RED HAT INC
Form 10-Q
January 08, 2016
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended November 30, 2015

OR

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

For the transition period from to .

Commission File Number: 001-33162

RED HAT, INC.

(Exact name of registrant as specified in its charter)

Delaware	**06-1364380**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

100 East Davie Street, Raleigh, North Carolina 27601

(Address of principal executive offices, including zip code)

(919) 754-3700

(Registrant s telephone number, including area code)

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

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

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

Large accelerated filer x	Accelerated filer ¨
Non-accelerated filer ¨	Smaller reporting company ¨

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

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

As of December 31, 2015, there were 182,625,154 shares of common stock outstanding.

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CAUTIONARY NOTE ON FORWARD-LOOKING STATEMENTS

Certain statements contained in this report and the documents incorporated by reference in this report, including in Management s Discussion and Analysis of Financial Condition and Results of Operations, constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements provide current expectations of future events based on certain assumptions, and any statement that is not strictly a historical statement could be deemed to be a forward-looking statement (for example, statements regarding current or future financial performance, management s plans and objectives for future operations, product plans and performance, management s expectations regarding market risk and market penetration, management s assessment of market factors or strategies, objectives and plans of Red Hat, Inc. together with its subsidiaries (Red Hat) and its partners). Words such as anticipate, believe, estimate, expect, intend, plan, project, will, and similar expressions, may als forward-looking statements. Red Hat may also make forward-looking statements in other filings made with the Securities and Exchange Commission (SEC), press releases, materials delivered to stockholders and oral statements made by management. Investors are cautioned that these forward-looking statements are inherently uncertain, are not guarantees of Red Hat s future performance and are subject to a number of risks and uncertainties that could cause Red Hat s actual results to differ materially from those found in the forward-looking statements and from historical trends. These risks and uncertainties include the risks and cautionary statements detailed in Part II, Item 1A, Risk Factors and elsewhere in this report as well as in Red Hat s other filings with the SEC, copies of which may be accessed through the SEC s web site at http://www.sec.gov. Readers are urged to carefully review these risks and cautionary statements. Moreover, Red Hat operates in a rapidly changing and highly competitive environment. It is impossible to predict all risks and uncertainties or assess the impact of any new risk or uncertainty on our business or any forward-looking statement. The forward-looking statements included in this report represent our views as of the date of this report. We specifically disclaim any obligation to update these forward-looking statements in the future. These forward-looking statements should not be relied upon as representing our views as of any date subsequent to the date of this report.

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RED HAT, INC.

CONSOLIDATED BALANCE SHEETS

(In thousands except share and per share amounts)

	November 30, 2015 (Unaudited)	February 28, 2015(1)
ASSETS		
Current assets:		
Cash and cash equivalents	$ 942,037	$ 1,047,473
Investments in debt securities, short-term	193,993	215,254
Accounts receivable, net of allowances for doubtful accounts of $2,224 and $2,247, respectively	396,545	468,021
Deferred tax assets, net	104,869	86,796
Prepaid expenses	135,402	150,715
Other current assets	1,095	1,980
Total current assets	$ 1,773,941	$ 1,970,239
Property and equipment, net of accumulated depreciation and amortization of $196,270 and $190,114, respectively	161,015	172,151
Goodwill	1,013,202	927,060
Identifiable intangibles, net	164,134	134,276
Investments in debt securities, long-term	735,426	546,016
Other assets, net	51,487	53,243
Total assets	$ 3,899,205	$ 3,802,985
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable and accrued expenses	$ 229,059	$ 237,733
Deferred revenue	1,080,572	1,095,115
Other current obligations	1,903	1,844
Total current liabilities	$ 1,311,534	$ 1,334,692
Long-term deferred revenue	406,562	387,213
Convertible notes	729,285	715,402
Other long-term obligations	107,031	77,340
Commitments and contingencies (NOTES 12 and 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, 234,735,200 and 233,061,964 shares issued, and 182,619,038 and 183,551,078 shares outstanding at November 30, 2015 and February 28, 2015, respectively	23	23
Additional paid-in capital	2,119,426	1,963,851

Retained earnings		1,046,702		900,373
Treasury stock at cost, 52,116,162 and 49,510,886 shares at November 30, 2015 and February 28, 2015, respectively		(1,738,752)		(1,515,288)
Accumulated other comprehensive loss		(82,606)		(60,621)
Total stockholders equity	$	1,344,793	$	1,288,338
Total liabilities and stockholders equity	$	3,899,205	$	3,802,985

(1) Derived from audited financial statements.

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

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RED HAT, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands except per share amounts)

(Unaudited)

	Three Months Ended November 30, 2015	Three Months Ended November 30, 2014	Nine Months Ended November 30, 2015	Nine Months Ended November 30, 2014
Revenue:				
Subscriptions	$ 457,488	$ 394,699	$ 1,323,807	$ 1,156,161
Training and services	66,092	61,196	184,921	169,387
Total subscription and training and services revenue	523,580	455,895	1,508,728	1,325,548
Cost of subscription and training and services revenue:				
Cost of subscriptions	32,246	28,574	93,088	84,125
Cost of training and services	48,802	42,791	135,321	118,857
Total cost of subscription and training and services revenue	81,048	71,365	228,409	202,982
Gross profit	442,532	384,530	1,280,319	1,122,566
Operating expense:				
Sales and marketing	215,784	187,218	619,757	538,576
Research and development	104,906	90,613	304,824	275,817
General and administrative	52,965	39,502	139,462	125,786
Total operating expense	373,655	317,333	1,064,043	940,179
Income from operations	68,877	67,197	216,276	182,387
Interest income	2,874	2,196	8,484	6,048
Interest expense	5,817	3,441	17,265	3,591
Other income (expense), net	49	1,559	(1,398)	1,777
Income before provision for income taxes	65,983	67,511	206,097	186,621
Provision for income taxes	19,135	19,578	59,768	54,120
Net income	$ 46,848	$ 47,933	$ 146,329	$ 132,501
Basic net income per common share	$ 0.26	$ 0.26	$ 0.80	$ 0.71

Diluted net income per common share	$ 0.25	$ 0.26	$ 0.78	$ 0.70
Weighted average shares outstanding				
Basic	182,850	185,039	183,054	187,533
Diluted	186,094	187,674	186,414	190,081

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

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RED HAT, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(In thousands)

(Unaudited)

	Three Months Ended		Nine Months Ended	
	November 30, 2015	November 30, 2014	November 30, 2015	November 30, 2014
Net income	$ 46,848	$ 47,933	$ 146,329	$ 132,501
Other comprehensive income (loss):				
Change in foreign currency translation adjustment	(17,338)	(16,013)	(20,344)	(27,765)
Available-for-sale securities:				
Unrealized gain (loss) on available-for-sale securities during the period	149	399	(2,395)	567
Reclassification for (gain) loss realized on available-for-sale securities, reported in Other income (expense), net	(7)	(1)	(4)	(151)
Tax benefit (expense)	39	(140)	758	28
Net change in available-for-sale securities (net of tax)	181	258	(1,641)	444
Total other comprehensive loss	(17,157)	(15,755)	(21,985)	(27,321)
Comprehensive income	$ 29,691	$ 32,178	$ 124,344	$ 105,180

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

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RED HAT, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

	Three Months Ended		Nine Months Ended	
	November 30, 2015	November 30, 2014	November 30, 2015	November 30, 2014
Cash flows from operating activities:				
Net income	$ 46,848	$ 47,933	$ 146,329	$ 132,501
Adjustments to reconcile net income to net cash provided by operating activities:				
Depreciation and amortization	19,858	18,651	56,944	57,114
Amortization of debt discount and transaction costs	5,279	3,085	15,697	3,085
Share-based compensation expense	43,407	33,623	120,466	98,942
Deferred income taxes	5,841	(780)	3,912	3,125
Net amortization of bond premium on debt securities available for sale	3,055	2,407	8,791	6,965
Other	853	(175)	2,761	(527)
Changes in operating assets and liabilities, net of effects of acquisitions:				
Accounts receivable	(96,964)	(75,917)	64,515	2,314
Prepaid expenses	(9,032)	(5,922)	3,618	(13,502)
Accounts payable and accrued expenses	21,886	26,254	3,954	56,175
Deferred revenue	96,664	83,912	40,085	57,955
Other	1,908	(83)	1,567	1,264
Net cash provided by operating activities	139,603	132,988	468,639	405,411
Cash flows from investing activities:				
Purchase of investment in debt securities available for sale	(180,744)	(141,928)	(783,568)	(461,069)
Proceeds from sales and maturities of investment in debt securities available for sale	235,931	93,578	589,131	503,110
Acquisition of businesses, net of cash acquired	(125,011)	(78,317)	(126,711)	(296,121)
Purchase of other intangible assets	(2,097)	(2,160)	(8,094)	(3,911)
Purchase of property and equipment	(8,486)	(12,201)	(29,458)	(35,085)
Other	(90)	482	(3,249)	2,917
Net cash used in investing activities	(80,497)	(140,546)	(361,949)	(290,159)

Cash flows from financing activities:				
Excess tax benefits from share-based payment arrangements	8,756	3,488	17,987	4,897
Proceeds from exercise of common stock options	723	465	3,312	1,154
Payments related to net settlement of share-based compensation awards	(27,879)	(21,754)	(60,816)	(39,314)
Purchase of treasury stock	(78,172)	(375,000)	(148,251)	(535,062)
Proceeds from issuance of convertible notes, net of issuance costs		790,394		790,394
Purchase of convertible note hedges		(148,040)		(148,040)
Proceeds from issuance of warrants		79,776		79,776
Payments on other borrowings	(615)	(402)	(1,352)	(2,392)
Net cash provided by (used in) financing activities	(97,187)	328,927	(189,120)	151,413
Effect of foreign currency exchange rates on cash and cash equivalents	(11,489)	(22,761)	(23,006)	(29,418)
Net increase (decrease) in cash and cash equivalents	(49,570)	298,608	(105,436)	237,247
Cash and cash equivalents at beginning of the period	991,607	585,381	1,047,473	646,742
Cash and cash equivalents at end of the period	$ 942,037	$ 883,989	$ 942,037	$ 883,989

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

Open source software is an alternative to proprietary software and represents a different model for the development and licensing of commercial software code than that typically used for proprietary software. Because open source software code is often freely shared, there are customarily no licensing fees for the use of open source software. Therefore, the Company does not recognize revenue from the licensing of the code itself. The Company provides value to its customers through the development, aggregation, integration, testing, certification, delivery, maintenance, enhancement and support of its Red Hat technologies, and by providing a level of performance, reliability, scalability, flexibility, stability and security for the technologies the Company packages and distributes. Moreover, because communities of developers not employed by the Company assist with the creation of the Company s open source offerings, opportunities for further innovation of the Company s offerings are supplemented by these communities.

The Company derives its revenue and generates cash from customers primarily from two sources: (i) subscription revenue and (ii) training and services revenue. These arrangements typically involve subscriptions to Red Hat technologies. The arrangements with the Company s customers that produce this revenue and cash are explained in further detail 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 fiscal year ended February 28, 2015.

NOTE 2 Summary of Significant Accounting Policies

Basis of presentation

The unaudited interim consolidated financial statements as of and for the three and nine months ended November 30, 2015 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 for a fair statement of the consolidated balance sheets, consolidated operating results, consolidated other comprehensive income 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 and nine months ended November 30, 2015 are not necessarily indicative of the results that may be expected for the fiscal year ending February 29, 2016. 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. These unaudited financial statements should be read in conjunction with the Company s Consolidated Financial Statements, including notes thereto, included in the Company s Annual Report on Form 10-K for the fiscal year ended February 28, 2015. Other than the transition to estimating certain cloud-usage revenue described below, 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 fiscal year ended

February 28, 2015. These unaudited financial statements should be read in conjunction with the financial statements included in the Annual Report on Form 10-K.

