)	\$ (15,591)	\$ 1,415,721
Net income	0	0	35,005	0	0	35,005
Foreign currency translation adjustment	0	0	0	0	1,242	1,242
Unrealized gain (loss) on securities during period, net of tax	0	0	0	0	1,252	1,252
Reclassification for gain recognized during period	0	0	0	0	(15)	(15)
Exercise of common stock options	0	2,626	0	0	0	2,626
Common stock repurchase (see NOTE 10)	0	0	0	(2,871)	0	(2,871)
Share-based compensation expense	0	23,859	0	0	0	23,859
Tax benefits related to share-based awards	0	10,720	0	0	0	10,720
Minimum tax withholdings paid by the Company on behalf of employees related to net settlement of employee share-based awards	0	(3,856)	0	0	0	(3,856)
Balance at August 31, 2012	\$ 23	\$ 1,761,524	\$ 464,142	\$ (728,894)	\$ (13,112)	\$ 1,483,683

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

The following table summarizes the changes in the Company's stockholders' equity, including other comprehensive income, during the three months ended August 31, 2011 (in thousands):

	Common Stock	Additional Paid-In Capital	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income (Loss)	Total Stockholders Equity
Balance at May 31, 2011	\$ 22	\$ 1,633,083	\$ 277,499	\$ (581,738)	\$ 1,636	\$ 1,330,502
Net income	0	0	39,968	0	0	39,968
Foreign currency translation adjustment	0	0	0	0	(9)	(9)
Unrealized gain (loss) on securities during period, net of tax	0	0	0	0	(1,968)	(1,968)
Reclassification for gain recognized during period	0	0	0	0	(666)	(666)
Exercise of common stock options	0	3,370	0	0	0	3,370
Common stock repurchase (see NOTE 10)	0	0	0	(38,006)	0	(38,006)
Share-based compensation expense	0	18,753	0	0	0	18,753
Tax benefits related to share-based awards	0	12,179	0	0	0	12,179
Minimum tax withholdings paid by the Company on behalf of employees related to net settlement of employee share-based awards	0	(2,952)	0	0	0	(2,952)
Balance at August 31, 2011	\$ 22	\$ 1,664,433	\$ 317,467	\$ (619,744)	\$ (1,007)	\$ 1,361,171

The following table summarizes the changes in the Company's stockholders' equity, including other comprehensive income, during the six months ended August 31, 2012 (in thousands):

	Common Stock	Additional Paid-In Capital	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income (Loss)	Total Stockholders Equity
Balance at February 29, 2012	\$ 23	\$ 1,709,082	\$ 391,676	\$ (696,012)	\$ (5,952)	\$ 1,398,817
Net income	0	0	72,466	0	0	72,466
Foreign currency translation adjustment	0	0	0	0	(8,078)	(8,078)
Unrealized gain (loss) on securities during period, net of tax	0	0	0	0	1,297	1,297
Reclassification for gain recognized during period	0	0	0	0	(379)	(379)
Exercise of common stock options	0	6,516	0	0	0	6,516
Common stock repurchase (see NOTE 10)	0	0	0	(32,882)	0	(32,882)
Share-based compensation expense	0	46,065	0	0	0	46,065
Tax benefits related to share-based awards	0	22,549	0	0	0	22,549
Minimum tax withholdings paid by the Company on behalf of employees related to	0	(22,688)	0	0	0	(22,688)

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net settlement of employee share-based awards

Balance at August 31, 2012	\$	23	\$ 1,761,524	\$ 464,142	\$ (728,894)	\$	(13,112)	\$ 1,483,683
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Table of Contents**RED HAT, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)**

The following table summarizes the changes in the Company's stockholders' equity, including other comprehensive income, during the six months ended August 31, 2011 (in thousands):

	Common Stock	Additional Paid-In Capital	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income (Loss)	Total Stockholders Equity
Balance at February 28, 2011	\$ 22	\$ 1,610,238	\$ 245,050	\$ (562,792)	\$ (1,819)	\$ 1,290,699
Net income	0	0	72,417	0	0	72,417
Foreign currency translation adjustment	0	0	0	0	2,615	2,615
Unrealized gain (loss) on securities during period, net of tax	0	0	0	0	(477)	(477)
Reclassification for gain recognized during period	0	0	0	0	(1,326)	(1,326)
Exercise of common stock options	0	8,413	0	0	0	8,413
Common stock repurchase (see NOTE 10)	0	0	0	(56,952)	0	(56,952)
Share-based compensation expense	0	34,940	0	0	0	34,940
Tax benefits related to share-based awards	0	22,827	0	0	0	22,827
Minimum tax withholdings paid by the Company on behalf of employees related to net settlement of employee share-based awards	0	(11,985)	0	0	0	(11,985)
Balance at August 31, 2011	\$ 22	\$ 1,664,433	\$ 317,467	\$ (619,744)	\$ (1,007)	\$ 1,361,171

NOTE 4 Identifiable Intangible Assets

Identifiable intangible assets consist primarily of purchased technologies, customer and reseller relationships, trademarks, copyrights and patents, which are amortized over the estimated useful life, generally on a straight-line basis with the exception of customer contracts and relationships which are generally amortized over the greater of straight-line or the related asset's pattern of economic benefit. Useful lives range from three to ten years. As of August 31, 2012 and February 29, 2012, trademarks with an indefinite estimated useful life totaled \$9.7 million and \$9.5 million, respectively. The following is a summary of identifiable intangible assets (in thousands):

	Gross Amount	August 31, 2012 Accumulated Amortization	Net Amount	Gross Amount	February 29, 2012 Accumulated Amortization	Net Amount
Trademarks, copyrights and patents (1)	\$ 89,956	\$ (23,515)	\$ 66,441	\$ 62,851	\$ (20,491)	\$ 42,360
Purchased technologies (2)	64,031	(42,474)	21,557	58,781	(39,390)	19,391
Customer and reseller relationships	86,895	(52,184)	34,711	86,951	(48,064)	38,887
Total identifiable intangible assets	\$ 240,882	\$ (118,173)	\$ 122,709	\$ 208,583	\$ (107,945)	\$ 100,638

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- (1) Patents purchased during the three months ended August 31, 2012 totaled \$22.4 million. Trademarks purchased as part of a business acquisition during the three months ended August 31, 2012 totaled \$0.9 million.

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

- (2) The balance as of August 31, 2012 includes middleware technology the Company acquired as part of a business combination which closed during the three months ended August 31, 2012. The technology is complementary to the Company's existing JBoss technology. The fair value of this complementary technology was estimated at \$5.3 million as of the acquisition date. Amortization expense associated with identifiable intangible assets recognized in the Company's Consolidated Financial Statements for the three months and six months ended August 31, 2012 and August 31, 2011 is summarized as follows (in thousands):

	Three Months Ended		Six Months Ended	
	August 31, 2012	August 31, 2011	August 31, 2012	August 31, 2011
Cost of revenue	\$ 1,149	\$ 1,216	\$ 1,819	\$ 2,195
Sales and marketing	2,120	1,958	4,196	3,918
Research and development	959	1,157	1,918	2,313
General and administrative	1,181	865	2,324	1,711
Total amortization expense	\$ 5,409	\$ 5,196	\$ 10,257	\$ 10,137

NOTE 5 Income Taxes*Income Tax Expense*

The following table summarizes the Company's tax provision for the three months and six months ended August 31, 2012 and August 31, 2011:

	Three Months Ended		Six Months Ended	
	August 31, 2012	August 31, 2011	August 31, 2012	August 31, 2011
Provision for income taxes:				
Income before provision for income taxes	\$ 51,478	\$ 54,931	\$ 106,568	\$ 101,959
Estimated annual effective tax rate on current year ordinary income	32%	31%	32%	31%
Provision for income taxes on current year ordinary income	16,473	17,029	34,102	31,608
Net discrete tax benefit from a reversal of the valuation allowance on the net operating loss of a foreign subsidiary	0	2,066	0	2,066
Provision for income taxes	\$ 16,473	\$ 14,963	\$ 34,102	\$ 29,542

The Company's estimated annual effective tax rates of 32% for fiscal 2013 and 31% for fiscal 2012 differ from the U.S. federal statutory rate of 35% principally due to foreign income taxed at lower rates.

Deferred Taxes

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As of August 31, 2012 deferred tax assets (current and non-current) totaled \$89.0 million, of which \$3.6 million was offset by a valuation allowance. The Company continues to maintain a valuation allowance against its deferred tax assets with respect to certain foreign net operating loss (NOL) carryforwards.

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

As of August 31, 2012, the Company had U.S. federal and state NOL carryforwards of approximately \$11.5 million and \$35.5 million, respectively. As of August 31, 2012, the Company had a U.S. federal research tax credit carryforward of approximately \$38.3 million. The tax credit carryforwards are scheduled to expire in varying amounts beginning in fiscal 2013.

Unrecognized tax benefits

The Company's unrecognized tax benefits were \$44.5 million as of August 31, 2012 and \$43.8 million as of February 29, 2012. The Company's unrecognized tax benefits at August 31, 2012 and February 29, 2012, which, if recognized, would affect the Company's effective tax rate were \$38.8 million and \$39.9 million, respectively.

During the six months ended August 31, 2012, the amount of unrecognized tax benefits increased \$0.7 million, primarily as a result of increases with respect to tax positions taken during prior periods. The results and timing of the resolution of tax audits is highly uncertain and the Company is unable to estimate the range of possible changes to the balance of unrecognized tax benefits. However, the Company does not currently expect that within the next 12 months the total amount of unrecognized tax benefits will significantly increase or decrease. It is the Company's policy to recognize interest and penalties related to uncertain tax positions as income tax expense. Accrued interest and penalties related to unrecognized tax benefits totaled \$3.7 million and \$3.5 million as of August 31, 2012 and February 29, 2012, respectively.

The Company or one of its subsidiaries files income tax returns in the U.S. federal jurisdiction and various states and foreign jurisdictions. The following table summarizes the tax years in the Company's major tax jurisdictions that remain subject to income tax examinations by tax authorities as of August 31, 2012. Due to NOL carryforwards, in some cases the tax years continue to remain subject to examination with respect to such NOLs:

Tax Jurisdiction	Years Subject to Income Tax Examination	
U.S. federal	1994	Present
North Carolina	1999	Present
Ireland	2008	Present
Japan*	2012	Present

* The Company has been examined for income tax for years through February 28, 2011. A tax examination was concluded in fiscal 2012 with no significant adjustments resulting. However, the statute of limitations remains open for five years. The Company believes it has adequately provided for any reasonably foreseeable outcomes related to tax audits.

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

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

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RED HAT, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Level 1 Quoted prices in active markets for identical assets or liabilities.

Level 2 Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 Unobservable inputs that are supported by little or no market activity and are significant to the fair value of the assets or liabilities.

The Company's investments are comprised primarily of debt securities that are classified as available for sale and recorded at their fair market values. Liquid investments with effective original maturities of 90 days or less from the balance sheet date are classified as cash equivalents. Investments with remaining effective maturities of twelve months or less from the balance sheet date are classified as short-term investments. Investments with remaining effective maturities of more than twelve months from the balance sheet date are classified as long-term investments. The Company's Level 1 financial instruments are valued using quoted prices in active markets for identical instruments. The Company's Level 2 financial instruments, including derivative instruments, are valued using quoted prices for identical instruments in less active markets or using other observable market inputs for comparable instruments.