The Company derives a portion of its revenue from Certified Cloud and Service Providers (CCSPs) that provide public clouds with and allow users to consume computing resources as a service. The Company earns

RED HAT, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

revenue based on subscription units consumed by the CCSP or its end users. These cloud-usage services began expanding significantly in fiscal 2013 and have continued to grow.

For periods prior to March 1, 2015, the Company recognized cloud-usage revenue upon receipt of usage reports from the CCSPs, which typically report fees owed to the Company one month or more after the fees have been earned. Effective March 1, 2015, the Company believes that it now has sufficient historical data and experience to estimate this cloud-usage revenue and has begun estimating the amount of and recognizing such revenue in the period earned. The estimates are based on the historical cloud-usage data available. As a result of the Company s transition to estimating cloud-usage revenue, the Company s subscription revenues and pre-tax income for the nine months ended November 30, 2015 include an additional, favorable adjustment of $5.3 million.

Consolidation policy

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 have been eliminated in consolidation. There are no significant foreign currency 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.

Recent accounting pronouncements

In November 2015, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update 2015-17, *Income Taxes (Topic 740): Balance Sheet Classification of Deferred Taxes* (ASU 2015-17). ASU 2015-17 removes the requirement that deferred tax assets and liabilities be classified as either current or noncurrent in a classified statement of financial position and instead considers deferred tax assets and liabilities to be classified as noncurrent. This guidance is effective for the Company as of the first quarter of the fiscal year ending February 28, 2018. The Company does not believe that this updated standard will have a material impact on its consolidated financial statements.

In September 2015, the FASB issued Accounting Standards Update 2015-16, *Business Combinations (Topic 805): Simplifying the Accounting for Measurement-Period Adjustments* (ASU 2015-16). The FASB issued ASU 2015-16 to simplify US GAAP to require that the acquirer record, in the same period s financial statements, the effect of changes to provisional, measurement period amounts calculated as if the accounting had been completed at the acquisition date and disclose the portion of the amount recorded in current-period earnings by line item that would have been recorded in previous reporting periods if the adjustment to the provisional amounts had been recognized as of the acquisition date. This guidance is effective for the Company as of the first quarter of the fiscal year ending February 28, 2017. The Company does not believe that this updated standard will have a material impact on its consolidated financial statements.

In April 2015, the FASB issued Accounting Standards Update 2015-03, *Interest Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs* (ASU 2015-03). The FASB issued

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RED HAT, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

ASU 2015-03 to simplify the presentation of debt issuance costs related to a recognized debt liability to present the debt issuance costs as a direct deduction from the carrying value of the debt liability rather than showing the debt issuance costs as a deferred charge on the balance sheet. This guidance is effective for fiscal years, and interim periods within those years, beginning after December 15, 2015, and is effective for the Company as of the first quarter of the fiscal year ending February 28, 2017. The Company does not believe that this updated standard will have a material impact on the Company s consolidated financial statements.

In May 2014, the FASB issued Accounting Standards Update 2014-09, *Revenue from Contracts with Customers* (ASU 2014-09). The FASB issued ASU 2014-09 to clarify the principles for recognizing revenue and to develop a common revenue standard for generally accepted accounting principles (GAAP) and International Financial Reporting Standards. The standard outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes the most current revenue recognition guidance. This guidance is effective for fiscal years and interim periods within those years beginning after December 15, 2017, which is effective for the Company as of the first quarter of the fiscal year ending February 28, 2019. The Company is evaluating the impact that the implementation of this standard will have on the Company s consolidated financial statements.

NOTE 3 Changes in Equity

The following table summarizes the changes in the Company s stockholders equity during the three months ended November 30, 2015 (in thousands):

	Common Stock	Additional Paid-In Capital	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income (Loss)	Total Stockholders Equity
Balance at August 31, 2015	$ 23	$ 2,094,202	$ 999,854	$ (1,660,580)	$ (65,449)	$ 1,368,050
Net income			46,848			46,848
Other comprehensive income (loss), net of tax					(17,157)	(17,157)
Exercise of common stock options		723				723
Common stock repurchase (see NOTE 10)				(78,172)		(78,172)
Share-based compensation expense		43,407				43,407
		505				505

Assumed employee share-based awards from a business combination						
Tax benefits related to share-based awards		8,468				8,468
Minimum tax withholdings paid by the Company on behalf of employees related to net settlement of employee share-based awards		(27,879)				(27,879)
Balance at November 30, 2015	$ 23	$ 2,119,426	$ 1,046,702	$ (1,738,752)	$ (82,606)	$ 1,344,793

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RED HAT, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

The following table summarizes the changes in the Company s stockholders equity during the three months ended November 30, 2014 (in thousands):

	Common Stock	Additional Paid-In Capital	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income (Loss)	Total Stockholders Equity
Balance at August 31, 2014	$ 23	$ 1,942,659	$ 804,740	$ (1,216,741)	$ (16,025)	$ 1,514,656
Net income			47,933			47,933
Other comprehensive income (loss), net of tax					(15,755)	(15,755)
Exercise of common stock options		465				465
Common stock repurchase		(75,000)		(300,000)		(375,000)
Share-based compensation expense		33,623				33,623
Tax benefits related to share-based awards		2,978				2,978
Minimum tax withholdings paid by the Company on behalf of employees related to net settlement of employee share-based awards		(21,754)				(21,754)
Equity component of convertible notes		96,890				96,890
Equity component of convertible notes issuance cost		(1,833)				(1,833)
Purchase of convertible note hedges		(148,040)				(148,040)
Proceeds from issuance of warrants		79,776				79,776
Deferred taxes related to convertible notes		19,868				19,868
Other adjustments		(1,453)		1,453		

Balance at November 30, 2014	$ 23	$ 1,928,179	$ 852,673	$ (1,515,288)	$ (31,780)	$ 1,233,807

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RED HAT, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

The following table summarizes the changes in the Company s stockholders equity during the nine months ended November 30, 2015 (in thousands):

	Common Stock	Additional Paid-In Capital	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income (Loss)	Total Stockholders Equity
Balance at February 28 , 2015	$ 23	$ 1,963,851	$ 900,373	$ (1,515,288)	$ (60,621)	$ 1,288,338
Net income			146,329			146,329
Other comprehensive income (loss), net of tax					(21,985)	(21,985)
Exercise of common stock options		3,312				3,312
Common stock repurchase (see NOTE 10)		75,000		(223,251)		(148,251)
Share-based compensation expense		120,466				120,466
Assumed employee share-based awards from a business combination		505				505
Tax benefits related to share-based awards		16,895				16,895
Minimum tax withholdings paid by the Company on behalf of employees related to net settlement of employee share-based awards		(60,816)				(60,816)
Other adjustments		213		(213)		
Balance at November 30, 2015	$ 23	$ 2,119,426	$ 1,046,702	$ (1,738,752)	$ (82,606)	$ 1,344,793

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RED HAT, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

The following table summarizes the changes in the Company s stockholders equity during the nine months ended November 30, 2014 (in thousands):

	Common Stock	Additional Paid-In Capital	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income (Loss)	Total Stockholders Equity
Balance at February 28, 2014	$ 23	$ 1,891,848	$ 720,172	$ (1,056,419)	$ (4,459)	$ 1,551,165
Net income			132,501			132,501
Other comprehensive income (loss), net of tax					(27,321)	(27,321)
Exercise of common stock options		1,154				1,154
Common stock repurchase		(75,000)		(460,062)		(535,062)
Share-based compensation expense		98,942				98,942
Assumed employee share-based awards from a business combination		895				895
Tax benefits related to share-based awards		4,186				4,186
Minimum tax withholdings paid by the Company on behalf of employees related to net settlement of employee share-based awards		(39,314)				(39,314)
Equity component of convertible notes		96,890				96,890
Equity component of convertible notes issuance cost		(1,833)				(1,833)
Purchase of convertible note hedges		(148,040)				(148,040)
Proceeds from issuance of warrants		79,776				79,776

Deferred taxes related to convertible notes		19,868				19,868
Other adjustments		(1,193)		1,193		
Balance at November 30, 2014	$ 23	$ 1,928,179	$ 852,673	$ (1,515,288)	$ (31,780)	$ 1,233,807

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RED HAT, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Accumulated other comprehensive loss

The following is a summary of accumulated other comprehensive loss as of November 30, 2015 and February 28, 2015 (in thousands):

	As of November 30, 2015	As of February 28, 2015
Accumulated loss from foreign currency translation adjustment	$ (81,330)	$ (60,986)
Accumulated unrealized gain (loss), net of tax, on available-for-sale securities	(1,276)	365
Accumulated other comprehensive loss	$ (82,606)	$ (60,621)

NOTE 4 Identifiable Intangible Assets

Identifiable intangible assets consist primarily of trademarks, copyrights and patents, purchased technologies, customer and reseller relationships and covenants not to compete which are amortized over the estimated useful life, generally on a straight-line basis with the exception of customer and reseller relationships which are generally amortized over the related asset s pattern of economic benefit or on a straight-line basis if a straight-line basis results in a greater amount of amortization for the period reported. Useful lives range from three to ten years. As of November 30, 2015 and February 28, 2015, trademarks with an indefinite estimated useful life totaled $13.9 million and $11.3 million, respectively.

The following is a summary of identifiable intangible assets (in thousands):

	As of November 30, 2015			As of February 28, 2015		
	Gross Amount	Accumulated Amortization	Net Amount	Gross Amount	Accumulated Amortization	Net Amount
Trademarks, copyrights and patents	$ 127,003	$ (47,616)	$ 79,387	$ 117,020	$ (42,630)	$ 74,390
Purchased technologies	98,174	(68,835)	29,339	81,482	(63,618)	17,864
Customer and reseller relationships	122,944	(78,326)	44,618	104,084	(71,512)	32,572
Covenants not to compete	14,469	(9,071)	5,398	10,683	(7,657)	3,026
Other intangible assets	8,833	(3,441)	5,392	8,833	(2,409)	6,424

Total identifiable intangible assets	$ 371,423	$ (207,289)	$ 164,134	$ 322,102	$ (187,826)	$ 134,276

Amortization expense associated with identifiable intangible assets recognized in the Company s Consolidated Financial Statements for the three and nine months ended November 30, 2015 and November 30, 2014 is summarized as follows (in thousands):

	Three Months Ended		Nine Months Ended	
	November 30, 2015	**November 30, 2014**	**November 30, 2015**	**November 30, 2014**
Cost of revenue	$ 3,444	$ 3,339	$ 9,323	$ 9,129
Sales and marketing	2,330	1,959	6,345	5,533
Research and development	312	250	854	2,167
General and administrative	1,238	1,438	3,450	4,474
Total amortization expense	$ 7,324	$ 6,986	$ 19,972	$ 21,303

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RED HAT, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

NOTE 5 Income Taxes

Income Tax Expense

The following table summarizes the Company s tax provision for the three and nine months ended November 30, 2015 and November 30, 2014 (in thousands):

	Three Months Ended		Nine Months Ended	
	November 30, 2015	November 30, 2014	November 30, 2015	November 30, 2014
Income before provision for income taxes	$ 65,983	$ 67,511	$ 206,097	$ 186,621
Estimated annual effective tax rate	29%	29%	29%	29%
Provision for income taxes	$ 19,135	$ 19,578	$ 59,768	$ 54,120

For the three and nine months ended November 30, 2015, the Company s estimated annual effective tax rate of 29% differed from the U.S. federal statutory rate of 35% principally due to foreign income taxed at lower rates, state income taxes net of federal benefits and the domestic production activities deduction. For the three and nine months ended November 30, 2014, the Company s then-estimated annual effective tax rate of 29% differed from the U.S. federal statutory rate of 35%, principally due to foreign income taxed at lower rates.