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

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

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

The following table summarizes the composition and fair value hierarchy of the Company's financial assets and liabilities at August 31, 2012 (in thousands):

	As of August 31, 2012	Quoted Prices In Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Money markets (1)	\$ 395,322	\$ 395,322	\$ 0	\$ 0
Interest-bearing deposits (1)	54,672	0	54,672	0
Available-for-sale securities (1):				
Commercial paper	51,882	0	51,882	0
U.S. agency securities	385,072	0	385,072	0
Municipal bonds	4,056	0	4,056	0
Corporate securities	287,345	0	287,345	0
Foreign government securities	36,974	0	36,974	0
Equity securities (1)	1,014	1,014	0	0
Foreign currency derivatives (2)	116	0	116	0
Liabilities:				
Foreign currency derivatives (3)	(87)	0	(87)	0
Total	\$ 1,216,366	\$ 396,336	\$ 820,030	\$ 0

(1) Included in either Cash and cash equivalents or investments in debt and equity securities in the Company's Consolidated Balance Sheet at August 31, 2012, in addition to \$143.3 million of cash.

(2) Included in Other current assets in the Company's Consolidated Balance Sheet at August 31, 2012.

(3) Included in Accounts payable and accrued expenses in the Company's Consolidated Balance Sheet at August 31, 2012.

The following table summarizes the composition and fair value hierarchy of the Company's financial assets and liabilities at February 29, 2012 (in thousands):

	As of February 29, 2012	Quoted Prices In Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Money markets (1)	\$ 322,207	\$ 322,207	\$ 0	\$ 0
Interest-bearing deposits (1)	445	0	445	0
Available-for-sale securities (1):				
U.S. Treasury securities	250	250	0	0
Commercial paper	46,478	0	46,478	0
U.S. agency securities	354,830	0	354,830	0
Municipal bonds	13,154	0	13,154	0

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Corporate securities	323,463	0	323,463	0
Foreign government securities	1,356	0	1,356	0
Equity securities (1)	1,275	1,275	0	0
Foreign currency derivatives (2)	147	0	147	0
Liabilities:				
Foreign currency derivatives (3)	(473)	0	(473)	0
Total	\$ 1,063,132	\$ 323,732	\$ 739,400	\$ 0

- (1) Included in either Cash and cash equivalents or investments in debt and equity securities in the Company's Consolidated Balance Sheet at February 29, 2012 in addition to \$196.9 million of cash.

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

- (2) Included in Other current assets in the Company's Consolidated Balance Sheet at February 29, 2012.
- (3) Included in Accounts payable and accrued expenses in the Company's Consolidated Balance Sheet at February 29, 2012.
- The following table represents the Company's investments measured at fair value as of August 31, 2012 (in thousands):

	Amortized Cost	Gross Unrealized		Aggregate Fair Value	Balance Sheet Classification		
		Gains	Losses(1)		Cash Equivalent Marketable Securities	Short-term Marketable Securities	Long-term Marketable Securities
Money markets	\$ 395,322	\$ 0	\$ 0	\$ 395,322	\$ 395,322	\$ 0	\$ 0
Interest-bearing deposits	54,672	0	0	54,672	0	54,672	0
Commercial paper	51,881	1	0	51,882	32,971	18,911	0
U.S. agency securities	384,813	350	(91)	385,072	0	40,439	344,633
Municipal bonds	4,034	22	0	4,056	0	4,056	0
Corporate securities	287,276	750	(681)	287,345	0	141,810	145,535
Foreign government securities	36,963	11	0	36,974	0	36,974	0
Equity securities	20	994	0	1,014	0	1,014	0
Total	\$ 1,214,981	\$ 2,128	\$ (772)	\$ 1,216,337	\$ 428,293	\$ 297,876	\$ 490,168

- (1) As of August 31, 2012, there were \$0.7 million of accumulated unrealized losses related to investments that have been in a continuous unrealized loss position for 12 months or longer.

The following table represents the Company's investments measured at fair value as of February 29, 2012 (in thousands):

	Amortized Cost	Gross Unrealized		Aggregate Fair Value	Balance Sheet Classification		
		Gains	Losses(1)		Cash Equivalent Marketable Securities	Short-term Marketable Securities	Long-term Marketable Securities
Money markets	\$ 322,207	\$ 0	\$ 0	\$ 322,207	\$ 322,207	\$ 0	\$ 0
Interest-bearing deposits	445	0	0	445	0	445	0
U.S. Treasury securities	250	0	0	250	0	250	0
Commercial paper	46,475	3	0	46,478	29,496	16,982	0
U.S. agency securities	354,758	172	(100)	354,830	0	38,943	315,887
Municipal bonds	13,103	51	0	13,154	0	13,154	0
Corporate securities	324,832	490	(1,859)	323,463	619	191,893	130,951
Foreign government securities	1,355	1	0	1,356	0	1,356	0
Equity securities	29	1,246	0	1,275	0	1,275	0
Total	\$ 1,063,454	\$ 1,963	\$ (1,959)	\$ 1,063,458	\$ 352,322	\$ 264,298	\$ 446,838

- (1) As of February 29, 2012, there were \$0.1 million of accumulated unrealized losses related to investments that have been in a continuous unrealized loss position for 12 months or longer.

Table of Contents**RED HAT, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)****NOTE 7 Derivative Instruments**

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

The effects of derivative instruments on the Company's Consolidated Financial Statements are as follows as of August 31, 2012 and for the three months and six months then ended (in thousands):

	As of August 31, 2012			Location of Gain (Loss) Recognized in Income on Derivative	Three Months Ended	Six Months Ended
	Balance Sheet Location	Fair Value	Notional Value		August 31, 2012	August 31, 2012
					Amount of Gain (Loss) Recognized in Income on Derivative	
Assets foreign currency forward contracts not designated as hedges	Other current assets	\$ 116	\$ 20,171	Other income (expense), net	\$ 295	\$ 574
Liabilities foreign currency forward contracts not designated as hedges	Accounts payable and accrued expenses	\$ (87)	\$ 17,128	Other income (expense), net	\$ (433)	\$ (1,142)
TOTAL		\$ 29	\$ 37,299		\$ (138)	\$ (568)

The effects of derivative instruments on the Company's Consolidated Financial Statements are as follows as of August 31, 2011 and for the three months and six months then ended (in thousands):

	As of August 31, 2011			Location of Gain (Loss) Recognized in Income on Derivative	Three Months Ended	Six Months Ended
	Balance Sheet Location	Fair Value	Notional Value		August 31, 2011	August 31, 2011
					Amount of Gain (Loss) Recognized in Income on Derivative	
Assets foreign currency forward contracts not designated as hedges	Other current assets	\$ 150	\$ 12,813	Other income (expense), net	\$ 452	\$ 999
Liabilities foreign currency forward contracts not designated as hedges	Accounts payable and accrued expenses	\$ (118)	\$ 46,364	Other income (expense), net	\$ (208)	\$ (717)

TOTAL	\$	32	\$	59,177	\$	244	\$	282
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Table of Contents**RED HAT, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)**

The aggregate notional amount of outstanding forward contracts at February 29, 2012 was \$59.7 million. The fair value of these outstanding contracts at February 29, 2012 was a gross \$0.1 million asset and a gross \$0.5 million liability, and is recorded in Other current assets and Accounts payable and accrued expenses, respectively, on the Consolidated Balance Sheets.

NOTE 8 Share-based Awards

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

The following summarizes share-based compensation expense recognized in the Company's Consolidated Financial Statements for the three months and six months ended August 31, 2012 and August 31, 2011 (in thousands):

	Three Months Ended		Six Months Ended	
	August 31, 2012	August 31, 2011	August 31, 2012	August 31, 2011
Cost of revenue	\$ 2,167	\$ 1,842	\$ 4,333	\$ 3,631
Sales and marketing	7,726	6,101	15,087	11,672
Research and development	7,294	4,883	14,106	9,077
General and administrative	6,672	5,927	12,539	10,560
Total share-based compensation	\$ 23,859	\$ 18,753	\$ 46,065	\$ 34,940

Share-based compensation expense qualifying for capitalization was insignificant for each of the three months and six months ended August 31, 2012 and August 31, 2011. Accordingly, no share-based compensation expense was capitalized during the three months and six months ended August 31, 2012 and August 31, 2011.

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

During the three months and six months ended August 31, 2012, the Company granted the following share-based awards:

	Three Months Ended		Six Months Ended	
	Shares and Shares Underlying Awards	Weighted Average Per Share Fair Value	Shares and Shares Underlying Awards	Weighted Average Per Share Fair Value
Stock options	8,458	\$ 22.12	22,563	\$ 24.63
Service-based shares and share units	267,349	\$ 51.98	456,679	\$ 55.33
Performance share units target(1)	50,900	\$ 56.48	306,900	\$ 52.23

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Performance share awards (2)	0	\$	0	128,000	\$	51.38
Total awards	326,707	\$	51.91	914,142	\$	52.97

- (1) On May 23, 2012, the Compensation Committee of the Company's Board of Directors (the Compensation Committee) approved the performance objectives to be used with, and authorized the grant of, performance

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

share units (PSUs) in FY2013 with payouts based on the Company's financial performance according to a formula specified in, and subject to the terms and conditions of, the form of financial performance-based PSU award agreement approved by the Compensation Committee on May 25, 2011 (the Operating Performance PSU Agreement). On the same date, the Compensation Committee approved the performance objective to be used with, and authorized the grant of, PSUs in FY2013 with payouts based on the performance of the Company's common stock according to a formula specified in, and subject to the terms and conditions of, the form of stock-performance based PSU award agreement approved by the Compensation Committee on May 25, 2011 (the Share Price Performance PSU Agreement). Under the Operating Performance PSU Agreement, an executive will be granted an award for a target number of PSUs, and depending on the Company's financial performance, the executive may earn up to 200% of the target number of PSUs (the Maximum PSUs) over a performance period with three separate performance segments corresponding to three fiscal years of the Company. Up to 25% of the Maximum PSUs may be earned in respect of the first performance segment; up to 50% of the Maximum PSUs may be earned in respect of the second performance segment, less the amount earned in the first performance segment; and up to 100% of the Maximum PSUs may be earned in respect of the third performance segment, less the amount earned in the first and second performance segments. Under the Share Price Performance PSU Agreement, an executive will be granted an award for a target number of PSUs, and depending on the performance of the Company's common stock over a thirty-six month period beginning on March 1, 2012 (the Share Price Performance Period), the executive may earn up to 200% of the target number of PSUs. The number of PSUs earned, according to the formula specified in the Share Price Performance PSU Agreement, will be determined based on a comparison of the performance of the Company's stock price relative to the performance of the stock price of specified peer companies during the Share Price Performance Period. This performance is measured by the change in the average price of common stock calculated over the ninety-day periods ending at both the beginning and the end of the Share Price Performance Period.

- (2) On May 23, 2012, the Compensation Committee approved the performance objective to be used with, and authorized the grant of, performance-based restricted stock awards (RSAs) in FY2013 subject to the terms and conditions of the form of RSA award agreement approved by the Compensation Committee on May 19, 2010 (the Performance RSA Agreement). Under the Performance RSA Agreement, executives are awarded shares of the Company's common stock subject to achievement of a specified dollar amount of total revenues established by the Committee as the performance objective for FY2013 (the RSA Performance Goal). If the Company fails to achieve the RSA Performance Goal for FY2013, then all shares of restricted stock subject to the award are forfeited. If the Company achieves the RSA Performance Goal for FY2013, 25% of the restricted stock vests on July 16, 2013, and the remainder vests ratably on a quarterly basis over the course of the subsequent three year period, provided that the executive's business relationship with the Company has not ceased.

NOTE 9 Earnings Per Share

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

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

The following table reconciles the numerators and denominators of the earnings per share calculation for the three months and six months ended August 31, 2012 and August 31, 2011 (in thousands, except per share amounts):

	Three Months Ended		Six Months Ended	
	August 31, 2012	August 31, 2011	August 31, 2012	August 31, 2011
Net income, basic and diluted	\$ 35,005	\$ 39,968	\$ 72,466	\$ 72,417
Weighted average common shares outstanding	193,064	192,937	193,005	193,046
Incremental shares attributable to assumed vesting or exercise of outstanding equity awards shares	2,731	3,234	2,924	3,382
Diluted shares	195,795	196,171	195,929	196,428
Diluted net income per share	\$ 0.18	\$ 0.20	\$ 0.37	\$ 0.37

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

	Three Months Ended		Six Months Ended	
	August 31, 2012	August 31, 2011	August 31, 2012	August 31, 2011
Number of shares considered anti-dilutive for calculating diluted EPS	90	752	214	58

NOTE 10 Share Repurchase Program

On March 28, 2012, the Company announced that its Board of Directors 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 1, 2012, and will expire on the earlier of (i) March 31, 2014, or (ii) a determination by the Board of Directors, Chief Executive Officer or Chief Financial Officer to discontinue the program.