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

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

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

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

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

The Company s investments are comprised primarily of debt securities that are classified as available for sale and recorded at their fair market values. Liquid investments with effective maturities of three months or less at the date of purchase 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

RED HAT, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

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

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

The following table summarizes the composition and fair value hierarchy of the Company s financial assets and liabilities at November 30, 2015 (in thousands):

	As of November 30, 2015	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)	$ 261,399	$ 261,399	$	$
Available-for-sale securities (1):				
U.S. agency securities	263,673		263,673	
Corporate securities	658,628		658,628	
Foreign government securities	7,118		7,118	
Foreign currency derivatives (2)	58		58	
Liabilities:				
Foreign currency derivatives (3)	(424)		(424)	
Total	$ 1,190,452	$ 261,399	$ 929,053	$

(1) Included in Cash and cash equivalents, Investments in debt securities, short-term or Investments in debt securities, long-term in the Company s Consolidated Balance Sheet at November 30, 2015, in addition to $680.6 million of cash.
(2) Included in Other current assets in the Company s Consolidated Balance Sheet at November 30, 2015.
(3) Included in Accounts payable and accrued expenses in the Company s Consolidated Balance Sheet at November 30, 2015.

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 February 28, 2015 (in thousands):

	As of February 28, 2015	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)	$ 369,926	$ 369,926	$	$
Interest-bearing deposits (1)	39		39	
Available-for-sale securities (1):				
Commercial paper	29,994		29,994	
U.S. agency securities	276,287		276,287	
Corporate securities	421,200		421,200	
Foreign government securities	63,744		63,744	
Foreign currency derivatives (2)	74		74	
Liabilities:				
Foreign currency derivatives (3)	(738)		(738)	
Total	$ 1,160,526	$ 369,926	$ 790,600	$

(1) Included in Cash and cash equivalents, Investments in debt securities, short-term or Investments in debt securities, long-term in the Company s Consolidated Balance Sheet at February 28, 2015, in addition to $647.6 million of cash.

(2) Included in Other current assets in the Company s Consolidated Balance Sheet at February 28, 2015.

(3) Included in Accounts payable and accrued expenses in the Company s Consolidated Balance Sheet at February 28, 2015.

The following table represents the Company s investments measured at fair value as of November 30, 2015 (in thousands):

Balance Sheet Classification

	Amortized Cost	Gross Unrealized		Aggregate Fair Value	Cash and cash equivalents	Investments in debt securities, short-term	Investments in debt securities, long-term
		Gains	Losses (1)				
Money markets	$ 261,399	$	$	$ 261,399	$ 261,399	$	$
U.S. agency securities	264,481	29	(837)	263,673		20,157	243,516
Corporate securities	660,035	766	(2,173)	658,628		166,718	491,910
Foreign government securities	7,115	3		7,118		7,118	
Total	$ 1,193,030	$ 798	$ (3,010)	$ 1,190,818	$ 261,399	$ 193,993	$ 735,426

(1) As of November 30, 2015, there were $0.4 million of accumulated unrealized losses related to investments that have been in a continuous unrealized loss position for 12 months or longer.

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RED HAT, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

The following table represents the Company s investments measured at fair value as of February 28, 2015 (in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses (1)	Aggregate Fair Value	Balance Sheet Classification: Cash and cash equivalents	Balance Sheet Classification: Investments in debt securities, short-term	Balance Sheet Classification: Investments in debt securities, long-term
Money markets	$ 369,926	$	$	$ 369,926	$ 369,926	$	$
Interest-bearing deposits	39			39		39	
Commercial paper	29,994			29,994	29,994		
U.S. agency securities	276,928	13	(654)	276,287		5,002	271,285
Corporate securities	420,431	1,219	(450)	421,200		146,469	274,731
Foreign government securities	63,687	59	(2)	63,744		63,744	
Total	$ 1,161,005	$ 1,291	$ (1,106)	$ 1,161,190	$ 399,920	$ 215,254	$ 546,016

(1) As of February 28, 2015, there were $0.3 million of accumulated unrealized losses related to investments that have been in a continuous unrealized loss position for 12 months or longer.

NOTE 7 Derivative Instruments

The Company transacts business in various foreign countries and is, therefore, subject to risk of foreign currency exchange rate fluctuations. The Company from time to time enters into forward contracts to 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. The Company does not designate these forward contracts as hedging instruments under applicable accounting guidance and, therefore, changes in fair value are recorded in the Consolidated Statements of Operations.

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RED HAT, INC.

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(Unaudited)

The effects of derivative instruments on the Company s Consolidated Financial Statements are as follows as of November 30, 2015 and for the three and nine months then ended (in thousands):

	As of November 30, 2015				Three Months Ended November 30, 2015	Nine Months Ended November 30, 2015
	Balance Sheet Location	Fair Value	Notional Value	Location of Gain (Loss) Recognized in Income on Derivatives	Amount of Gain (Loss) Recognized in Income on Derivatives	
Assets foreign currency forward contracts not designated as hedges	Other current assets	$ 58	$ 16,586	Other income (expense), net	$ 193	$ 1,465
Liabilities foreign currency forward contracts not designated as hedges	Accounts payable and accrued expenses	(424)	21,530	Other income (expense), net	(616)	(1,862)
TOTAL		$ (366)	$ 38,116		$ (423)	$ (397)

The effects of derivative instruments on the Company s Consolidated Financial Statements are as follows as of November 30, 2014 and for the three and nine months then ended (in thousands):

As of November 30, 2014				Three Months Ended November 30, 2014	Nine Months Ended November 30, 2014
Balance Sheet Location	Fair Value	Notional Value	Location of Gain (Loss) Recognized in Income on Derivatives	Amount of Gain (Loss) Recognized in Income on Derivatives	

Assets foreign currency forward contracts not designated as hedges	Other current assets	$ 7	$ 1,099	Other income (expense), net	$ 48	$ 312
Liabilities foreign currency forward contracts not designated as hedges	Accounts payable and accrued expenses	(411)	20,324	Other income (expense), net	(811)	(1,352)
TOTAL		$ (404)	$ 21,423		$ (763)	$ (1,040)

NOTE 8 Share-based Awards

The Company measures share-based compensation cost at the 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.

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RED HAT, INC.

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(Unaudited)

The following summarizes share-based compensation expense recognized in the Company s Consolidated Financial Statements for the three and nine months ended November 30, 2015 and November 30, 2014 (in thousands):

	Three Months Ended		Nine Months Ended	
	November 30, 2015	November 30, 2014	November 30, 2015	November 30, 2014
Cost of revenue	$ 4,074	$ 3,915	$ 11,952	$ 10,458
Sales and marketing	17,192	15,866	49,386	39,794
Research and development	13,059	8,129	35,955	28,091
General and administrative	9,082	5,713	23,173	20,599
Total share-based compensation	$ 43,407	$ 33,623	$ 120,466	$ 98,942

Share-based compensation expense qualifying for capitalization was insignificant for each of the three and nine months ended November 30, 2015 and November 30, 2014. Accordingly, no share-based compensation expense was capitalized during the three and nine months ended November 30, 2015 and November 30, 2014.

Estimated annual forfeitures An estimated forfeiture rate of 10.0% per annum, which approximates the Company s historical rate, was applied to options and non-vested 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 and nine months ended November 30, 2015, the Company granted the following share-based awards:

	Three Months Ended November 30, 2015		Nine Months Ended November 30, 2015	
	Shares and Shares Underlying Awards	Weighted Average Per Share Fair Value	Shares and Shares Underlying Awards	Weighted Average Per Share Fair Value
Service-based shares and share units	916,163	$ 77.62	1,842,640	$ 76.58
Performance share units target (1)		$	370,478	$ 78.28
Performance share awards (2)		$	154,705	$ 78.48
Assumed (3)	119,515	$ 58.22	119,515	$ 58.22
Total awards	1,035,678	$ 75.38	2,487,338	$ 76.07

(1) Certain executives and senior management were awarded a target number of performance share units (PSUs). PSU grantees may earn up to 200% of the target number of PSUs. Half of the target number of PSUs can be earned by the grantees depending upon the Company s financial performance measured against the financial performance of specified peer companies during a three-year performance period beginning on March 1, 2015. The remaining target number of PSUs can be earned by the grantees depending upon the Company s total shareholder return performance measured against the total shareholder return performance of specified peer companies during a three-year period beginning on March 1, 2015.

(2) Certain executives were granted restricted stock awards. These shares were awarded subject to the achievement of a specified dollar amount of revenue for FY2016 (the RSA Performance Goal). If the Company fails to achieve the RSA Performance Goal for FY2016, then all such shares are forfeited. If the Company achieves the RSA Performance Goal for FY2016, then 25% of the restricted stock vests on

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RED HAT, INC.

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July 16, 2016, and the remainder vests ratably on a quarterly basis over the course of the subsequent three year period, provided that the grantee s business relationship with the Company has not ceased.

(3) Amount represents partially vested options assumed as part of a business combination.

NOTE 9 Earnings Per Share

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

The following table reconciles the numerators and denominators of the earnings per share (EPS) calculation for the three and nine months ended November 30, 2015 and November 30, 2014 (in thousands, except per share amounts):

	Three Months Ended		Nine Months Ended	
	November 30, 2015	November 30, 2014	November 30, 2015	November 30, 2014
Net income, basic and diluted	$ 46,848	$ 47,933	$ 146,329	$ 132,501
Weighted average common shares outstanding	182,850	185,039	183,054	187,533
Incremental shares attributable to assumed vesting or exercise of outstanding equity award shares	2,854	2,635	3,011	2,548
Dilutive effect of convertible notes	390		349	
Diluted shares	186,094	187,674	186,414	190,081
Diluted net income per share	$ 0.25	$ 0.26	$ 0.78	$ 0.70

With respect to the Company s convertible notes, the Company has the option to pay cash or deliver, as the case may be, either cash, shares of its common stock or a combination of cash and shares of its common stock for the aggregate amount due upon conversion of the convertible notes. The Company s intent is to settle the principal amount of the convertible notes in cash upon conversion. As a result, upon conversion of the convertible notes, only the amounts payable in excess of the principal amounts of the convertible notes would be considered in diluted earnings per share under the treasury stock method. See NOTE 15 Convertible Notes to the Company s Consolidated Financial Statements for detailed information on the convertible notes.

Warrants to purchase 10,965,630 shares of the Company s common stock at $101.65 per share were outstanding during the three and nine months ended November 30, 2015 but were not included in the computation of diluted EPS because the warrants exercise price was greater than the average market price of the Company s common stock during the related period.

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

	Three Months Ended		Nine Months Ended	
	November 30, 2015	November 30, 2014	November 30, 2015	November 30, 2014
Number of shares considered anti-dilutive for calculating diluted EPS	19	39	160	151

NOTE 10 Share Repurchase Programs

On March 25, 2015, the Company announced that its Board of Directors has authorized the repurchase of up to $500.0 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, 2015, and will expire on the earlier of (i) March 31, 2017, or (ii) a determination by the Board, Chief Executive Officer or Chief Financial Officer to discontinue the program.

As of November 30, 2015, the Company had repurchased 1,882,115 shares of its common stock for $148.3 million under this repurchase program.