As of August 31, 2012, the amount available under the program for the repurchase of the Company's common stock was \$267.1 million.

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

The following summarizes revenue and income (loss) from operations for the three months and six months ended August 31, 2012 and August 31, 2011 and total assets and total cash, cash equivalents and available-for-sale investment securities as of August 31, 2012 and August 31, 2011 by geographic segment (in thousands):

	Americas	EMEA	Asia Pacific	Corporate (1)	Total
Three Months Ended August 31, 2012					
Revenue from unaffiliated customers	\$ 209,134	\$ 66,860	\$ 46,601	\$ 0	\$ 322,595
Income (loss) from operations	\$ 42,136	\$ 19,721	\$ 11,982	\$ (23,859)	\$ 49,980
Three Months Ended August 31, 2011					
Revenue from unaffiliated customers	\$ 176,078	\$ 64,883	\$ 40,359	\$ 0	\$ 281,320
Income (loss) from operations	\$ 41,267	\$ 19,465	\$ 10,499	\$ (18,753)	\$ 52,478
Six Months Ended August 31, 2012					
Revenue from unaffiliated customers	\$ 413,128	\$ 133,482	\$ 90,717	\$ 0	\$ 637,327
Income (loss) from operations	\$ 85,489	\$ 37,931	\$ 23,533	\$ (46,065)	\$ 100,888
Cash, cash equivalents and available-for-sale investments	\$ 929,472	\$ 309,589	\$ 120,559	\$ 0	\$ 1,359,620
Total assets	\$ 1,986,615	\$ 431,083	\$ 187,943	\$ 0	\$ 2,605,641
Six Months Ended August 31, 2011					
Revenue from unaffiliated customers	\$ 342,119	\$ 126,484	\$ 77,463	\$ 0	\$ 546,066
Income (loss) from operations	\$ 75,779	\$ 37,208	\$ 19,790	\$ (34,940)	\$ 97,837
Cash, cash equivalents and available-for-sale investments	\$ 952,314	\$ 274,024	\$ 74,763	\$ 0	\$ 1,301,101
Total assets	\$ 1,783,207	\$ 374,323	\$ 151,000	\$ 0	\$ 2,308,530

(1) Amounts represent share-based compensation expense for each of the three months and six months ended August 31, 2012 and August 31, 2011, which was not allocated to geographic segments.

The following table lists, for the three months and six months ended August 31, 2012 and August 31, 2011, revenue from unaffiliated customers in the United States, the Company's country of domicile, revenue from unaffiliated customers in Japan, which in terms of revenue, was the only individual country outside the United States approaching 10% or more of revenue and revenue from other foreign countries.

	Three Months Ended		Six Months Ended	
	August 31, 2012	August 31, 2011	August 31, 2012	August 31, 2011
United States, the Company's country of domicile	\$ 182,858	\$ 153,300	\$ 361,222	\$ 297,861
Japan	25,318	22,634	49,219	43,880
Other foreign	114,419	105,386	226,886	204,325
Total revenue from unaffiliated customers	\$ 322,595	\$ 281,320	\$ 637,327	\$ 546,066

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

Total tangible long-lived assets located in the United States, the Company's country of domicile, and similar tangible long-lived assets held outside the United States are summarized in the following table as of August 31, 2012 and February 29, 2012:

	As of August 31, 2012	As of February 29, 2012
United States, the Company's country of domicile	\$ 81,702	\$ 63,069
Foreign	31,390	28,996
Total tangible long-lived assets	\$ 113,092	\$ 92,065

For the three months ended August 31, 2012, approximately 11% of our revenue was generated by the U.S. government and its agencies. For the three months ended August 31, 2011 there were no individual customers from which the Company generated 10% or greater revenue.

For the six months ended August 31, 2012, approximately 11% of our revenue was generated by the U.S. government and its agencies. For the six months ended August 31, 2011 there were no individual customers from which the Company generated 10% or greater revenue.

NOTE 12 Commitments and Contingencies*Operating Leases*

As of August 31, 2012, the Company leased office space and certain equipment under various non-cancelable operating leases. Rent expense under operating leases was \$6.7 million and \$6.2 million for the three months ended August 31, 2012 and August 31, 2011, respectively. Rent expense under operating leases for the six months ended August 31, 2012 and August 31, 2011 was \$13.0 million and \$12.2 million, respectively.

Facility Exit Costs

In December 2011, the Company entered into an agreement to sublease a building located in downtown Raleigh, North Carolina to accommodate growth in the business. In connection with the transition to the Company's new building, the Company has endeavored to assign, sublease or otherwise dispose of its existing leases related to the two facilities that currently constitute our headquarters in Raleigh, North Carolina.

In May 2012, the Company entered into a sublease agreement with an unrelated third-party to lease one of the two facilities. As a result, the Company has recognized a loss of \$3.1 million for the six months ended August 31, 2012 which represents the excess of the Company's remaining obligation on the space over the agreed sublease income.

The Company will continue to market the remaining facility for sublease. However, to the extent the Company is unable to sublease or otherwise dispose of such space and recover the full amount of its remaining obligation, it will be required to recognize a loss at the date the Company ceases using this facility, currently estimated to be May 2013. At that time the Company's net loss with respect to the remaining facility is expected to be approximately \$4.0 million.

Amortization of related leasehold improvements has been accelerated to coincide with the Company's exit from the two facilities. This change in estimated useful life resulted in incremental depreciation expense of

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

\$1.0 million and \$2.2 million for the three months and six months ended August 31, 2012, respectively, and is included in general and administration expense on the Company's Consolidated Statement of Operations.

Product Indemnification

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

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

NOTE 13 Legal Proceedings

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 position, results of operations or cash flows.

NOTE 14 Business Combinations*Acquisition of Gluster, Inc.*

On October 7, 2011, the Company completed its acquisition of all issued and outstanding shares of Gluster, Inc. (Gluster), a provider of scale-out, open source storage solutions. The acquisition expands the Company's enterprise software offerings to include management of unstructured data. Under the terms of the purchase agreement, the consideration transferred by the Company totaled \$137.2 million. The Company incurred \$0.5 million in transaction costs including legal and accounting fees relating to the acquisition. These costs have been expensed as incurred and included in general and administrative expense on the Consolidated Statement of Operations for the three months and six months ended August 31, 2011.

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

	Total Consideration Transferred
Cash consideration paid to and/or on behalf of holders of Gluster stock and vested options	\$ 135,906
Fair value of unvested employee share-based awards assumed and attributed to pre-combination services (1)	1,244

Total	\$	137,150
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Table of Contents**RED HAT, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)**

- (1) The total fair value, as of October 7, 2011, of all assumed nonvested share-based 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.

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

	Total Consideration Allocated
Estimated identifiable intangible assets (see detail below)	\$ 6,800
Cash	696
Accounts receivable	321
Fixed assets	454
Deferred tax assets, net	3,263
Other assets	1,093
Accrued liabilities	(1,872)
Deferred revenue	(321)
Goodwill	126,716
 Total consideration allocated	 \$ 137,150

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

	Amortization Expense Type	Estimated Life (Years)	Total
Customer relationships	Sales and marketing	5	\$ 6,200
Tradenames and trademarks	General and administrative	Indefinite	600
 Total identifiable intangible assets			 \$ 6,800

Pro forma consolidated financial information

The following unaudited pro forma consolidated financial information reflects the results of operations of the Company for the three months and six months ended August 31, 2011 (in thousands, except per share amounts) as if the acquisition of Gluster had occurred at March 1, 2011, after giving effect to certain purchase

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

accounting adjustments. These pro forma results are not necessarily indicative of what the Company's operating results would have been had the acquisition actually taken place at the beginning of the period.

	Three Months Ended August 31, 2011	Six Months Ended August 31, 2011
Revenue (1)	\$ 281,430	\$ 546,281
Net income	37,914	68,574
Basic net income per common share	\$ 0.20	\$ 0.36
Diluted net income per common share	\$ 0.19	\$ 0.35

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

Related party matters

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

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

Other acquisitions

During the three months ended August 31, 2012, the Company entered into agreements to acquire two businesses operating in the middleware space. These acquisitions include technologies that are complementary to the Company's JBoss middleware technology. One acquisition, which included certain assets and related operations acquired from Polymita Technologies S.L., 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. Transaction fees related to these two acquisitions totaled \$1.0 million for the three months ended August 31, 2012 and are included in general and administrative expense on the Company's Consolidated Statement of Operations for the three months ended August 31, 2012.

The business acquired from Polymita did not have a significant impact on the Company's financial results for the three months and six months ended August 31, 2012.

Goodwill

The following is a summary of changes in goodwill for the six months ended August 31, 2012 (in thousands):

Balance at February 29, 2012	\$ 591,563
Other business acquisition	5,083
Impact of foreign currency fluctuations and other adjustments	(1,216)

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Balance at August 31, 2012

\$ 595,430

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

We are a global leader in providing open source software technologies to enterprise customers. These offerings include our core enterprise operating system platform, Red Hat Enterprise Linux, our enterprise middleware platform, Red Hat JBoss Middleware, as well as our virtualization, cloud, and storage offerings and other Red Hat enterprise technologies.

Open source software is an alternative to proprietary software and represents a different model for the development and licensing of commercial software code than that typically used for proprietary software. Because open source software code is often freely shared, there are customarily no licensing fees for the 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 and support of our Red Hat enterprise technologies, and by providing a level of performance, reliability, scalability 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 offer our enterprise technologies 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 including large enterprises, government agencies, small- and medium-size businesses and educational institutions.

We have focused on introducing and gaining acceptance for Red Hat enterprise technologies that comprise our open source architecture. Our core enterprise operating system platform, Red Hat Enterprise Linux, has gained widespread independent software vendor (ISV) and independent hardware vendor (IHV) support. We have continued to build our open source architecture by expanding our enterprise offerings and introducing middleware, virtualization, cloud, storage 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 Policies and Estimates" and in NOTE 2 "Summary of Significant Accounting Policies to the Consolidated Financial Statements of our Annual Report on Form 10-K for the year ended February 29, 2012.

In our fiscal year ended February 29, 2012, we focused and expect in our fiscal year ending February 28, 2013 to continue to focus on, among other things, generating (i) widespread adoption of Red Hat enterprise technologies, including virtualization, cloud and storage technologies, by users globally, (ii) increased revenue from our existing user base by renewing existing subscriptions, converting users of free versions of our enterprise technologies to paying subscribers, providing additional value to our customers and growing the number of open source enterprise technologies we offer, (iii) increased revenue by providing additional consulting and other targeted services and (iv) increased revenue from channel partner relationships, including original equipment manufacturers (OEMs), IHVs, ISVs, cloud computing providers, value added resellers (VARs) and system integrators, and from our own international expansion, among other means.

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Revenue. For the three months ended August 31, 2012, total revenue increased 14.7% or \$41.3 million to \$322.6 million from \$281.3 million for the three months ended August 31, 2011. Subscription revenue increased 17.0% or \$40.5 million, driven primarily by additional subscriptions related to our principal Red Hat Enterprise Linux (RHEL) technologies, which continue to gain broader market acceptance in mission-critical areas of computing, and our expansion of sales channels and geographic footprint. The increase is, in part, a result of the continued migration of enterprises in industries such as financial services, government, technology and telecommunications to our open source solutions from proprietary technologies. Training and services revenue increased 1.9% or \$0.8 million for the three months ended August 31, 2012 as compared to the three months ended August 31, 2011. We believe that the growth rate for our training and services revenue was adversely affected by an overall macroeconomic environment in which enterprises remained cautious with respect to discretionary items such as training and consulting and by our efforts to enable channel partners to provide consulting services that can generate additional subscription revenue for us.