As of November 30, 2015, the amount available under the program for the repurchase of the Company s common stock was $351.7 million.

Accelerated share repurchase

During the fiscal year ended February 28, 2015, the Company entered into an accelerated share repurchase program (the ASR Agreement). On October 7, 2014, under the ASR Agreement, the Company paid $375.0 million to the ASR Agreement counterparty and received 5,312,555 shares of its common stock from the ASR Agreement counterparty, which represented 80 percent of the shares deliverable to the Company under the ASR Agreement assuming an average share price of $56.47 (the Company s closing share price at October 1, 2014). The ASR Agreement was completed on February 27, 2015. On March 4, 2015, the ASR Agreement counterparty delivered 720,101 additional shares of the Company s common stock to the Company in settlement of the ASR Agreement.

The Company initially accounted for the ASR Agreement as two separate transactions: (i) the 5,312,555 shares of common stock initially delivered to the Company were accounted for as a treasury stock transaction with $300.0 million, or 80 percent, of the $375.0 million upfront payment being recorded in Treasury stock in the Company s Consolidated Balance Sheet at February 28, 2015 and (ii) the unsettled portion of the ASR Agreement of $75.0

million was recorded in Additional paid-in capital on the Company s Consolidated Balance Sheet as of February 28, 2015. The $75.0 million representing the unsettled portion of the ASR originally recorded in Additional paid-in capital was reclassified upon settlement to Treasury stock during the nine months ended November 30, 2015.

The total number of shares of common stock the Company repurchased under the ASR Agreement was 6,032,656 shares with a weighted average share price of $62.16.

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RED HAT, INC.

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(Unaudited)

NOTE 11 Segment Reporting

The following summarizes revenue from unaffiliated customers and income (loss) from operations for the three and nine months ended November 30, 2015 and November 30, 2014 and total cash, cash equivalents and available-for-sale investment securities and total assets as of November 30, 2015 and November 30, 2014, by geographic segment (in thousands):

	Americas	EMEA	Asia Pacific	Corporate (1)	Consolidated
	Three Months Ended November 30, 2015				
Revenue from unaffiliated customers	$ 342,368	$ 114,909	$ 66,303	$	$ 523,580
Income (loss) from operations	$ 73,377	$ 23,824	$ 15,083	$ (43,407)	$ 68,877
	Three Months Ended November 30, 2014				
Revenue from unaffiliated customers	$ 290,525	$ 105,755	$ 59,615	$	$ 455,895
Income (loss) from operations	$ 68,620	$ 19,805	$ 12,395	$ (33,623)	$ 67,197
	Nine Months Ended November 30, 2015				
Revenue from unaffiliated customers	$ 996,405	$ 320,836	$ 191,487	$	$ 1,508,728
Income (loss) from operations	$ 222,851	$ 67,243	$ 46,648	$ (120,466)	$ 216,276
Total cash, cash equivalents and available-for-sale investment securities	$ 1,162,302	$ 488,003	$ 221,151	$	$ 1,871,456
Total assets	$ 2,787,555	$ 785,844	$ 325,806	$	$ 3,899,205
	Nine Months Ended November 30, 2014				
Revenue from unaffiliated customers	$ 838,757	$ 310,025	$ 176,766	$	$ 1,325,548
Income (loss) from operations	$ 170,093	$ 70,056	$ 41,180	$ (98,942)	$ 182,387
Total cash, cash equivalents and available-for-sale investment securities	$ 1,078,060	$ 383,972	$ 184,489	$	$ 1,646,521
Total assets	$ 2,546,504	$ 717,611	$ 283,756	$	$ 3,547,871

(1) Amounts represent share-based compensation expense for each of the three and nine months ended November 30, 2015 and November 30, 2014, which was not allocated to geographic segments.

Supplemental information about geographic areas

The following table lists, for each of the three and nine months ended November 30, 2015 and November 30, 2014, revenue from unaffiliated customers in the United States, the Company s country of domicile, and revenue from unaffiliated customers from foreign countries (in thousands):

	Three Months Ended		Nine Months Ended	
	November 30, 2015	November 30, 2014	November 30, 2015	November 30, 2014
United States, the Company s country of domicile	$ 306,762	$ 264,242	$ 894,872	$ 746,105
Foreign	216,818	191,653	613,856	579,443
Total revenue from unaffiliated customers	$ 523,580	$ 455,895	$ 1,508,728	$ 1,325,548

RED HAT, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Total tangible long-lived assets, net of accumulated depreciation, located in the United States, the Company s country of domicile, and similar tangible long-lived assets, net of accumulated depreciation, held outside the United States are summarized in the following table as of November 30, 2015 and February 28, 2015 (in thousands):

	As of November 30, 2015	As of February 28, 2015
United States, the Company s country of domicile	$ 123,196	$ 131,792
Foreign	37,819	40,359
Total tangible long-lived assets	$ 161,015	$ 172,151

Supplemental information about major customers

For each of the three and nine months ended November 30, 2015 and November 30, 2014, the U.S. government and its agencies represented approximately 10% of the Company s total revenue.

Supplemental information about products and services

The following table, for each of the three and nine months ended November 30, 2015 and November 30, 2014, provides further detail, by type, of our subscription and services revenues. Infrastructure-related offerings subscription revenue includes subscription revenue generated from Red Hat Enterprise Linux and related technologies such as Red Hat Enterprise Virtualization. Subscription revenue generated from our Application development-related and other emerging technology offerings includes Red Hat JBoss Middleware, Red Hat Storage Technologies and Red Hat cloud offerings such as Red Hat Enterprise Linux OpenStack Platform and OpenShift by Red Hat (in thousands):

	Three Months Ended		Nine Months Ended	
	November 30, 2015	November 30, 2014	November 30, 2015	November 30, 2014
Subscription revenue:				
Infrastructure-related offerings	$ 373,091	$ 332,897	$ 1,089,758	$ 983,915
Application development-related and other emerging technology offerings	84,397	61,802	234,049	172,246
Total subscription revenue	457,488	394,699	1,323,807	1,156,161

Training and services revenue:				
Consulting services	50,746	44,588	141,211	125,578
Training	15,346	16,608	43,710	43,809
Total training and services revenue	66,092	61,196	184,921	169,387
Total subscription and training and services revenue	$ 523,580	$ 455,895	$ 1,508,728	$ 1,325,548

NOTE 12 Commitments and Contingencies

Operating leases

As of November 30, 2015, the Company had leases of office space and certain equipment under various non-cancelable operating leases. Rent expense under operating leases for the three months ended November 30,

RED HAT, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

2015 and November 30, 2014 was $8.1 million and $8.0 million, respectively. Rent expense under operating leases for the nine months ended November 30, 2015 and November 30, 2014 was $23.7 million and $23.0 million, respectively.

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 Ansible, Inc.

On October 15, 2015 the Company completed its acquisition of all of the shares of Ansible, Inc. (Ansible). Ansible is a provider of IT automation solutions that allows its users to manage applications across hybrid cloud environments. The acquisition is intended to augment the Company s management portfolio and help customers deploy and manage applications across private and public clouds, speed service delivery through development/operations initiatives, streamline OpenStack installations and upgrades and accelerate container adoption by simplifying orchestration and configuration.

The consideration paid was $126.3 million and includes $125.5 million of cash. Based on management s provisional assessment of the acquisition-date fair value of the assets acquired and liabilities assumed, the total consideration transferred of $126.3 million has been allocated to the Company s assets and liabilities on a preliminary basis as follows: $91.9 million to goodwill, $42.4 million to identifiable intangible assets and $8.0 million to working capital as a net current liability.

The Company incurred approximately $3.8 million in transaction costs, including legal and accounting fees, relating to the acquisition. These transaction costs have been expensed as incurred and included in general and administrative expense on the Company s Consolidated Statement of Operations for the three and nine months ended November 30, 2015.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Acquisition of FeedHenry Ltd.

On October 8, 2014 the Company completed its acquisition of all of the shares of FeedHenry Ltd. (FeedHenry). FeedHenry is a provider of cloud-based enterprise mobile application platforms. The acquisition is intended to expand the Company s portfolio of application development, integration and platform-as-a-service solutions, enabling the Company to support mobile application development in public and private environments.

The consideration paid was $80.2 million and has been allocated to the Company s assets and liabilities as follows: $68.5 million to goodwill, $9.0 million to identifiable intangible assets and the remaining $2.7 million to net working capital.

Acquisition of eNovance, SAS

On June 24, 2014, the Company completed its acquisition of all of the shares of eNovance, SAS (eNovance), a provider of open source cloud computing services. The acquisition is intended to assist in advancing the Company s market position in OpenStack, and the addition of eNovance s systems integration capabilities and engineering talent is expected to help meet growing demand for enterprise OpenStack consulting, design and deployment.

The consideration paid was $67.6 million and has been allocated to the Company s assets and liabilities as follows: $60.8 million to goodwill, $5.3 million to identifiable intangible assets and the remaining $1.5 million to net working capital.

In addition to the cash consideration transferred, the Company issued a total of 529,057 restricted common shares to certain employee-shareholders. The vesting of these restricted shares is conditioned on continued employment with the Company. As a result of the employment condition, the transfer of these shares has been accounted for apart from the business combination. The shares effectively vest 25% per year, with the closing-date fair value of the shares being amortized, on a straight-line basis, to share-based compensation expense in the Company s Consolidated Statement of Operations.

Acquisition of Inktank Storage, Inc.

On April 30, 2014, the Company completed its acquisition of all of the shares of Inktank Storage, Inc. (Inktank), a provider of scale-out, open source storage systems, whose technology, Inktank Ceph Enterprise, delivers object and block storage software to enterprises deploying public or private clouds. The acquisition is intended to complement the Company s existing GlusterFS-based storage and Red Hat Enterprise Linux OpenStack Platform offerings.

The consideration paid was $152.5 million and has been allocated to the Company s assets and liabilities as follows: $131.4 million to goodwill, $10.8 million to identifiable intangible assets and the remaining $10.3 million to net working capital.

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RED HAT, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Pro forma consolidated financial information

The following unaudited pro forma consolidated financial information reflects the results of operations of the Company for the three and nine months ended November 30, 2015 and November 30, 2014 (in thousands, except per share amounts) as if the acquisitions of Ansible, FeedHenry, eNovance and Inktank had closed on March 1, 2014, after giving effect to certain purchase accounting adjustments. These pro forma results are not necessarily indicative of what the Company s operating results would have been had the acquisitions actually taken place at the beginning of the period.

	Three Months Ended		Nine Months Ended	
	November 30, 2015	November 30, 2014	November 30, 2015	November 30, 2014
Revenue	$ 524,360	$ 456,280	$ 1,511,556	$ 1,331,424
Net income	$ 44,635	$ 45,851	$ 138,634	$ 116,697
Basic net income per common share	$ 0.24	$ 0.25	$ 0.76	$ 0.62
Diluted net income per common share	$ 0.24	$ 0.24	$ 0.74	$ 0.61

Post-acquisition financial information

The following is a summary of the post-acquisition revenue, expenses and losses of Ansible that are included in the Company s Consolidated Statement of Operations for the three and nine months ended November 30, 2015 (in thousands):

	Three Months Ended November 30, 2015	Nine Months Ended November 30, 2015
Revenue	$ 198	$ 198
Operating expenses	(2,248)	(2,248)
Operating loss	(2,050)	(2,050)
Other loss	(2)	(2)
Loss before tax benefit	(2,052)	(2,052)
Tax benefit	595	595
Net loss	$ (1,457)	$ (1,457)

Goodwill

The following is a summary of changes in goodwill for the nine months ended November 30, 2015 (in thousands):

Balance at February 28, 2015	$ 927,060
Acquisition of Ansible	91,943
Impact of foreign currency fluctuations and other adjustments	(5,801)
Balance at November 30, 2015	$ 1,013,202

The excess of purchase price paid for Ansible, FeedHenry, eNovance, Inktank and other acquisitions over the fair value of the net assets acquired was recognized as goodwill. Goodwill comprises the majority of the purchase price paid for each of the acquired businesses because these businesses were focused on emerging technologies such as development and operations automation, mobile technologies, cloud-enabling technologies

RED HAT, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

and software-defined storage technologies, which consequently at the time of acquisition generated relatively little revenue. However, these acquired businesses, with their assembled, highly-specialized workforces and community of contributors, are expected to both expand the Company s existing technology portfolio and advance the Company s market position overall in open source solutions.

NOTE 15 Convertible Notes

Convertible note offering

On October 7, 2014, the Company completed its offering of $805.0 million aggregate principal amount of its 0.25% Convertible Senior Notes due 2019 (the convertible notes). The convertible notes were sold in a private placement under a purchase agreement, dated as of October 1, 2014, entered into by and among the Company and Morgan Stanley & Co. LLC, Merrill Lynch, Pierce, Fenner & Smith Incorporated, Citigroup Global Markets Inc. and J.P. Morgan Securities LLC as representatives of the several initial purchasers named therein (collectively, the Initial Purchasers), for resale to qualified institutional buyers pursuant to Rule 144A under the Securities Act of 1933, as amended.

The Company used $148.0 million of the net proceeds from the offering of the convertible notes to pay the cost of the privately-negotiated convertible note hedge transactions described below. The Company received proceeds of $79.8 million from the sale of warrants pursuant to the warrant transactions described below.

In addition, the Company used $375.0 million of the net proceeds from the offering of the convertible notes to repurchase shares of its common stock under an accelerated share repurchase program pursuant to an agreement that the Company entered into on October 1, 2014, as described in NOTE 10 Share Repurchase Programs to the Company s Consolidated Financial Statements.

The Company intends to use the remaining net proceeds from the offering for working capital and other general corporate purposes, which may include capital expenditures, potential acquisitions or strategic transactions.

Indenture

On October 7, 2014, the Company entered into an indenture (the Indenture) with respect to the convertible notes with U.S. Bank National Association, as trustee (the Trustee). Under the Indenture, the convertible notes will be senior unsecured obligations of the Company and bear interest at a rate of 0.25% per year, payable semiannually in arrears on April 1 and October 1 of each year, and began on April 1, 2015. The convertible notes will mature on October 1, 2019, unless previously purchased or converted.

The convertible notes are convertible into shares of the Company s common stock at an initial conversion rate of 13.6219 shares per $1,000 principal amount of convertible notes (which is equivalent to an initial conversion price of approximately $73.41 per share), subject to adjustment upon the occurrence of certain events. The initial conversion price represents a premium of approximately 30% to the $56.47 per share closing price of the Company s common stock on October 1, 2014. Upon conversion of the convertible notes, holders will receive cash or shares of the Company s common stock or a combination thereof, at the Company s election.

Prior to April 1, 2019, the convertible notes will be convertible only upon the occurrence of certain circumstances, and will be convertible thereafter at any time until the close of business on the second scheduled trading day immediately preceding the maturity date of the convertible notes.

RED HAT, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

The conversion rate is subject to customary anti-dilution adjustments. If certain corporate events described in the Indenture occur prior to the maturity date, the conversion rate will be increased for a holder who elects to convert its convertible notes in connection with such corporate event in certain circumstances.

The convertible notes are not redeemable prior to maturity, and no sinking fund is provided for the convertible notes. If the Company undergoes a fundamental change, as defined in the Indenture, subject to certain conditions, holders may require the Company to purchase for cash all or any portion of their convertible notes. The fundamental change purchase price will be 100% of the principal amount of the convertible notes to be purchased plus any accrued and unpaid special interest up to but excluding the fundamental change purchase date.

The Indenture contains customary terms and covenants, including that upon certain events of default occurring and continuing, either the Trustee or the holders of at least 25% in principal amount of the outstanding convertible notes may declare 100% of the principal of, and accrued and unpaid interest, if any, on, all the convertible notes to be due and payable.

In accounting for the issuance of the convertible notes, the Company separated the convertible notes into liability and equity components. The carrying amount of the liability component was calculated by measuring the estimated fair value of a similar liability that does not have an associated convertible feature. The carrying amount of the equity component representing the conversion option was determined by deducting the fair value of the liability component from the face value of the convertible notes as a whole. The excess of the face value of the convertible notes as a whole over the carrying amount of the liability component (the debt discount) is amortized to interest expense over the term of the convertible notes using the effective interest method with an effective interest rate of 2.86% per annum. The equity component is not remeasured as long as it continues to meet the conditions for equity classification.

As of November 30, 2015, the convertible notes consisted of the following (in thousands):

	As of November 30, 2015	As of February 28, 2015
Liability component		
Principal	$ 805,000	$ 805,000
Less: debt discount	(75,715)	(89,598)
Net carrying amount	$ 729,285	$ 715,402
Equity component (1)	$ 96,890	$ 96,890

(1) Recorded in the Consolidated Balance Sheet in Additional paid-in capital.

In accounting for the transaction costs related to the convertible note issuance, the Company allocated the total amount incurred of $15.2 million to the liability and equity components based on their relative fair values. Issuance costs attributable to the liability component totaled $13.4 million and are being amortized to interest expense over the term of the convertible notes using the effective interest method. The remaining $1.8 million of issuance costs have been allocated to the equity component and are included in Additional paid-in capital on the Company s Consolidated Balance Sheet as of November 30, 2015. Additionally, the Company recorded a deferred tax asset of $0.7 million related to the $1.8 million equity component of transactional costs which are deductible for tax purposes.

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RED HAT, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

The following table includes total interest expense recognized related to the convertible notes for the three and nine months ended November 30, 2015 and November 30, 2014 (in thousands):

	Three Months Ended		Nine Months Ended	
	November 30, 2015	November 30, 2014	November 30, 2015	November 30, 2014
Coupon rate 0.25% per year, payable semiannually	$ 503	$ 302	$ 1,509	$ 302
Amortization of convertible note issuance costs liability component	615	351	1,813	351
Accretion of debt discount	4,664	2,734	13,884	2,734
Total interest expense related to convertible notes	$ 5,782	$ 3,387	$ 17,206	$ 3,387

The fair value of the convertible notes, which was determined based on inputs that are observable in the market (Level 2), and the carrying value of the convertible notes (the carrying value excludes the equity component of the convertible notes classified in equity) are as follows (in thousands):

	As of November 30, 2015	
	Fair Value	Carrying Value
Convertible notes	$ 738,477	$ 729,285

Convertible note hedge transactions and warrant transactions

On October 1, 2014, the Company entered into convertible note hedge transactions and warrant transactions with certain of the Initial Purchasers of the convertible notes or their respective affiliates.

The convertible note hedge transactions are expected to offset the potential dilution with respect to shares of the Company s common stock upon any conversion of the convertible notes and/or offset any cash payments the Company is required to make in excess of the principal amount of the converted notes, as the case may be. To partially offset the $148.0 million cost of the convertible note hedge transactions, the Company issued warrants and received proceeds of $79.8 million. The number of shares of the Company s common stock underlying the warrants total 10,965,630, the same number of shares underlying the convertible notes and the convertible note hedge transactions. The combination of the convertible note hedge transactions and the warrant transactions effectively increases the initial conversion price of the convertible notes from $73.41 per share to $101.65 per share. As a result, the warrant transactions will have a dilutive effect with respect to the Company s common stock to the extent that the market price per share of the Company s common stock, as measured under the terms of the warrant transactions, exceeds the $101.65 strike price of the warrants. However, subject to certain conditions, the Company may elect to settle all of the warrants in cash. The $101.65 strike price of the warrants represents a premium of approximately 80% over the $56.47 per share closing price of the Company s common stock on October 1, 2014.

The purchase of convertible note hedges and proceeds from issuance of warrants were recorded in stockholders equity and will continue to be classified as stockholders equity.

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

OVERVIEW

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

Open source software is an alternative to proprietary software and represents a different model for the development and licensing of commercial software code than that typically used for proprietary software. Because open source software code is often freely shared, there are customarily no licensing fees for the use of open source software. Therefore, we do not recognize revenue from the licensing of the code itself. We provide value to our customers through the development, aggregation, integration, testing, certification, delivery, maintenance, enhancement and support of our Red Hat technologies, and by providing a level of performance, reliability, scalability, flexibility, stability and security for the 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 market our offerings primarily to customers in the form of annual or multi-year subscriptions, and we recognize revenue over the period of the subscription agreements with our customers. Our technologies are also offered by Certified Cloud and Service Providers (CCSPs) as a service available on demand, and this revenue is recognized by us upon delivery.

We have focused on introducing and gaining acceptance for Red Hat technologies that comprise our open source architecture. Red Hat Enterprise Linux (RHEL) and Red Hat JBoss Middleware offerings have 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 operating system and middleware offerings and introducing virtualization, storage, cloud and other offerings.

We derive our revenue and generate cash from customers primarily from two sources: (i) subscription revenue and (ii) training and services revenue. These arrangements typically involve subscriptions to Red Hat technologies. Our revenue is affected by, among other factors, corporate, government and consumer spending levels. In evaluating the performance of our business, we consider a number of factors, including total revenue, deferred revenue, operating income, operating margin and cash flows from operations.

The arrangements with our customers that produce this revenue and cash are explained in further detail in Part II, Item 7 under Critical Accounting Estimates and in NOTE 2 Summary of Significant Accounting Policies to the Consolidated Financial Statements of our Annual Report on Form 10-K for the fiscal year ended February 28, 2015.

In our fiscal year ended February 28, 2015, we focused on and expect in our fiscal year ending February 29, 2016 to continue to focus on, among other things, (i) promoting the widespread adoption of Red Hat offerings by customers globally, (ii) expanding our portfolio of virtualization, storage, management and other technology offerings that enable cloud computing, (iii) investing in the development of open source technologies, (iv) pursuing strategic acquisitions and alliances, (v) increasing revenue from our existing customer base, (vi) increasing revenue by promoting a range of services to help our customers derive additional value, (vii) expanding routes to market, and (viii) growing our presence in international markets.

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Revenue

For the three months ended November 30, 2015, total revenue increased 14.8%, or $67.7 million, to $523.6 million from $455.9 million for the three months ended November 30, 2014. Excluding the impact of foreign currency exchange rate fluctuations, total revenue increased by 21.1% for the three months ended November 30, 2015, as detailed in the following table.