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

the extent to which we can expand the breadth and depth of our technology and service offerings;

our ability to enhance the value of subscriptions for Red Hat enterprise technologies through frequent and continuing innovations to these technologies while maintaining stable platforms over multi-year periods;

our ability to generate increasing revenue from channel partner and other strategic relationships, including distributors, OEMs, IHVs, ISVs, cloud computing providers, VARs and system integrators;

the acceptance and widespread deployment of open source technologies by small, medium and large enterprises, educational institutions and government agencies;

our ability to generate recurring subscription revenue for Red Hat enterprise technologies; and

our ability to provide customers with consulting and training services that generate additional revenue.

Deferred Revenue. Our deferred revenue, current and long-term, balance at August 31, 2012 was \$944.4 million. Because of our subscription model and revenue recognition policies, deferred revenue improves predictability of future revenue. Deferred revenue at August 31, 2012 decreased \$2.3 million or 0.2% as compared to the balance at February 29, 2012 of \$946.7 million.

The decrease in deferred revenue reported on our Consolidated Balance Sheets of \$2.3 million differs from the \$21.3 million increase in deferred revenue we reported on our Consolidated Statements of Cash Flows for the six months ended August 31, 2012 due to changes in foreign currency exchange rates used to translate deferred revenue balances from our foreign subsidiaries' functional currency into U.S. dollars.

Subscription revenue. Our enterprise technologies are sold under subscription agreements. These agreements typically have a one- or three-year subscription period. The subscription entitles the end user to maintenance, which generally consists of a specified level of support, as well as security updates, fixes, functionality enhancements and upgrades to the technology, when and if available, during the term of the subscription. Our customers have the ability to purchase higher levels of subscriptions that increase the level of support the customer is entitled to receive. Subscription revenue increased sequentially for the first and second quarters of fiscal 2013 and each quarter of fiscal 2012, 2011 and 2010 and is being driven primarily by the increased market acceptance and use of open source software by the enterprise and our expansion of sales channels and geographic footprint during these periods.

Revenue by geography. For the three months ended August 31, 2012, approximately \$139.7 million or 43.3% of our revenue was generated outside the United States compared to approximately \$128.0 million or 45.5% for the three months ended August 31, 2011. Our international operations are expected to grow as our international sales force and channels become more mature and as we enter new locations or expand our presence in existing locations. As of August 31, 2012, we had offices in more than 75 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 Japan, Singapore, India, Australia, South Korea and China). Revenue generated by the Americas, EMEA and APAC for the three months ended August 31, 2012 totaled \$209.1 million, \$66.9 million and \$46.6 million, respectively, which resulted in year-over-year revenue growth in the Americas, EMEA and APAC of 18.8%, 3.0% and 15.5% respectively. Our growth rate in EMEA was adversely affected by fluctuations in exchange rates between the U.S. Dollar and the Euro. Excluding the impact of foreign currency exchange rates, EMEA revenue grew 19.2% for the three months ended August 31, 2012 as compared to the three months ended August 31, 2011. As we expand further within each region, we anticipate revenue growth rates in local currencies to be similar among our geographic regions due to the similarity of products and services offered and the similarity in customer types or classes.

Gross profit. Overall gross profit margin increased to 85.2% for the three months ended August 31, 2012 from 83.4% for the three months ended August 31, 2011 due to both a product-mix shift from training and services to subscriptions and improved margins on our services offerings.

Gross profit margin by geography. Gross profit margins generated by our geographic segments for the three months ended August 31, 2012 were as follows: Americas 85.1%, EMEA 89.7% and APAC 83.6%. For the three months ended August 31, 2011, gross profit margins generated by our geographic segments were as follows: Americas 83.5%, EMEA 87.1% and APAC 81.8%. As we continue to expand our sales and support services within our geographic segments, we expect gross profit margins to further converge over the long run due to the similarity of products and services offered, similarity in production and distribution methods and the similarity in customer types or classes.

Income from operations. Operating income was 15.5% and 18.7% of total revenue for the three months ended August 31, 2012 and August 31, 2011, respectively. The decrease in operating income as a percentage of revenue was due to investments made to expand our sales and marketing and research and development functions as well as costs incurred to relocate our headquarters, update our data processing systems and acquire two businesses. These investments, which are described further in our analysis of results of operation below, increased operating expenses as a percent of revenue to 69.7% for the three months ended August 31, 2012 from 64.8% for the three months ended August 31, 2011.

Income from operations by geography. Operating income as a percentage of revenue generated by our geographic segments for the three months ended August 31, 2012 was as follows: Americas 20.1%, EMEA 29.5% and APAC 25.7%. For the three months ended August 31, 2011, income from operations as a percentage of revenue generated by our geographic segments was as follows: Americas 23.5%, EMEA 30.0% and APAC 26.0%. These geographic operating margins exclude the impact of share-based compensation expense, which was not allocated to our geographic segments.

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 August 31, 2012 totaled \$1.36 billion. Cash generated from operating activities for the three months ended August 31, 2012 totaled \$103.9 million, which represents an increase of 34.7% in operating cash flow as compared to the three months ended August 31, 2011. 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 43.3% of our revenue for the three months ended August 31, 2012 was produced by sales outside the United States. We are exposed to significant risks of foreign currency fluctuation primarily from receivables denominated in foreign currency and

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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 the second quarter of our prior fiscal year ended February 29, 2012, our revenue and operating expenses from non-U.S. operations for the three months ended August 31, 2012 would have been higher than we reported using the average exchange rates for the second quarter of our current fiscal year ending February 28, 2013 by approximately \$14.2 million and \$10.3 million, respectively, which would have resulted in income from operations being higher by \$3.9 million.

Business combinations. On October 7, 2011, we acquired Gluster, Inc. (Gluster). Gluster develops, distributes and provides support for open-source, scale-out storage software. The acquisition expands our enterprise software offerings to include management of unstructured data. Total consideration transferred as part of the acquisition was \$137.2 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. See NOTE 14 Business Combinations to our Consolidated Financial Statements for further discussion related to our acquisition of Gluster.

During the three months ended August 31, 2012, we entered into agreements to acquire two businesses operating in the middleware space. These acquisitions include technologies that are complementary to our JBoss middleware technology. One acquisition, which included certain assets and related operations acquired from Polymita Technologies S.L., 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. Transaction fees related to these two acquisitions totaled \$1.0 million for the three months ended August 31, 2012 and are included in general and administrative expense on our Consolidated Statement of Operations for the three months ended August 31, 2012. As a result of these acquisitions, we anticipate operating expenses will increase by approximately \$8.0 million for the remainder of our fiscal year ending February 28, 2013.

Facility Exit Costs. In December 2011, we entered into an agreement to sublease a building located in downtown Raleigh, North Carolina to accommodate growth in the business. In connection with the transition to our new building, we have endeavored to assign, sublease or otherwise dispose of our existing leases related to the two facilities that currently constitute 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. As a result, we have recognized a loss of \$3.1 million for the six months ended August 31, 2012 which represents the excess of our remaining obligation on the space over the agreed sublease income.

We will continue to market the remaining facility for sublease. However, to the extent we are unable to sublease or otherwise dispose of such space and recover the full amount of our remaining obligation, we will be required to recognize a loss at the date we cease using this facility, currently estimated to be May 2013. At that time, our net loss with respect to the remaining facility is expected to be approximately \$4.0 million.

Amortization of related leasehold improvements has been accelerated to coincide with our exit from the two facilities. This change in estimated useful life resulted in incremental depreciation expense of \$1.0 million and \$2.2 million for the three months and six months ended August 31, 2012, respectively, and is included in general and administration expense on our Consolidated Statement of Operations.

Table of Contents**RESULTS OF OPERATIONS****Three months ended August 31, 2012 and August 31, 2011**

The following table is a summary of our results of operations for the three months ended August 31, 2012 and August 31, 2011 (in thousands):

	Three Months Ended (Unaudited)		\$ Change	% Change
	August 31, 2012	August 31, 2011		
Revenue:				
Subscriptions	\$ 278,800	\$ 238,337	\$ 40,463	17.0%
Training and services	43,795	42,983	812	1.9
Total subscription and training and services revenue	322,595	281,320	41,275	14.7
Cost of subscription and training and services revenue:				
Cost of subscriptions	18,846	16,596	2,250	13.6
As a % of subscription revenue	6.8%	7.0%		
Cost of training and services	29,012	30,043	(1,031)	(3.4)
As a % of training and services revenue	66.2%	69.9%		
Total cost of subscription and training and services revenue	47,858	46,639	1,219	2.6
As a % of total revenue	14.8%	16.6%		
Total gross profit	274,737	234,681	40,056	17.1
Operating expense:				
Sales and marketing	123,578	99,730	23,848	23.9
Research and development	63,366	51,488	11,878	23.1
General and administrative	37,813	30,985	6,828	22.0
Facility exit costs				
Total operating expense	224,757	182,203	42,554	23.4
Income from operations	49,980	52,478	(2,498)	(4.8)
Interest income	2,154	2,127	27	1.3
Other income (expense), net	(656)	326	(982)	(301.2)
Income before provision for income taxes	51,478	54,931	(3,453)	(6.3)
Provision for income taxes	16,473	14,963	1,510	10.1
Net income	\$ 35,005	\$ 39,968	\$ (4,963)	(12.4)%
Gross profit margin:				
Gross profit margin-subscriptions	93.2%	93.0%		
Gross profit margin-training and services	33.8%	30.1%		
Gross profit margin	85.2%	83.4%		
As a % of total revenue:				
Subscription revenue	86.4%	84.7%		
Training and services revenue	13.6%	15.3%		
Sales and marketing expense	38.3%	35.5%		
Research and development expense	19.6%	18.3%		
General and administrative expense	11.7%	11.0%		

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Facility exit costs		
Total operating expenses	69.7%	64.8%
Income from operations	15.5%	18.7%
Income before provision for income taxes	16.0%	19.5%
Net income	10.9%	14.2%
Estimated annual effective income tax rate (1)	32.0%	31.0%

- (1) Estimated annual effective tax rate is based on estimated ordinary income and excludes certain discrete tax benefits of \$2.1 million that we recognized during the three months ended August 31, 2011.

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

Subscription revenue, which is primarily comprised of direct and indirect sales of Red Hat enterprise technologies, increased by 17.0% or \$40.5 million to \$278.8 million for the three months ended August 31, 2012 from \$238.3 million for the three months ended August 31, 2011. The increase in subscription revenue is primarily due to increases in volumes sold, including additional subscriptions attributable to geographic expansion, and continuing innovation, which attracts new customers and helps to drive renewals from existing customers.

Training and services revenue

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 1.9% or \$0.8 million to \$43.8 million for the three months ended August 31, 2012 from \$43.0 million for the three months ended August 31, 2011. Training revenue decreased 1.1% or \$0.1 million, which we believe was due to an overall macroeconomic environment in which enterprises remained cautious with respect to spending on discretionary items such as training and related travel and our efforts to enable channel partners to provide consulting services that can generate additional subscription revenue for us. Our services revenue increased by 3.2% or \$1.0 million as a result of increased subscription sales. Combined training and services revenue decreased as a percentage of total revenue to 13.6% for the three months ended August 31, 2012 from 15.3% for the three months ended August 31, 2011.

Cost of revenue*Cost of subscription revenue*

The cost of subscription revenue primarily consists of expenses we incur to support, distribute, manufacture and package Red Hat enterprise technologies. These costs include labor related cost to provide technical support and maintenance, as well as cost for fulfillment, physical media, literature, packaging and shipping. Cost of subscription revenue increased by 13.6% or \$2.3 million to \$18.8 million for the three months ended August 31, 2012 from \$16.6 million for the three months ended August 31, 2011. The increase is partially the result of continued additions to our technical support staff to meet the demands of our growing subscriber base for support and maintenance, and includes additional compensation of \$1.6 million. 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 a rate slower than that of subscription revenue growth due to economies of scale. As a result of such economies, gross profit margin on subscriptions increased to 93.2% for the three months ended August 31, 2012 from 93.0% for the three months ended August 31, 2011.

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 decreased by 3.4% or \$1.0 million to \$29.0 million for the three months ended August 31, 2012 from \$30.0 million for the three months ended August 31, 2011. The cost to deliver training decreased 17.8% or \$1.5 million to \$6.8 million for the three months ended August 31, 2012 compared to \$8.3 million for the three months ended August 31, 2011. The decrease in training costs correlates with a decrease in training revenue. In addition, the cost to deliver training as a percentage of training revenue decreased to 53.7% for the three months ended August 31, 2012 from 64.7% for the three months ended August 31, 2011 due to better utilization of both instructors and class room space as we implemented a contractual arrangement with a global training partner that provides training services on our behalf and bears a portion of the fixed costs of providing such services. Costs to deliver our services revenue increased by 2.0% or \$0.4 million and relate to additional employee compensation and travel associated with additions to our staff. Total costs to deliver training and services as a percentage of training and services revenue decreased to 66.2% for the three months ended August 31, 2012 from 69.9% for the three months ended August 31, 2011.

Table of Contents**Gross profit**

Gross profit margin increased to 85.2% for the three months ended August 31, 2012 from 83.4% for the three months ended August 31, 2011 due to both a product-mix shift from training and services to subscriptions and improved margins on our services offerings.

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 23.9% or \$23.8 million to \$123.6 million for the three months ended August 31, 2012 from \$99.7 million for the three months ended August 31, 2011. This increase was primarily due to a \$13.0 million increase in selling costs, which includes \$7.1 million of additional employee compensation expense attributable to the expansion of our sales force from the prior year and \$2.1 million related to travel. The remaining increase relates to marketing costs, which grew \$10.8 million or 52.9% for the three months ended August 31, 2012 as compared to the three months ended August 31, 2011. The increase in marketing costs includes \$4.2 million, \$1.5 million and \$3.4 million related to increased headcount, outside professional services expense and advertising expense, respectively, to support our expanding marketing efforts. Sales and marketing expense increased as a percentage of revenue to 38.3% for the three months ended August 31, 2012 from 35.5% for the three months ended August 31, 2011 as we continue to invest in our sales and marketing function to expand the breadth of our global sales coverage and depth of our product sales coverage.

Research and development

Research and development expense consists primarily of personnel and related costs for development of software technologies and systems management offerings. Research and development expense increased by 23.1% or \$11.9 million to \$63.4 million for the three months ended August 31, 2012 from \$51.5 million for the three months ended August 31, 2011. The increase in research and development costs primarily resulted from the expansion of our engineering group through direct hires. Employee compensation increased by \$8.2 million. The remaining increase in research and development costs relates primarily to facilities expansion and process and technology infrastructure enhancements, which increased \$1.3 million and \$2.1 million, respectively. Research and development expense was 19.6% and 18.3% of total revenue for the three months ended August 31, 2012 and August 31, 2011, respectively.

General and administrative

General and administrative expense consists primarily of personnel and related costs for general corporate functions, including information systems, finance, accounting, legal, human resources and facilities expense. General and administrative expense increased by 22.0% or \$6.8 million to \$37.8 million for the three months ended August 31, 2012 from \$31.0 million for the three months ended August 31, 2011. The increase in general and administrative expenses results from increased compensation-related expense of \$2.2 million, outside professional service fees, primarily related to data processing systems upgrades, which increased \$2.1 million, incremental leasehold amortization expense of \$1.0 million associated with our exit from one of our facilities in Raleigh, NC and transaction costs related to business acquisitions of \$1.0 million. General and administrative expense increased as a percentage of revenue to 11.7% for the three months ended August 31, 2012 from 11.0% for the three months ended August 31, 2011.

Interest income

Interest income increased by 1.3% for the three months ended August 31, 2012 as compared to the three months ended August 31, 2011. The increase in interest income for the three months ended August 31, 2012 is attributable to prevailing low yields earned on our higher cash and investment balances.

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Other income (expense), net

Other income (expense), net decreased \$1.0 million for the three months ended August 31, 2012 as compared to the three months ended August 31, 2011. Prior year's other income of \$0.3 million, included \$0.7 million of gains realized from available-for-sale equity securities. No such sales were made during the current quarter ended August 31, 2012. The remaining difference relates primarily to net foreign currency losses recognized from the remeasurement of foreign currency accounts receivable balances.

Income taxes

During the three months ended August 31, 2012, we recorded \$16.5 million of income tax expense, which is based on an estimated annual effective tax rate of 32.0%. Our estimated annual effective tax rate of 32.0% is less than the U.S. federal statutory rate of 35% principally due to foreign income taxed at lower rates.

During the three months ended August 31, 2011, we recorded \$15.0 million of income tax expense, which was based on a then estimated annual effective tax rate of 31.0%, excluding a discrete tax benefit of \$2.1 million primarily related to the reversal of a valuation allowance on the NOL of a foreign subsidiary. Excluding the impact of the discrete tax benefit, our estimated annual effective tax rate of 31.0% was less than the U.S. federal statutory rate of 35% principally due to foreign income taxed at lower rates.

Table of Contents**Six months ended August 31, 2012 and August 31, 2011**

The following table is a summary of our results of operations for the six months ended August 31, 2012 and August 31, 2011 (in thousands):

	Six Months Ended (Unaudited)		\$ Change	% Change
	August 31, 2012	August 31, 2011		
Revenue:				
Subscriptions	\$ 551,371	\$ 463,870	\$ 87,501	18.9%
Training and services	85,956	82,196	3,760	4.6
Total subscription and training and services revenue	637,327	546,066	91,261	16.7
Cost of subscription and training and services revenue:				
Cost of subscriptions	36,786	31,835	4,951	15.6
As a % of subscription revenue	6.7%	6.9%		
Cost of training and services	57,092	57,251	(159)	(0.3)
As a % of training and services revenue	66.4%	69.7%		
Total cost of subscription and training and services revenue	93,878	89,086	4,792	5.4
As a % of total revenue	14.7%	16.3%		
Total gross profit	543,449	456,980	86,469	18.9
Operating expense:				
Sales and marketing	244,449	197,056	47,393	24.1
Research and development	123,246	99,776	23,470	23.5
General and administrative	71,724	62,311	9,413	15.1
Facility exit costs	3,142	0	3,142	
Total operating expense	442,561	359,143	83,418	23.2
Income from operations	100,888	97,837	3,051	3.1
Interest income	4,448	4,063	385	9.5
Other income, net	1,232	59	1,173	1,988.1
Income before provision for income taxes	106,568	101,959	4,609	4.5
Provision for income taxes	34,102	29,542	4,560	15.4
Net income	\$ 72,466	\$ 72,417	\$ 49	0.1%
Gross profit margin-subscriptions	93.3%	93.1%		
Gross profit margin-training and services	33.6%	30.3%		
Gross profit margin	85.3%	83.7%		
As a % of total revenue:				
Subscription revenue	86.5%	84.9%		
Training and services revenue	13.5%	15.1%		
Sales and marketing expense	38.4%	36.1%		
Research and development expense	19.3%	18.3%		
General and administrative expense	11.3%	11.4%		
Facility exit costs	0.5%			
Total operating expenses	69.4%	65.8%		
Income from operations	15.8%	17.9%		

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Income before provision for income taxes	16.7%	18.7%
Net income	11.4%	13.3%
Estimated annual effective income tax rate (1)	32.0%	31.0%

- (1) Estimated annual effective tax rate is based on estimated ordinary income and excludes certain discrete tax benefits of \$2.1 million that we recognized during the six months ended August 31, 2011.

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

Subscription revenue increased by 18.9% or \$87.5 million to \$551.4 million for the six months ended August 31, 2012 from \$463.9 million for the six months ended August 31, 2011. The increase in subscription revenue is primarily due to increases in volumes sold, including additional subscriptions attributable to geographic expansion, and continuing innovation, which attracts new customers and helps to drive renewals from existing customers.

Training and services revenue

Total training and services revenue increased by 4.6% or \$3.8 million to \$86.0 million for the six months ended August 31, 2012 from \$82.2 million for the six months ended August 31, 2011. Training revenue decreased 3.5% or \$0.9 million, which we believe was due to an overall macroeconomic environment in which enterprises remained cautious with respect to spending on discretionary items such as training and related travel and our efforts to enable channel partners to provide consulting services that can generate additional subscription revenue for us. Our services revenue increased by 8.2% or \$4.7 million as a result of increased subscription sales. Combined training and services revenue decreased as a percentage of total revenue to 13.5% for the six months ended August 31, 2012 from 15.1% for the six months ended August 31, 2011.

Cost of revenue*Cost of subscription revenue*

Cost of subscription revenue increased by 15.6% or \$5.0 million to \$36.8 million for the six months ended August 31, 2012 from \$31.8 million for the six months ended August 31, 2011. Compensation expense increased \$3.6 million for the six months ended August 31, 2012 as compared to the same period ended August 31, 2011 due primarily to continued additions to our technical support staff to meet the demands of our growing subscriber base for support and maintenance. The remaining variance is principally due to increased expense related to expansion of support facilities of \$1.0 million. Although we expect associated support cost will continue to increase, we expect such cost to grow at a rate slower than that of subscription revenue growth due to economies of scale. As a result, gross profit margin on subscriptions increased to 93.3% for the six months ended August 31, 2012 from 93.1% for the six months ended August 31, 2011.

Cost of training and services revenue

Cost of training and services revenue decreased by 0.3% or \$0.2 million to \$57.1 million for the six months ended August 31, 2012 from \$57.3 million for the six months ended August 31, 2011. The cost to deliver training decreased 19.0% or \$3.2 million to \$13.6 million for the six months ended August 31, 2012 as compared to \$16.8 million for the six months ended August 31, 2011. Costs to deliver our training decreased as a percentage of training revenue to 54.9% for the six months ended August 31, 2012 from 65.4% for the six months ended August 31, 2011 due to better utilization of both instructors and class room space as we transition from an on-site, employee-based, fixed-cost delivery model to a third-party, variable-cost delivery model. Costs to deliver our services revenue increased by 7.5% or \$3.0 million and primarily relate to additional compensation and travel expenses of \$3.9 million associated with additions to our staff, offset partially by a decrease of outside contractors costs of \$1.2 million. The remaining increase in costs to deliver our engineering and professional services relates to process and technology infrastructure investments we continue to make to enhance the delivery of our services. Total costs to deliver training and services as a percentage of training and services revenue decreased to 66.4% for the six months ended August 31, 2012 from 69.7% for the six months ended August 31, 2011.

Gross profit

Gross profit margin increased to 85.3% for the six months ended August 31, 2012 from 83.7% for the six months ended August 31, 2011 as a result of both a product mix shift to subscriptions and an overall increase in

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profit margins related to training and services. Subscription revenue as a percent of total revenue increased to 86.5% for the six months ended August 31, 2012 from 84.9% for the six months ended August 31, 2011. Gross profit margin on training and services revenue increased to 33.6% for the six months ended August 31, 2012 from 30.3% for the six months ended August 31, 2011, as a result of better utilization of training classes and consulting resources.