The growth rates of subscription revenue by offering type and training and services revenue, as reported and excluding the impact of foreign currency exchange rate fluctuations, for the three and nine months ended November 30, 2015 versus the three and nine months ended November 30, 2014 are as follows (in thousands):

	Three Months Ended			Nine Months Ended		
	November 30, 2015	November 30, 2014	Year-Over-Year Growth Rate	November 30, 2015	November 30, 2014	Year-Over-Year Growth Rate
Infrastructure-related subscription revenue, as reported	$ 373,091	$ 332,897	12.1%	$ 1,089,758	$ 983,915	10.8%
Adjustment for foreign currency exchange rates	18,550			68,781		
Infrastructure-related subscription revenue, excluding foreign currency impact	391,641	332,897	17.6%	1,158,539	983,915	17.7%
Application development-related and other emerging technology subscription revenue, as reported	84,397	61,802	36.6%	234,049	172,246	35.9%
Adjustment for foreign currency exchange rates	5,330			18,212		
Application development-related and other emerging technology subscription revenue, excluding foreign currency impact	89,727	61,802	45.2%	252,261	172,246	46.5%
Total subscription revenue, as reported	457,488	394,699	15.9%	1,323,807	1,156,161	14.5%
Adjustment for foreign currency exchange rates	23,880			86,993		
Total subscription revenue, excluding foreign currency	481,368	394,699	22.0%	1,410,800	1,156,161	22.0%

impact						
Total training and services revenue, as reported	66,092	61,196	8.0%	184,921	169,387	9.2%
Adjustment for foreign currency exchange rates	4,603			15,487		
Total training and services revenue, excluding foreign currency impact	70,695	61,196	15.5%	200,408	169,387	18.3%
Total subscription and training and services revenue, as reported	523,580	455,895	14.8%	1,508,728	1,325,548	13.8%
Adjustment for foreign currency exchange rates	28,483			102,480		
Total subscription and training and services revenue, excluding foreign currency impact	$ 552,063	$ 455,895	21.1%	$ 1,611,208	$ 1,325,548	21.6%

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Revenue from our non-U.S. operations has been translated into U.S. dollars using the average exchange rates for each month of the three and nine months ended November 30, 2015. In an effort to provide a comparable framework for assessing how our business performed when compared to the three and nine months ended November 30, 2014 in light of the effect of exchange rate differences, we believe it is helpful to exclude the impact of foreign currency exchange rate fluctuations by translating revenue from our non-U.S. operations for each of the three and nine months ended November 30, 2015 using the average foreign currency exchanges rates for each of the three and nine months ended November 30, 2014.

Subscription revenue

Our enterprise technologies are delivered primarily under subscription agreements. These agreements typically have a one- or three-year subscription period. A subscription generally entitles a customer to, among other things, a specified level of support, as well as new versions of the software, security updates, fixes, functionality enhancements, upgrades to the technology, if and when available, and compatibility with an ecosystem of certified hardware and software. Subscription revenue increased sequentially for the first, second and third quarters of fiscal 2016 and for each quarter of fiscal 2015 and fiscal 2014 and was driven primarily by the increased use of our offerings by customers and our expansion of sales channels and geographic footprint during these periods.

Subscription revenue increased 15.9%, or $62.8 million, for the three months ended November 30, 2015 as compared to the three months ended November 30, 2014. Excluding the impact of foreign currency exchange rate fluctuations, subscription revenue increased by 22.0% for the three months ended November 30, 2015. The increase in subscription revenue is driven primarily by additional subscriptions related to our principal RHEL and Red Hat JBoss Middleware offerings, which continue to gain broader market acceptance in mission-critical areas of computing, and the expansion of our sales channels and our geographic footprint. The increase is, in part, a result of the continued migration of enterprises in industries such as financial services, government, technology and telecommunications to our open source solutions from proprietary technologies.

Training and services revenue

Training and services revenue increased 8.0%, or $4.9 million, for the three months ended November 30, 2015 as compared to the three months ended November 30, 2014. Excluding the impact of foreign currency exchange rates, training and services revenue increased by 15.5%. The increase is driven primarily by customer interest in new products and increased demand for our open source solutions.

We believe our success is influenced by:

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

- our ability to enhance the value of Red Hat offerings through frequent and continuing innovation while maintaining stable platforms over multi-year periods;

our involvement and leadership in key open source communities which enables us to develop, enhance and maintain our offerings;

our ability to generate increasing revenue from partners and other strategic relationships, including CCSPs, distributors, embedded technology partners, IHVs, ISVs, original equipment manufacturers (OEMs), systems integrators, and value added resellers;

our ability to generate new and recurring revenue for Red Hat offerings;

the widespread and increasing deployment of open source technologies by enterprises and similar institutions, such as government agencies and universities; and

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

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Deferred revenue and billings proxy

Year-to-date deferred revenue

Our deferred revenue, current and long-term, balance at November 30, 2015 was $1.49 billion. Total deferred revenue at November 30, 2015 increased 0.3%, or $4.8 million, as compared to the balance of $1.48 billion at February 28, 2015. The slight increase in deferred revenue is primarily attributable to our typically-lower, seasonal first and second quarter billings and the year-to-date impact of foreign currency exchange rate fluctuations as discussed in the following paragraph. Because of our subscription model and revenue recognition policies, deferred revenue improves predictability of future revenue. For example, current deferred revenue provides a baseline for revenue to be recognized over the next twelve months. Similarly, long-term deferred revenue provides a baseline for revenue to be recognized beyond twelve months. Revenue derived from CCSPs for the delivery of our technologies as a service available on demand is recognized by us in the period earned and billed in arrears. As a result, revenue derived from CCSPs has no associated deferred revenue.

The increase in deferred revenue reported on our Consolidated Balance Sheets of $4.8 million differs from the increase of $40.1 million we reported on our Consolidated Statements of Cash Flows for the nine months ended November 30, 2015 as the amount reported on our Consolidated Statements of Cash Flows for the nine months ended November 30, 2015 excludes (i) the impact of changes in foreign currency exchange rates used to translate deferred revenue balances from our foreign subsidiaries functional currency into U.S. dollars and (ii) deferred revenue acquired as part of business combinations.

Year-over-year deferred revenue

Total deferred revenue increased by 14.4%, or $187.0 million, to $1.49 billion at November 30, 2015 from $1.30 billion at November 30, 2014. Excluding the impact of foreign currency exchange rate fluctuations, total deferred revenue increased by 20.4%, or $265.0 million, from November 30, 2014 to November 30, 2015. This increase in deferred revenue of $265.0 million is the summation of the changes in deferred revenue that we reported on our Consolidated Statements of Cash Flows for each quarter of the four-fiscal-quarter period ended November 30, 2015, plus $0.2 million related to deferred revenue acquired from business combinations during the same period.

Current deferred revenue increased by 14.8%, or $139.1 million, to $1.08 billion at November 30, 2015 from $941.4 million at November 30, 2014 and long-term deferred revenue increased by 13.3%, or $47.9 million, to $406.6 million at November 30, 2015 from $358.7 million at November 30, 2014. Excluding the impact of foreign currency exchange rate fluctuations, current deferred revenue increased by 20.1%, or $189.2 million, and long-term deferred revenue increased by 21.1%, or $75.8 million, from November 30, 2014 to November 30, 2015.

Billings proxy

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

For the four-fiscal-quarter period ended November 30, 2015, our rolling average billings proxy increased by 14.8%, or $72.3 million, to $559.4 million from $487.1 million for the four-fiscal-quarter period ended November 30, 2014. Using the average foreign currency exchange rates for each quarter of our four-fiscal-quarter period ended

November 30, 2014, our rolling average billings proxy for the four-fiscal-quarter period ended November 30, 2015 would have increased by approximately 21.3%, or $103.7 million. For information regarding seasonality, see Part II, Item 7 under Overview of our Annual Report on Form 10-K for the fiscal year ended February 28, 2015.

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Revenue by geography

For the three months ended November 30, 2015, approximately $216.8 million, or 41.4%, of our revenue was generated outside the United States compared to approximately $191.7 million, or 42.0%, for the three months ended November 30, 2014. The relative decrease in the percentage of revenue generated outside of the United States for the three months ended November 30, 2015 compared to the percentage of revenue generated outside of the United States for the three months ended November 30, 2014 is due to foreign currency exchange rate fluctuations. 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 November 30, 2015, we had offices in more than 85 locations throughout the world.

We operate our business in three geographic regions: the Americas (U.S., Latin America and Canada); EMEA (Europe, Middle East and Africa); and Asia Pacific (principally Australia, China, India, Japan, Singapore and South Korea). Revenue generated by the Americas, EMEA and Asia Pacific for the three months ended November 30, 2015 and the three months ended November 30, 2014 was as follows (in thousands):

	Americas	EMEA	Asia Pacific	Consolidated
Three Months Ended November 30, 2015	$ 342,368	$ 114,909	$ 66,303	$ 523,580
Three Months Ended November 30, 2014	$ 290,525	$ 105,755	$ 59,615	$ 455,895

Year-over-year revenue growth rates in U.S. dollars for our three geographical regions were as follows for the three months ended November 30, 2015 and three months ended November 30, 2014:

	Americas	EMEA	Asia Pacific	Consolidated
Three Months Ended November 30, 2015	17.8%	8.7%	11.2%	14.8%
Three Months Ended November 30, 2014	16.3%	12.7%	12.5%	15.0%

Excluding the impact of foreign currency exchange rate fluctuations, Americas, EMEA, Asia Pacific and Consolidated revenue grew 19.3%, 24.8%, 23.0% and 21.1%, respectively, for the three months ended November 30, 2015 as compared to the three months ended November 30, 2014.

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

Gross profit margin was 84.5% and 84.3% for each of the three months ended November 30, 2015 and November 30, 2014, respectively. A favorable mix shift, as subscription revenue increased relative to services, was partially offset by increased costs to deliver our services. Such increases in costs to deliver our consulting services result from investments in personnel, infrastructure and processes to support our emerging technologies.

Gross profit margin by geography

Gross profit margins by our geographic regions for the three months ended November 30, 2015 and November 30, 2014 were as follows:

	Americas	EMEA	Asia Pacific	Consolidated (1)
Three Months Ended November 30, 2015	85.5%	86.3%	82.5%	84.5%
Three Months Ended November 30, 2014	85.5%	86.0%	82.4%	84.3%

(1) Consolidated gross margin includes corporate (non-allocated) share-based compensation expense for the three months ended November 30, 2015 and November 30, 2014 of $4.1 million and $3.9 million, respectively. For additional information, see NOTE 11 Segment Reporting to our Consolidated Financial Statements.

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

As we continue to expand our sales and support services within our geographic regions, we expect gross profit margins across geographic regions to further converge over the long run due to the similarity of products and services offered, similarity in production and distribution methods and the similarity in customer types or classes. These geographic profit margins exclude the impact of share-based compensation expense, which was not allocated to our geographic regions.

Income from operations

Operating income as a percentage of revenue decreased to 13.2% for the three months ended November 30, 2015 from 14.7% for the three months ended November 30, 2014. The decrease was primarily driven by the integration of our recent business combinations.

Income from operations by geography

Operating income as a percentage of revenue generated by our geographic regions for the three months ended November 30, 2015 and the three months ended November 30, 2014 was as follows:

	Americas	EMEA	Asia Pacific	Consolidated (1)
Three Months Ended November 30, 2015	21.4%	20.7%	22.7%	13.2%
Three Months Ended November 30, 2014	23.6%	18.7%	20.8%	14.7%

(1) Consolidated operating income as a percentage of revenue includes corporate (non-allocated) share-based compensation expense for the three months ended November 30, 2015 and November 30, 2014 of $43.4 million and $33.6 million, respectively. For additional information, see NOTE 11 Segment Reporting to our Consolidated Financial Statements.

Operating margin for Americas decreased for the three months ended November 30, 2015 as compared to the three months ended November 30, 2014 primarily as a result of closing and integrating the Ansible acquisition.

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 securities and cash flow from operations

Cash, cash equivalents and short-term and long-term available-for-sale investments in debt securities balances at November 30, 2015 totaled $1.87 billion. Cash generated from operating activities for the three months ended November 30, 2015 totaled $139.6 million which represents an increase of 5.0% in operating cash flow as compared to the three months ended November 30, 2014. This increase is due to increases in subscription revenue and services revenues, billings and collections during the same periods.