Operating expenses*Sales and marketing*

Sales and marketing expense increased by 24.1% or \$47.4 million to \$244.4 million for the six months ended August 31, 2012 from \$197.1 million for the six months ended August 31, 2011. This increase was partially attributable to a \$29.4 million increase in selling costs, which includes \$18.1 million of additional compensation expense, which was due to the expansion of our sales force during the current fiscal year. The remaining increase relates to marketing costs, which grew \$18.0 million or 44.4% for the six months ended August 31, 2012 as compared to the six months ended August 31, 2011. The increase in marketing costs includes \$7.8 million of additional compensation expense and incremental advertising expense of \$5.3 million. Sales and marketing expense increased as a percentage of revenue to 38.4% for the six months ended August 31, 2012 from 36.1% for the six months ended August 31, 2011 as we continue to invest in our sales and marketing function to expand the breadth of our global sales coverage and depth of our product sales coverage.

Research and development

Research and development expense increased by 23.5% or \$23.5 million to \$123.2 million for the six months ended August 31, 2012 from \$99.8 million for the six months ended August 31, 2011. The increase in research and development costs primarily resulted from the expansion of our engineering group through both direct hires and acquisitions. Compensation related expenses increased by \$17.5 million. The remaining increase in research and development costs relates primarily to process and technology infrastructure enhancements, which increased \$4.6 million. Research and development expense was 19.3% and 18.3% of total revenue for the six months ended August 31, 2012 and August 31, 2011, respectively.

General and administrative

General and administrative expense increased by 15.1% or \$9.4 million to \$71.7 million for the six months ended August 31, 2012 from \$62.3 million for the six months ended August 31, 2011. The increase in general and administrative expenses results from increased compensation expense of \$5.1 million, outside professional service fees, primarily related to data processing systems upgrades, which increased \$3.3 million and costs related to technology infrastructure enhancements which increased \$4.0 million. These increases in general and administrative costs were partially offset by litigation related expenses which were \$3.5 million lower for the six months ended August 31, 2012 as compared to the six months ended August 31, 2011. General and administrative expense decreased as a percentage of revenue to 11.3% for the six months ended August 31, 2012 from 11.4% for the six months ended August 31, 2011.

Interest income

Interest income increased by 9.5% or \$0.4 million to \$4.4 million for the six months ended August 31, 2012 from \$4.1 million for the six months ended August 31, 2011. The increase in interest income for the six months ended August 31, 2012 is attributable to prevailing low yields earned on our higher cash and investment balances.

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Other income, net increased \$1.2 million for the six months ended August 31, 2012 as compared to the six months ended August 31, 2011. The increase is principally due to an investment gain for the six months ended August 31, 2012 as compared to the same period ended August 31, 2011.

Income taxes

During the six months ended August 31, 2012, we recorded \$34.1 million of income tax expense, which is based on an estimated annual effective tax rate of 32.0%. Our estimated annual effective tax rate of 32.0% is less than the U.S. federal statutory rate of 35% principally due to foreign income taxed at lower rates.

During the six months ended August 31, 2011, we recorded \$29.5 million of income tax expense, which is based on an estimated annual effective tax rate of 31.0%, excluding a discrete tax benefit of \$2.1 million primarily related to a reversal of the valuation allowance on the NOL of a foreign subsidiary. Excluding the impact of the discrete tax benefit, our estimated annual effective tax rate of 31.0% is less than the U.S. federal statutory rate of 35% principally due to foreign income taxed at lower rates.

LIQUIDITY AND CAPITAL RESOURCES

We have historically derived a significant portion of our liquidity and operating capital from cash flows from operations as well as the sale of equity securities, including private sales of preferred stock and the sale of common stock in our initial and follow-on public offerings, and the issuance of convertible debentures. At August 31, 2012, we had total cash and investments of \$1,359.6 million, which was comprised of \$571.6 million in cash and cash equivalents, \$242.2 million of short-term, available-for-sale, fixed-income investments, \$1.0 million of available-for-sale equity securities, \$490.2 million of long-term, available-for-sale fixed-income investments, and \$54.7 million in interest-bearing deposit accounts with maturity dates greater than 30 days. This compares to total cash and investments of \$1,260.4 million at February 29, 2012.

With \$571.6 million in cash and cash equivalents on hand, we believe our cash and cash equivalent balances, together with our ability to generate additional cash from operations, should be sufficient to satisfy our cash requirements for the next twelve months and for the foreseeable future. We presently do not intend to liquidate our short and long-term investments in debt securities prior to their scheduled maturity dates. However, in the event that we liquidate these investments prior to their scheduled maturities and there are adverse changes in market interest rates or the overall economic environment, we could be required to recognize a realized loss on those investments when we liquidate. At August 31, 2012, accumulated unrealized gains on our available-for-sale debt securities totaled \$0.4 million. At February 29, 2012, accumulated unrealized losses on our available-for-sale debt securities totaled \$1.2 million. At August 31, 2012 and February 29, 2012, accumulated unrealized gains related to our short-term equity securities available for sale totaled \$1.0 million and \$1.2 million, respectively.

Six months ended August 31, 2012*Cash flows overview*

At August 31, 2012, cash and cash equivalents totaled \$571.6 million, an increase of \$22.4 million as compared to February 29, 2012. The increase in cash and cash equivalents for the six months ended August 31, 2012 is primarily the result of cash provided by operations which generated \$228.3 million. Partially offsetting cash provided by operating activities was cash used to repurchase 611,260 shares of our common stock at a total cost of \$32.9 million and investing activities, including net purchases of available-for-sale debt securities of \$90.0 million, the acquisition of certain assets and related operations from Polymita Technologies for \$10.1 million and purchases of tangible and intangible assets of \$63.1 million. Net cash generated by operating activities and used for investing and financing activities is further described below.

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Cash flows from operations

Cash provided by operations of \$228.3 million during the six months ended August 31, 2012 includes net income of \$72.5 million, adjustments to exclude the impact of non-cash revenues and expenses, which totaled \$76.1 million net source of cash, and changes in operating assets and liabilities, which totaled a \$79.7 million net source of cash. Cash provided by changes in operating assets and liabilities for the six months ended August 31, 2012 was primarily the result of collections on our fourth quarter fiscal 2012 billings which generated operating cash flow of \$35.8 million and cash generated from an increase in deferred revenue which generated operating cash flow of \$21.3 million. Changes in accounts payable and accrued expenses which increased operating cash flow \$26.3 million were the result of both increased operating expenses and timing of disbursements. Adjustments to reconcile income related to deferred income taxes of \$23.1 million was primarily due to share-based compensation deductions which were in excess of amounts originally recognized in our consolidated statements of operations. Excess tax benefits from share-based compensation, which totaled \$19.8 million, is considered a financing source of cash.

Cash flows from investing

Cash used in investing activities of \$162.8 million for the six months ended August 31, 2012 includes net purchases of available-for-sale debt securities of \$90.0 million, investments in property and equipment of \$36.2 million, primarily related to process and information technology infrastructure enhancements and leasehold improvements, investments in other intangible assets, primarily patents, of \$26.9 million and a business acquisition, net of cash acquired of \$10.1 million.

Cash flows from financing

Cash used in financing activities of \$29.7 million for the six months ended August 31, 2012 includes \$32.9 million used to repurchase 611,260 shares of our common stock. Payments made in return for common shares received from employees to satisfy employees' minimum tax withholding obligations related to restricted share awards vesting during the six months ended August 31, 2012 totaled \$22.7 million. Partially offsetting financing activities using cash were proceeds from excess tax benefits related to share-based employee compensation which totaled \$19.8 million and proceeds from employees' exercise of common stock options which totaled \$6.5 million. Payments on other borrowings totaled \$0.5 million for the six months ended August 31, 2012.

Investments in debt and equity securities

Our investments are comprised primarily of debt securities that are classified as available for sale and recorded at their fair market values. At August 31, 2012 and February 29, 2012, the vast majority of our investments were priced by pricing vendors. These pricing vendors use the most recent observable market information in pricing these securities or, if specific prices are not available for these securities, use other observable inputs. In the event observable inputs are not available, we assess other factors to determine the securities' market value, including broker quotes or model valuations. Independent price verifications of all of our holdings are performed by the pricing vendors, which we review. In the event a price fails a pre-established tolerance check, it is researched so that we can assess the cause of the variance to determine what we believe is the appropriate fair market value.

Capital requirements

We have experienced a substantial increase in our operating expenses since our inception in connection with the growth of our operations, the development of our enterprise technologies, the expansion of our services operations and our acquisition activity. Our capital requirements during the year ending February 28, 2013 will depend on numerous factors, including the amount of resources we devote to:

funding the continued development of our enterprise technology offerings;

accelerating the development of our systems management offerings;

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improving and extending our services and the technologies used to deliver these services to our customers and support our business;

pursuing strategic acquisitions and alliances;

investing in businesses, products and technologies; and

investing in enhancements to the systems we use to run our business and the expansion of our office facilities, including capital expenditures related to our future headquarters facility.

We have utilized, and will continue from time to time to utilize, cash and investments to fund, among other potential uses, purchases of our common stock, purchases of fixed assets, purchases of intellectual property and mergers and acquisitions. Given our historically strong operating cash flow and the \$1.36 billion of cash and investments held at August 31, 2012, we do not presently anticipate the need to raise cash to fund our operations, either through the sale of additional equity or through the issuance of debt, in the foreseeable future. However, we may take advantage of favorable capital market situations that may arise from time to time to raise additional capital.

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

As of August 31, 2012, our cash, cash equivalents and available-for-sale investment securities totaled \$1.36 billion, of which \$449.7 million was held outside the U.S. Our intent is to reinvest the earnings of foreign subsidiaries indefinitely outside the U.S. to fund both organic growth and acquisitions.

With 66.9% of our available cash, cash equivalents and available-for-sale investments, as of August 31, 2012, held within the U.S., we do not anticipate a need to repatriate any foreign earnings for the foreseeable future. However, if cash held outside the U.S. were needed to fund our U.S. operations, under current tax law we would be subject to additional taxes on the portion related to repatriated earnings of our foreign subsidiaries. As of February 29, 2012, undistributed foreign earnings totaled \$91.5 million. For further discussion, see NOTE 11 Income Taxes contained in our Annual Report on Form 10-K for the year ended February 29, 2012.

Off-balance sheet arrangements

As of August 31, 2012 and February 29, 2012, we have no off-balance sheet financing arrangements and do not utilize any structured debt, special purpose or similar unconsolidated entities for liquidity or financing purposes.

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ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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

Interest Rate Risk

Our exposure to market rate risk for changes in interest rates relates primarily to our investment portfolio. The primary objective of our investment activities is to preserve principal and liquidity while at the same time maximizing yields without significantly increasing risk. To achieve this objective, we maintain our portfolio of cash equivalents and short-term and long-term investments in a variety of fixed-income securities, including both government and corporate obligations, interest-bearing deposits and money market funds. Investments in both fixed rate and floating rate interest earning instruments carry a degree of interest rate risk. Fixed rate securities may have their fair market value adversely impacted due to a rise in prevailing interest rates, while floating rate securities may produce less income than expected if interest rates fall. Due in part to these factors, our future investment income may fall short of expectations due to changes in interest rates, or we may suffer losses in principal if forced to sell securities which have declined in market value due to changes in interest rates or perceived credit risk related to the securities issuers. A hypothetical one percentage point change in interest rates, assuming a parallel shift of all interest rates, would result in an \$8.8 million change in annual interest income derived from investments in our portfolio as of August 31, 2012. For further discussion related to our investments as of August 31, 2012 and February 29, 2012, see NOTE 6 Assets and Liabilities Measured at Fair Value on a Recurring Basis to the Consolidated Financial Statements.

Investment Risk

The fair market value of our investment portfolio is subject to interest rate risk. Based on a sensitivity analysis performed on this investment portfolio, a hypothetical one percentage point increase in prevailing interest rates would result in an approximate \$9.1 million decrease in the fair value of our available-for-sale investment securities as of August 31, 2012. For further discussion related to our investments as of August 31, 2012 and February 29, 2012, see NOTE 6 Assets and Liabilities Measured at Fair Value on a Recurring Basis to the Consolidated Financial Statements.

Credit Risk

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

As of August 31, 2012, two customers each accounted for approximately 13% of the Company's accounts receivable. As of February 29, 2012, one customer accounted for approximately 10% of the Company's accounts receivable.

Foreign Currency Risk

Approximately 43.3% of our revenue for the three months ended August 31, 2012 was produced by sales outside the United States. We are exposed to significant risks of foreign currency fluctuation primarily from receivables denominated in foreign currency and are subject to transaction gains and losses, which are recorded as a component in determining net income. The income statements of our non-U.S. operations are translated into U.S. dollars at the average exchange rates for each applicable month in a period. To the extent the U.S. dollar weakens against foreign currencies, the translation of these foreign currency statements results in increased revenue and operating expenses for our non-U.S. operations. Similarly, our revenue and operating expenses for our non-U.S. operations decreases if the U.S. dollar strengthens against foreign currencies.

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Using the average foreign currency exchange rates from the second quarter of our prior fiscal year ended February 29, 2012, our revenue and operating expenses from non-U.S. operations for the three months ended August 31, 2012 would have been higher than we reported using the average exchange rates for the second quarter of our current fiscal year ending February 28, 2013 by approximately \$14.2 million and \$10.3 million, respectively, which would have resulted in income from operations being higher by \$3.9 million.

Derivative Instruments

We transact business in various foreign countries and are, therefore, subject to risk of foreign currency exchange rate fluctuations. We sometimes enter into forward contracts to economically hedge transactional exposure associated with commitments arising from trade accounts receivable, trade accounts payable and fixed purchase obligations denominated in a currency other than the functional currency of the respective operating entity. All derivative instruments are recorded on the Consolidated Balance Sheets at their respective fair market values in accordance with FASB ASC Section 815. The Company has elected not to prepare and maintain the documentation required to qualify its forward contracts for hedge accounting treatment and, therefore, changes in fair value are recorded in the Consolidated Statements of Operations. For further discussion related to our management of foreign currency risk see NOTE 7 Derivative Instruments to the Consolidated Financial Statements.

The aggregate notional amount of outstanding forward contracts at August 31, 2012 was \$37.3 million. The fair value of these outstanding contracts at August 31, 2012 was a gross \$0.1 million asset and a gross \$0.1 million liability, and is recorded in Other current assets and Accounts payable and accrued expenses, respectively on the Consolidated Balance Sheets. The forward contracts generally expire within three months of the period ended August 31, 2012. The forward contracts will settle in Australian dollars, Canadian dollars, Czech koruna, Danish krone, Euros, Israeli shekels, Japanese yen, Norwegian krona, Singapore dollars, Swedish krona, Swiss francs and Taiwan dollars.

The aggregate notional amount of outstanding forward contracts at February 29, 2012 was \$59.7 million. The fair value of these outstanding contracts at February 29, 2012 was a gross \$0.1 million asset and a gross \$0.5 million liability, and is recorded in Other current assets and Accounts payable and accrued expenses, respectively on the Consolidated Balance Sheets. The forward contracts generally expire within three months of the period ended February 29, 2012. The forward contracts will settle in Australian dollars, Canadian dollars, Czech koruna, Euros, Israeli shekels, Japanese yen, Mexican pesos, New Zealand dollars, Norwegian krona, Singapore dollars, Swedish krona, Swiss francs and U.S. dollars.

RECENT ACCOUNTING PRONOUNCEMENTS

In July 2012, the FASB issued Accounting Standards Update No. 2012-02, *Intangibles Goodwill and Other (Topic 350) Testing Indefinite-Lived Intangible Assets for Impairment* (ASU 2012-02), to simplify how entities test intangibles with indefinite lives for impairment. ASU 2012-02 gives entities the option to first assess qualitative factors to determine whether it is more likely than not that the fair value of an intangible asset is less than its carrying amount. If a greater than 50 percent likelihood exists that the fair value is less than the carrying amount then a quantitative impairment test as described in Subtopic 350-30 must be performed. ASU 2012-02 is effective for us in our first quarter of fiscal 2014 but is eligible for early adoption. We currently do not believe that this updated standard will have a significant impact on our consolidated financial statements.

In December 2011, the FASB issued Accounting Standards Update No. 2011-11, *Balance Sheet (Topic 210) Disclosures about Offsetting Assets and Liabilities* (ASU 2011-11), to require entities to disclose information about offsetting and related arrangements of financial instruments and derivative instruments. ASU 2011-11 is effective for us in the first quarter of our fiscal year ending February 28, 2014 (fiscal 2014). We currently do not believe that this updated standard will have a significant impact on our consolidated financial statements.

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ITEM 4. CONTROLS AND PROCEDURES

Role of Controls and Procedures

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

Evaluation of Disclosure Controls and Procedures

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

Changes in Internal Control Over Financial Reporting

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

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PART II

ITEM 1. 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 position, results of operations or cash flows.

ITEM 1A. RISK FACTORS

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

Moreover, certain statements contained in this report and the documents incorporated by reference in this report, including in Management's Discussion and Analysis of Financial Condition and Results of Operations, constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements provide current expectations of future events based on certain assumptions and include any statement that is not strictly a historical statement (for example, statements regarding current or future financial performance, management's plans and objectives for future operations, product plans and performance, management's expectations regarding market risk and market penetration, management's assessment of market factors or strategies, objectives and plans of Red Hat and its partners). Words such as anticipates, believes, expects, estimates, intends, plans, projects, and similar expressions, may also identify such forward-looking statements. Investors are cautioned that these forward-looking statements are not guarantees of Red Hat's future performance and are subject to a number of risks and uncertainties that could cause Red Hat's actual results to differ materially from those found in the forward-looking statements and from historical trends. These risks and uncertainties include the risks and cautionary statements detailed below and elsewhere in this report as well as in Red Hat's other filings with the Securities and Exchange Commission (SEC), copies of which may be accessed through the SEC's web site at <http://www.sec.gov>. Readers are urged to carefully review these risks and cautionary statements. The forward-looking statements included in this report represent our views as of the date of this report. We specifically disclaim any obligation to update these forward-looking statements in the future. These forward-looking statements should not be relied upon as representing our views as of any date subsequent to the date of this report.

RISKS RELATED TO BUSINESS UNCERTAINTY

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

Economic weakness and uncertainty, tightened credit markets and constrained IT spending from time to time contribute to slowdowns in the technology industry, as well as in the specific 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, such as the debt crisis in certain countries in the European Union. 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

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United States, European Union 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 and operating results.

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

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

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

Recruiting and retaining qualified channel partners and training them in the use of our enterprise technologies requires significant time and resources. If we fail to devote sufficient resources to support and expand our network of channel partners, our operating results 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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We have entered into and may continue to enter into or seek to enter into business combinations and acquisitions, which may be difficult to complete and integrate, disrupt our business, divert management's attention, adversely affect our financial condition, 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 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;

Maintaining or establishing acceptable standards, controls, procedures and policies;

Disruption of our ongoing business and distraction of management;

Impairment of relationships with our employees and customers as a result of any integration of new management and other personnel;

Inability to maintain relationships with customers of the acquired business;

Cultural challenges associated with integrating employees from the acquired company into our organization;

Loss of key employees of the acquired business;

Maintaining good relationships with our existing business partners or those of the acquired business, including as a result of the changes in the competitive landscape affected by the transaction;

Incorporating and further developing acquired technology and rights into our offerings and maintaining quality standards consistent with our brands;

Failure to achieve the expected benefits of the transaction;

Expenses related to the transaction;

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Claims and liabilities we may assume from the acquired business or technology, or that are otherwise related to the transaction;

Increased operating expenses related to the acquired business or technology;

Entering into new markets in which we have little or no experience or in which competitors may have stronger market positions;

Impairment of tangible assets and 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, 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 payment and 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, 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 financial condition and operating results.

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If we fail to effectively manage our growth, our 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 \$909.3 million for the fiscal year ended February 28, 2011 to \$1.13 billion for the fiscal year ended February 29, 2012. Moreover, the total number of our employees increased from over 3,700 as of February 28, 2011 to over 4,500 as of February 29, 2012 and is expected to generally increase in the foreseeable future. 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, we must also continue to hire, train, supervise and manage new employees. We may not be able to adequately screen and hire or adequately train, supervise and manage sufficient personnel or develop management, or effectively manage and develop our controls and oversight functions and information systems to adequately manage our growth effectively. If we are unable to adequately manage our growth, our business, financial condition, operating results and cash flows could be adversely affected.

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.

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. Our ability to retain key management personnel or hire capable new management personnel as we grow may be challenged to the extent the technology sector performs well and/or if companies with more generous compensation packages or greater perceived growth opportunities compete for the same personnel. In addition, historically we have used share-based compensation as a key component of our compensation packages. Changes in the accounting for share-based compensation could adversely affect our earnings or force us to use more cash compensation to attract and retain capable personnel. If the price of our common stock falls, the value of our share-based awards to 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.

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

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

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

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

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

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

We provide Red Hat enterprise technologies under annual or multi-year subscriptions. Through the life of a subscription, a customer is entitled to specified levels of support as well as security updates, fixes, functionality enhancements and upgrades to the technology, when and if available, via the Red Hat Customer Portal. While we believe this practice complies with the requirements of the GNU General Public License, and while we have reviewed this practice with the Free Software Foundation, the organization that maintains and provides interpretations of the GNU General Public License, we may still encounter customer resistance to this distribution model or customers may fail to honor the terms of our subscription agreements. To the extent we are unsuccessful in promoting or defending this distribution model, our business and operating results could be materially and adversely affected. In addition, our customers generally undertake a significant evaluation process that may result in a lengthy sales cycle. We spend substantial time, effort, and money on our sales efforts without any assurance that our efforts will produce any sales. As technologies and the markets for our enterprise offerings change, our subscription-based contract model may no longer meet the needs of our customers. If we are unable to adapt our contract model to changes in the marketplace, our business and operating results could be adversely impacted.

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

Our customers may not renew their subscriptions 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

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decline or fluctuate as a result of a number of factors, including their level of satisfaction with our services and their ability to continue their operations and spending levels. Government contracts could be subject to future funding that may affect the extension or termination of programs and generally are subject to the right of the government to terminate for convenience or non-appropriation. If we experience a decline in the renewal rates for our customers or they opt for lower-priced editions of our offerings or fewer subscriptions, our operating results may be adversely impacted.

If open source software programmers, most of whom we do not employ, do not continue to develop and enhance open source technologies, we may be unable to develop new 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.

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

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

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

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 financial performance.

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

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

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

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

We operate in highly competitive markets that are characterized by rapid technological change and frequent new product and service announcements. We must continue to invest significant resources in research and development in order to enhance our existing offerings and introduce new high-quality offerings. If we are unable to ensure that our users and customers have a high-quality experience with our offerings, then they may become dissatisfied and move to competitors' products and services. In addition, if we are unable to predict user preferences or industry changes, or if we are unable to modify our offerings on a timely basis, we may lose customers.

Our future success will depend on our ability to adapt to rapidly changing technologies, to adapt our services to evolving industry standards and to improve the performance and reliability of our services. Our failure to adapt to such changes could harm our business. In addition, the widespread adoption of other technological changes could require substantial expenditures to modify or adapt our 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 develop and complete new offerings in a timely manner, successfully promote the offerings, manage the risks associated with the offerings, make sufficient resources available to support them and address any quality or other defects in the early stages of introduction.

Moreover, we believe that our continued success depends on our investing in new business strategies or initiatives that complement our strategic direction and technology road map. Such endeavors may involve significant risks and uncertainties, including distraction of management's attention away from other business operations, and insufficient revenue generation to offset liabilities and expenses undertaken with such strategies

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and initiatives. Because these endeavors may be inherently risky, no assurance can be given that such endeavors will not materially adversely affect 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 substantial investments that may not be successful. If we fail to promote and maintain our brands, or if we incur excessive costs in doing so, our business, operating results and financial condition may be materially and adversely affected. 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.