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

Foreign currency exchange rates   impact on results of operations

Approximately 41.4% of our revenue for the three months ended November 30, 2015 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 of 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.

Three Months Ended November 30, 2015

Using the average foreign currency exchange rates from the third quarter of our prior fiscal year ended February 28, 2015, our revenue and operating expenses from non-U.S. operations for the three months ended November 30, 2015 would have been higher than we reported by approximately $28.5 million and $24.1 million, respectively, which would have resulted in income from operations being higher by $4.4 million.

Nine Months Ended November 30, 2015

Using the average foreign currency exchange rates for the nine months ended November 30, 2014, our revenue and operating expenses from non-U.S. operations for the nine months ended November 30, 2015 would have been higher than we reported by approximately $102.5 million and $78.5 million, respectively, which would have resulted in income from operations being higher by $24.0 million.

Business combinations

Ansible

On October 15, 2015 we completed our acquisition of all of the shares of Ansible for total consideration of $126.3 million. Ansible is a provider of IT automation solutions that allows its users to manage applications across hybrid cloud environments. The acquisition is intended to augment our management portfolio and help customers deploy and manage applications across private and public clouds, speed service delivery through development/operations initiatives, streamline OpenStack installations and upgrades and accelerate container adoption by simplifying orchestration and configuration.

FeedHenry

On October 8, 2014, we completed our acquisition of all of the shares of FeedHenry for approximately $80.2 million. FeedHenry is a provider of cloud-based enterprise mobile application platforms. The acquisition is intended to expand our portfolio of application development, integration and platform-as-a-service (Paas) solutions, enabling us to support mobile application development in public and private environments.

eNovance

On June 24, 2014, we completed our acquisition of all of the shares of eNovance, a provider of open source cloud computing services, for $67.6 million. The acquisition is intended to assist in advancing our market position in OpenStack, and the addition of eNovance s systems integration capabilities and engineering talent is expected to help meet growing demand for enterprise OpenStack consulting, design and deployment.

Inktank

On April 30, 2014, we completed our acquisition of all of the shares of Inktank, a provider of scale-out, open source storage systems, whose flagship technology, Inktank Ceph Enterprise, delivers object and block storage software to enterprises deploying public or private clouds for consideration of $152.5 million. The acquisition is intended to complement our existing GlusterFS-based storage and Red Hat Enterprise Linux OpenStack Platform offerings.

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Convertible note offering

On October 7, 2014, we completed our offering of $805.0 million aggregate principal amount of our 0.25% Convertible Senior Notes due 2019 (the convertible notes). The convertible notes were sold in a private placement under a purchase agreement, dated as of October 1, 2014, entered into by and among us and Morgan Stanley & Co. LLC, Merrill Lynch, Pierce, Fenner & Smith Incorporated, Citigroup Global Markets Inc. and J.P. Morgan Securities LLC as representatives of the several initial purchasers named therein, for resale to qualified institutional buyers pursuant to Rule 144A under the Securities Act of 1933, as amended.

We used $148.0 million of the net proceeds from the offering of the convertible notes to pay the cost of the privately-negotiated convertible note hedge transactions described in NOTE 15 Convertible Notes to our Consolidated Financial Statements. Proceeds of $79.8 million were received by us from the sale of warrants pursuant to the warrant transactions also described in NOTE 15 Convertible Notes to our Consolidated Financial Statements.

In addition, we used $375.0 million of the net proceeds from the offering of the convertible notes to repurchase shares of our common stock under an accelerated share repurchase program pursuant to an agreement that we entered into on October 1, 2014, as described in NOTE 10 Share Repurchase Programs to our Consolidated Financial Statements.

We intend to use the remaining net proceeds from the offering for working capital and other general corporate purposes, which may include capital expenditures, potential acquisitions or strategic transactions.

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RESULTS OF OPERATIONS

Three months ended November 30, 2015 and November 30, 2014

The following table is a summary of our results of operations for the three months ended November 30, 2015 and November 30, 2014 (in thousands):

	Three Months Ended (Unaudited)			
	November 30, 2015	November 30, 2014	$ Change	% Change
Revenue:				
Subscriptions	$ 457,488	$ 394,699	$ 62,789	15.9%
Training and services	66,092	61,196	4,896	8.0
Total subscription and training and services revenue	523,580	455,895	67,685	14.8
Cost of subscription and training and services revenue:				
Cost of subscriptions	32,246	28,574	3,672	12.9
As a % of subscription revenue	7.0%	7.2%		
Cost of training and services	48,802	42,791	6,011	14.0
As a % of training and services revenue	73.8%	69.9%		
Total cost of subscription and training and services revenue	81,048	71,365	9,683	13.6
As a % of total revenue	15.5%	15.7%		
Total gross profit	442,532	384,530	58,002	15.1
Operating expense:				
Sales and marketing	215,784	187,218	28,566	15.3
Research and development	104,906	90,613	14,293	15.8
General and administrative	52,965	39,502	13,463	34.1
Total operating expense	373,655	317,333	56,322	17.7
Income from operations	68,877	67,197	1,680	2.5
Interest income	2,874	2,196	678	30.9
Interest expense	5,817	3,441	2,376	69.0
Other income (expense), net	49	1,559	(1,510)	(96.9)
Income before provision for income taxes	65,983	67,511	(1,528)	(2.3)
Provision for income taxes	19,135	19,578	(443)	(2.3)
Net income	$ 46,848	$ 47,933	$ (1,085)	(2.3)%

Gross profit margin-subscriptions	93.0%	92.8%
Gross profit margin-training and services	26.2%	30.1%
Gross profit margin	84.5%	84.3%
As a % of total revenue:		
Subscription revenue	87.4%	86.6%
Training and services revenue	12.6%	13.4%
Sales and marketing expense	41.2%	41.1%
Research and development expense	20.0%	19.9%
General and administrative expense	10.1%	8.7%
Total operating expenses	71.4%	69.6%
Income from operations	13.2%	14.7%
Income before provision for income taxes	12.6%	14.8%
Net income	8.9%	10.5%
Estimated annual effective income tax rate	29.0%	29.0%

Revenue

Subscription revenue

Subscription revenue, which is primarily comprised of direct and indirect sales of Red Hat offerings, increased by 15.9%, or $62.8 million, to $457.5 million for the three months ended November 30, 2015 from $394.7 million for the three months ended November 30, 2014.

Revenue derived from the sale of subscriptions supporting our Infrastructure-related offerings increased by 12.1%, or $40.2 million, to $373.1 million for the three months ended November 30, 2015 from $332.9 million for the three months ended November 30, 2014. The increase in subscription revenue is primarily due to increases in volumes sold, including additional subscriptions attributable to geographic expansion and the continued migration of customers to our open source Linux platform from proprietary operating systems.

Revenue derived from the sale of subscriptions supporting our Application development-related and other emerging technology offerings increased by 36.6%, or $22.6 million, to $84.4 million for the three months ended November 30, 2015 from $61.8 million for the three months ended November 30, 2014. The increase is primarily due to additional subscriptions for Red Hat JBoss Middleware offerings. We expect the growth rate of revenue derived from our Application development-related and other emerging technology offerings to exceed the growth rate of revenue derived from our Infrastructure-related offerings as our Application development-related and other emerging technology offerings continue to gain broader market acceptance in the enterprise IT environment.

Training and services revenue

Training revenue includes fees paid by our customers for delivery of educational materials and instruction. Services revenue includes fees received from customers for consulting services regarding our offerings, deployment of Red Hat technologies and for delivery of added functionality to Red Hat technologies for our major customers and OEM partners. Total training and services revenue increased by 8.0%, or $4.9 million, to $66.1 million for the three months ended November 30, 2015 from $61.2 million for the three months ended November 30, 2014. The increase is due to services revenue which increased by 13.8%, or $6.2 million, as a result of an increase in consulting engagements driven by increased demand for our open source solutions. Training revenue decreased by 7.6%, or $1.3 million. Training revenue in the current year decreased relative to the prior year s training revenue which included incremental revenue related to the then recently released RHEL 7 offering. Combined training and services revenue decreased as a percentage of total revenue to 12.6% for the three months ended November 30, 2015 from 13.4% for the three months ended November 30, 2014.

Cost of revenue

Cost of subscription revenue

The cost of subscription revenue primarily consists of expenses we incur to support, distribute and package Red Hat offerings. These costs include labor-related costs to provide technical support, security updates and fixes, as well as costs for fulfillment, physical media, literature, packaging and shipping. Cost of subscription revenue increased by 12.9%, or $3.7 million, to $32.2 million for the three months ended November 30, 2015 from $28.6 million for the three months ended November 30, 2014. The increase is primarily due to the expansion of our technical staff in order to meet the demands of our growing subscriber base for support, security updates and fixes, and includes additional compensation of $2.7 million. The remaining increase is driven primarily by incremental travel and outside services costs. Gross profit margin on subscriptions was 93.0% and 92.8%, respectively, for each of the three months ended

November 30, 2015 and November 30, 2014. As the number of our 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.

Cost of training and services revenue

Cost of training and services revenue is mainly comprised of personnel and third-party consulting costs for the design, development and delivery of custom engineering, training courses and professional services provided to various types of customers. Cost of training and services revenue increased by 14.0%, or $6.0 million, to $48.8 million for the three months ended November 30, 2015 from $42.8 million for the three months ended November 30, 2014. Costs to deliver our services revenue increased by 17.6%, or $6.0 million, and relate to additional third-party consulting costs incurred to meet a surge in demand for and additional employee compensation and travel associated with additions to our emerging technologies staff. Total costs to deliver training and services as a percentage of training and services revenue was 73.8% and 69.9% for each of the three month periods ended November 30, 2015 and November 30, 2014, respectively.

Gross profit

Gross profit margin was 84.5% and 84.3% for the three months ended November 30, 2015 and November 30, 2014, respectively. A favorable mix shift, as subscription revenue increased relative to services, was partially offset by increased costs to deliver our services. Such increases in costs to deliver our consulting services result from investments in personnel, infrastructure and processes to support our emerging technologies.

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 15.3%, or $28.6 million, to $215.8 million for the three months ended November 30, 2015 from $187.2 million for the three months ended November 30, 2014. This increase was partially due to a $17.1 million increase in selling costs, which includes $12.3 million of additional employee compensation expense attributable to the expansion of our sales force from the prior year. The remaining increase relates to marketing costs, which grew 25.5%, or $11.5 million, for the three months ended November 30, 2015 as compared to the three months ended November 30, 2014 and includes incremental employee compensation and marketing program costs of $4.4 million and $6.5 million, respectively. Sales and marketing expense increased as a percentage of revenue to 41.2% for the three months ended November 30, 2015 from 41.1% for the three months ended November 30, 2014.

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 15.8%, or $14.3 million, to $104.9 million for the three months ended November 30, 2015 from $90.6 million for the three months ended November 30, 2014. The increase in research and development costs primarily resulted from the expansion of our engineering group as a result of both direct hires and business combinations as we continue investing in cloud management and our other emerging technologies. Employee compensation and travel costs increased by $12.2 million and $0.4 million, respectively. Research and development expense was 20.0% and 19.9% of total revenue for the three months ended November 30, 2015 and November 30, 2014, 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 34.1%, or $13.5 million, to $53.0 million for the three months ended November 30, 2015 from $39.5 million for the three months ended November 30, 2014. General and

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administrative expenses include increased compensation-related expense of $6.0 million, transaction costs related to business combinations of $2.7 million and infrastructure and facilities costs of $2.2 million. General and administrative expense increased as a percentage of revenue to 10.1% for the three months ended November 30, 2015 from 8.7% for the three months ended November 30, 2014. Although general and administrative expense increased as a percentage of total revenue for the three months ended November 30, 2015, we expect such costs to decrease relative to revenue as we begin to leverage benefits from investments made during the current year to expand and enhance our corporate processes and technology infrastructure.