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

Our Red Hat Virtualization, cloud computing and storage 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. The cloud computing, storage and virtualization market segments are rapidly evolving, and we expect competition to remain intense. In addition, we may make errors in predicting and reacting to relevant business trends.

Adoption of virtualization 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 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. In either case, our business, financial condition and operating results could be adversely affected.

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

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 materially or our revenue may decline substantially, which could adversely affect our stock price.

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

Our business involves the production and distribution of enterprise software technologies. As part of our business we receive and process information about our employees, customers and partners, and we may store (or contract with third parties to store) our customers' data. While we take security and testing measures relating to our offerings and operations, those measures may not prevent security breaches that could harm our business. Advances in computer capabilities, new discoveries in the field of cryptography, inadequate technology or facility security measures or other factors may result in a compromise or breach of our systems and the data we store and process. Our security measures may be breached as a result of actions by third parties or employee error or malfeasance. A party who is able to circumvent our security measures or exploit inadequacies in our 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 or expose customers (and their customers) to computer viruses or other disruptions or vulnerabilities. Any compromise of our systems or the data we store or process could result in a loss of confidence in the security of our offerings, damage our reputation, disrupt our business, lead to legal liability and adversely affect our financial condition, operating results and cash flows. A compromise to our systems could remain undetected for an extended period of time,

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exacerbating the impact of that compromise. Actual or perceived vulnerabilities may lead to claims against us by customers, partners or other third parties, which could be material. While our customer agreements typically contain provisions that seek to limit our liability, there is no assurance these provisions will be enforceable and effective under applicable law. In addition, the cost and operational consequences of implementing further data protection measures could be significant.

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

We rely on our technology infrastructure for many functions, including selling our offerings, supporting our partners, fulfilling orders and billing, collecting and making payments. We also rely on the technology infrastructure of third parties to provide some of our offerings. 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 is not sufficient for every eventuality. This technology infrastructure is also subject to break-ins, sabotage and intentional acts of vandalism by internal employees, contractors and third parties. Despite any precautions we may take, such problems could result in, among other consequences, interruptions in our services and loss of data, which could harm our reputation, business and financial condition. We do not carry business interruption insurance sufficient to protect us from all losses that may result from interruptions in our services as a result of technology infrastructure failures or to cover all contingencies. Any interruption in the availability of our websites and on-line interactions with customers and partners would create a large volume of questions and complaints that would need to be addressed by our support personnel. If our support personnel cannot meet this demand, customer and partner satisfaction levels may fall, which in turn could cause additional claims, reduced revenue or loss of customers.

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

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

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

Our contracts with our customers may include unique and specialized performance requirements. In particular, our contracts with federal, state, provincial and local governmental customers are subject to various procurements regulations, contract provisions and other requirements relating to their formation, administration and performance. Any failure by us to comply with the specific provisions in our customer contracts or any violation of government contracting regulations could result in the imposition of various civil and criminal penalties, which may include termination of contracts, forfeiture of profits, suspension of payments and, in the case of our government contracts, fines and suspension from future government contracting. In addition, we may be subject to *qui tam* litigation, the process by which a private individual sues or prosecutes on behalf of the government relating to government contracts and shares in the proceeds of any successful litigation or settlement, which could include claims for up to treble damages. Further, any negative publicity related to our customer contracts or any proceedings surrounding them, regardless of its accuracy, may damage our business and affect our ability to compete for new contracts. There is increased pressure for governments and their agencies, both domestically and internationally, to reduce spending. If our customer contracts are terminated, if we are suspended from government work, or if our ability to compete for new contracts is adversely affected, we could suffer an adverse effect on our business, operating results and financial condition.

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RISKS RELATED TO LEGAL UNCERTAINTY

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

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 often have limitations on these commitments, satisfying the commitments could be costly and time consuming and could materially and adversely affect our operating results and financial condition. In addition, our insurance policies would likely not adequately cover our exposure to this type of claim.

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

We are vulnerable to claims that our 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. Moreover, because the scope of software patent protection is often not well defined or readily determinable, patent applications in the United States are not publicly disclosed at the time of filing, and the number of software patents that are issued each year is significant and growing, we may be unable to assess the relevance of patents to our technologies, or take appropriate responsive action, in a timely or economic manner. 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. These risks have been amplified by the increase in third parties whose sole or primary business is to assert such claims.

In the past, our technologies have been subject to intellectual property infringement claims. We expect these claims to increase as the size of our business and market share grow, the number of products and competitors in our industry 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 adverse legal decision regarding the intellectual property in and to our technology and other offerings could adversely affect our business and may do so materially. See Legal Proceedings .

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

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

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 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 will continue to be found in our enterprise technologies after deployment. This risk is exacerbated by the fact that much of the code in our technologies is developed by independent parties over whom we exercise no supervision or control. If errors are discovered, we may have to make significant expenditures of capital and devote significant technical resources to analyze, correct, eliminate or work around them and may not be able to successfully do so in a timely manner or at all. Errors and failures in our 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. In addition, our insurance policies may not adequately limit our exposure to this type of claim. These claims, even if unsuccessful, could be costly and time consuming to defend and could materially harm our business.

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

Our collection of trademarks is valuable and important to our business. The protective steps we have taken in the past have been, and may in the future continue to be, inadequate to protect and deter misappropriation of our

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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, which in turn could limit our ability to continue to rely on this community, upon which we are dependent, as a resource to help develop and improve our 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 have a material adverse effect on our performance or stock price.

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

Our business is subject to a variety of U.S. and international laws regarding data 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 Internet commerce continues to evolve, increasing regulation by federal, state or foreign agencies becomes more likely. Increased regulation in the area of data privacy and protection, and laws and regulations applying to the solicitation, collection, processing, protection or use of information could affect our ability to use and share data, or the adoption of our cloud offerings by customers. Any failure by us to comply with our posted privacy policies or other federal, state or international privacy-related or data protection laws and regulations could result in proceedings against us by governmental entities or others which could have a material adverse effect on our business, operating results and financial condition.

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

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

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

The trading price of our common stock has been and may continue to be subject to wide fluctuations. Our stock price may fluctuate in response to a number of events and factors, such as quarterly variations in operating results, announcements of technological innovations or new products by us or our competitors, announcements relating to strategic decisions, announcements related to key personnel, customer purchase delays, service disruptions, changes in financial estimates and recommendations by securities analysts, the operating and stock price performance of other companies that investors may deem comparable to us, news reports relating to trends in our markets, general economic conditions and other risks listed herein.

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

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

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

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

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

We face competition in the market for services related to the deployment of enterprise technologies and the development and integration of applications. Our competitors in the market include Accenture plc, HP, IBM and Tata Consultancy Services Limited, as well as other technology consulting companies. Some of these competitors may be able to leverage their existing service organizations and provide higher levels of consulting and training on a more cost-effective basis than we can.

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With our cloud technologies we compete with companies that provide tools for enterprises to create private clouds, such as Microsoft and VMware, as well as with companies that provide public clouds, such as Amazon, Google Inc., Microsoft and Rackspace Hosting, Inc.

With our storage offerings we compete with companies that provide software-based storage products, such as EMC Corporation and NetApp, Inc.

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

We may not be able to meet the financial and operational challenges that we will encounter as our international operations, which represented approximately 45.1% of our total revenue for the fiscal year ended February 29, 2012, continue to expand.

Our international operations accounted for approximately 45.1% of total revenue for the fiscal year ended February 29, 2012. 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 negatively affect our operating results.

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

Fluctuations in exchange rates;

Pricing environments;

Longer payment cycles and less financial stability of customers;

Compliance with a wide variety of foreign laws;

Difficulty selecting and monitoring channel partners outside of the United States;

Lower levels of availability or use of the internet, through which our software is often delivered;

Difficulty protecting our intellectual property rights overseas due to, among other reasons, the uncertainty of laws and enforcement in certain countries relating to the protection of intellectual property rights;

Difficulty in staffing, developing and managing foreign operations as a result of distance, language, legal, cultural and other differences;

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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;

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Changes in import/export duties, quotas or other trade barriers 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 could result in the loss or forfeiture of some foreign assets and the loss of sums spent developing and marketing those assets and the revenue associated with them.

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

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

During our fiscal year ended February 29, 2012, a substantial portion of our subscription revenues 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 revenues from Red Hat Enterprise Linux, our 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 different from our historical income tax provisions and accruals. The results of an audit or litigation could have a material effect on our financial statements in the period or periods for which that determination is made.

We earn a significant amount of our operating income from outside the U.S., and any repatriation of funds currently held in foreign jurisdictions may result in higher effective tax rates for the company. In addition, there have been proposals to change U.S. tax laws that would significantly impact how U.S. multinational corporations are taxed on foreign earnings. Although we cannot predict whether or in what form this proposed legislation may pass, if enacted it could have a material adverse impact on 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

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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 resulting in an adverse impact on 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 position of our business could be harmed; current and potential future shareholders could lose confidence in us and/or our reported financial results, which may cause a negative effect on our trading price; and we could be exposed to litigation or regulatory proceedings, which may be costly or divert management attention.

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

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

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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 29, 2012 consisted primarily of money market funds, U.S. government and agency securities, German sovereign securities, certificates of deposit, corporate securities and equity securities. Although we follow an established investment policy and seek to minimize the risks associated with our investments by investing primarily in investment grade, highly liquid securities and by limiting the amounts invested with any one institution, type of security or issuer, we cannot give assurances that the assets in our investment portfolio will not lose value or become impaired, or that our interest income will not decline.

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 impact our financial condition and operating results.

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

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

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

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

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

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

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The table below sets forth information regarding the Company's purchases of its common stock during its second fiscal quarter ended August 31, 2012:

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)
June 1, 2012 - June 30, 2012	0	\$ 0.00	0	\$ 270.0 million
July 1, 2012 - July 31, 2012	131,257	\$ 51.24	57,611	\$ 267.1 million
August 1, 2012 - August 31, 2012	26	\$ 60.21	0	\$ 267.1 million
Total	131,283	\$ 51.24	57,611	\$ 267.1 million

- (1) During the three months ended August 31, 2012, the Company withheld an aggregate of 73,672 shares of its common stock from employees to satisfy minimum tax withholding obligations relating to the vesting of restricted share awards. These shares were not withheld pursuant to the program described in Note 2 below.
- (2) On March 28, 2012, the Company announced that its Board of Directors 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 1, 2012, and will expire on the earlier of (i) March 31, 2014, or (ii) a determination by the Board of Directors, Chief Executive Officer or Chief Financial Officer to discontinue the program.

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ITEM 6. EXHIBITS

(a) List of Exhibits

Exhibit No.	Exhibit
10.1 *	Red Hat, Inc. 2004 Long-Term Incentive Plan, as Amended and Restated
31.1	Certification of the registrant's Chief Executive Officer pursuant to Rule 13a-14(a)/Rule 15d-14(a) under the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of the registrant's Chief Financial Officer pursuant to Rule 13a-14(a)/Rule 15d-14(a) under the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification of the registrant's principal executive officer and principal financial officer pursuant to 18 U.S.C. Section 1350
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema
101.CAL	XBRL Taxonomy Extension Calculation Linkbase
101.DEF	XBRL Taxonomy Extension Definition Linkbase
101.LAB	XBRL Taxonomy Extension Label Linkbase
101.PRE	XBRL Taxonomy Extension Presentation Linkbase

* Indicates a management contract or compensatory plan, contract or arrangement.

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SIGNATURES

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

Date: October 5, 2012

RED HAT, INC.

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

President and Chief Executive Officer

(Duly Authorized Officer on Behalf of the Registrant)

Date: October 5, 2012

RED HAT, INC.

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

Executive Vice President and

Chief Financial Officer

(Principal Financial Officer)

Date: October 5, 2012

RED HAT, INC.

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

Vice President and Controller

(Principal Accounting Officer)