Interest income

Interest income increased by 30.9%, or $0.7 million, for the three months ended November 30, 2015 as compared to the three months ended November 30, 2014. The increase in interest income for the three months ended November 30, 2015 is attributable to slightly higher yields earned on larger cash and investment balances.

Interest expense

Interest expense increased by $2.4 million, for the three months ended November 30, 2015 as compared to the three months ended November 30, 2014. The increase in interest expense for the three months ended November 30, 2015 is attributable to the issuance of convertible notes during the three months ended November 30, 2014 which is described in NOTE 15 Convertible Notes to our Consolidated Financial Statements.

Other income (expense), net

Other income (expense), net decreased by $1.5 million, for the three months ended November 30, 2015 as compared to the three months ended November 30, 2014. The decrease is primarily due to net gains recognized from the settlement of foreign currency transactions during the three months ended November 30, 2014 that were not repeated during the three months ended November 30, 2015.

Income taxes

During the three months ended November 30, 2015, we recorded $19.1 million of income tax expense, which is based on an estimated annual effective tax rate of 29%. Our estimated annual effective tax rate of 29% is less than the U.S. federal statutory rate of 35% primarily due to foreign income taxed at lower rates, state income taxes net of federal benefits and the domestic production activities deduction.

During the three months ended November 30, 2014, we recorded $19.6 million of income tax expense, which was based on a then estimated annual effective tax rate of 29%. Our estimated annual effective tax rate of 29% was less than the U.S. federal statutory rate of 35% primarily due to foreign income taxed at lower rates.

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Nine months ended November 30, 2015 and November 30, 2014

The following table is a summary of our results of operations for the nine months ended November 30, 2015 and November 30, 2014 (in thousands):

	Nine Months Ended (Unaudited)			
	November 30, 2015	November 30, 2014	$ Change	% Change
Revenue:				
Subscriptions	$ 1,323,807	$ 1,156,161	$ 167,646	14.5%
Training and services	184,921	169,387	15,534	9.2
Total subscription and training and services revenue	1,508,728	1,325,548	183,180	13.8
Cost of subscription and training and services revenue:				
Cost of subscriptions	93,088	84,125	8,963	10.7
As a % of subscription revenue	7.0%	7.3%		
Cost of training and services	135,321	118,857	16,464	13.9
As a % of training and services revenue	73.2%	70.2%		
Total cost of subscription and training and services revenue	228,409	202,982	25,427	12.5
As a % of total revenue	15.1%	15.3%		
Total gross profit	1,280,319	1,122,566	157,753	14.1
Operating expense:				
Sales and marketing	619,757	538,576	81,181	15.1
Research and development	304,824	275,817	29,007	10.5
General and administrative	139,462	125,786	13,676	10.9
Total operating expense	1,064,043	940,179	123,864	13.2
Income from operations	216,276	182,387	33,889	18.6
Interest income	8,484	6,048	2,436	40.3
Interest expense	17,265	3,591	13,674	380.8
Other income (expense), net	(1,398)	1,777	(3,175)	(178.7)
Income before provision for income taxes	206,097	186,621	19,476	10.4
Provision for income taxes	59,768	54,120	5,648	10.4
Net income	$ 146,329	$ 132,501	$ 13,828	10.4%
Gross profit margin-subscriptions	93.0%	92.7%		

Gross profit margin-training and services	26.8%	29.8%
Gross profit margin	84.9%	84.7%
As a % of total revenue:		
Subscription revenue	87.7%	87.2%
Training and services revenue	12.3%	12.8%
Sales and marketing expense	41.1%	40.6%
Research and development expense	20.2%	20.8%
General and administrative expense	9.2%	9.5%
Total operating expenses	70.5%	70.9%
Income from operations	14.3%	13.8%
Income before provision for income taxes	13.7%	14.1%
Net income	9.7%	10.0%
Estimated annual effective income tax rate	29.0%	29.0%

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Revenue

Subscription revenue

Subscription revenue increased by 14.5%, or $167.6 million, to $1.32 billion for the nine months ended November 30, 2015 from $1.16 billion for the nine months ended November 30, 2014.

Revenue derived from the sale of subscriptions supporting our Infrastructure-related offerings increased by 10.8%, or $105.8 million, to $1.09 billion for the nine months ended November 30, 2015 from $983.9 million for the nine months ended November 30, 2014 and includes a favorable revenue adjustment of $5.3 million related to cloud-usage revenues through our CCSP program, as described further in NOTE 2 Summary of Significant Accounting Policies to our Consolidated Financial Statements. The remaining increase in subscription revenue is primarily due to increases in volumes sold, including additional subscriptions attributable to geographic expansion and the continued migration of customers to our open source Linux platform from proprietary operating systems.

Revenue derived from the sale of subscriptions supporting our Application development-related and other emerging technology offerings increased by 35.9%, or $61.8 million, to $234.0 million for the nine months ended November 30, 2015 from $172.2 million for the nine months ended November 30, 2014. The increase is primarily due to additional subscriptions for Red Hat JBoss Middleware offerings.

Training and services revenue

Total training and services revenue increased by 9.2%, or $15.5 million, to $184.9 million for the nine months ended November 30, 2015 from $169.4 million for the nine months ended November 30, 2014. The increase is due to services revenue which increased by 12.4%, or $15.6 million, as a result of an increase in consulting engagements driven by increased demand for our open source solutions. Training revenue decreased by 0.2%, or $0.1 million. Combined training and services revenue decreased as a percentage of total revenue to 12.3% for the nine months ended November 30, 2015 from 12.8% for the nine months ended November 30, 2014.

Cost of revenue

Cost of subscription revenue

Cost of subscription revenue increased by 10.7%, or $9.0 million, to $93.1 million for the nine months ended November 30, 2015 from $84.1 million for the nine months ended November 30, 2014. The increase is primarily due to the expansion of our technical staff in order to meet the demands of our growing subscriber base for support, security updates and fixes, and includes additional compensation of $6.9 million. The remaining increase is driven primarily by incremental travel, outside services and equipment costs of $1.2 million. Gross profit margin on subscriptions was 93.0% and 92.7%, respectively, for each of the nine months ended November 30, 2015 and November 30, 2014. Excluding the favorable revenue adjustment of $5.3 million related to cloud-usage revenue, gross profit margin on subscriptions for the nine months ended May 31, 2015 was 92.9%.

Cost of training and services revenue

Cost of training and services revenue increased by 13.9%, or $16.5 million, to $135.3 million for the nine months ended November 30, 2015 from $118.9 million for the nine months ended November 30, 2014. Costs to deliver our services revenue increased by 16.7%, or $16.0 million, and relate to additional third-party consulting costs incurred to meet a surge in demand for and additional employee compensation and travel associated with additions to our emerging technologies staff. Total costs to deliver training and services as a percentage of training and services revenue was 73.2% and 70.2% for each of the nine months ended November 30, 2015 and November 30, 2014, respectively.

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Gross profit

Excluding the favorable revenue adjustment of $5.3 million described previously, gross profit margin increased slightly to 84.8% for the nine months ended November 30, 2015 from 84.7% for the nine months ended November 30, 2014. The increase was due to a favorable mix shift as subscription revenue increased relative to services and was partially offset by increased costs to deliver our services due to additions to our emerging technologies staff.

Operating expenses

Sales and marketing

Sales and marketing expense increased by 15.1%, or $81.2 million, to $619.8 million for the nine months ended November 30, 2015 from $538.6 million for the nine months ended November 30, 2014. This increase was partially due to a $53.0 million increase in selling costs, which includes $43.4 million of additional employee compensation expense attributable to the expansion of our sales force from the prior year. The remaining increase relates to marketing costs, which grew 22.0%, or $28.1 million, for the nine months ended November 30, 2015 as compared to the nine months ended November 30, 2014 and includes incremental employee compensation and marketing program costs of $12.2 million and $14.9 million, respectively. Primarily as a result of expanded sales and marketing staffing, sales and marketing expense increased as a percentage of revenue to 41.1% for the nine months ended November 30, 2015 from 40.6% for the nine months ended November 30, 2014.

Research and development

Research and development expense increased by 10.5%, or $29.0 million, to $304.8 million for the nine months ended November 30, 2015 from $275.8 million for the nine months ended November 30, 2014. The increase in research and development costs primarily resulted from the expansion of our engineering group as a result of both direct hires and business combinations as we continue investing in cloud management and our other emerging technologies. Employee compensation increased by $26.2 million and travel costs increased by $1.2 million. Research and development expense was 20.2% and 20.8% of total revenue for the nine months ended November 30, 2015 and November 30, 2014, respectively.

General and administrative

General and administrative expense increased by 10.9%, or $13.7 million, to $139.5 million for the nine months ended November 30, 2015 from $125.8 million for the nine months ended November 30, 2014. General and administrative expenses include increased compensation-related expense of $9.2 million and infrastructure and facilities costs of $2.6 million. General and administrative expense decreased as a percentage of revenue to 9.2% for the nine months ended November 30, 2015 from 9.5% for the nine months ended November 30, 2014.

Interest income

Interest income increased by 40.3%, or $2.4 million, for the nine months ended November 30, 2015 as compared to the nine months ended November 30, 2014. The increase in interest income for the nine months ended November 30, 2015 is attributable to slightly higher yields earned on larger cash and investment balances.

Interest expense

Interest expense increased by $13.7 million, for the nine months ended November 30, 2015 as compared to the nine months ended November 30, 2014. The increase in interest expense for the nine months ended November 30, 2015 is attributable to the issuance of convertible notes during the nine months ended November 30, 2014 which is described in NOTE 15 Convertible Notes to our Consolidated Financial Statements.

Other income (expense), net

Other income (expense), net decreased by $3.2 million, for the nine months ended November 30, 2015 as compared to the nine months ended November 30, 2014. The decrease is primarily due to net gains realized on the sale of non-marketable, cost-basis investments in equity securities during the nine months ended November 30, 2014 that were not repeated during the nine months ended November 30, 2015.

Income taxes

During the nine months ended November 30, 2015, we recorded $59.8 million of income tax expense, which is based on an estimated annual effective tax rate of 29%. Our estimated annual effective tax rate of 29% is less than the U.S. federal statutory rate of 35% primarily due to foreign income taxed at lower rates, state income taxes net of federal benefits and the domestic production activities deduction.

During the nine months ended November 30, 2014, we recorded $54.1 million of income tax expense, which was based on a then estimated annual effective tax rate of 29%. Our estimated annual effective tax rate of 29% was less than the U.S. federal statutory rate of 35% primarily due to foreign income taxed at lower rates.

LIQUIDITY AND CAPITAL RESOURCES

We derive our liquidity and operating capital primarily from cash flows from operations. Historically, we also received cash from 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 notes, including our recent issuance of convertible notes with par value totaling $805.0 million described previously in Overview Convertible note offering and in detail in NOTE 15 Convertible Notes to our Consolidated Financial Statements. At November 30, 2015, we had total cash and investments of $1.87 billion, which was comprised of $942.0 million in cash and cash equivalents, $194.0 million of short-term, available-for-sale, fixed-income investments and $735.4 million of long-term, available-for-sale fixed-income investments. This compares to total cash and investments of $1.81 billion at February 28, 2015.

With $942.0 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. However, we may take advantage of favorable capital market conditions that may arise from time to time to raise additional capital. 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 those investments. At November 30, 2015, net accumulated unrealized losses on our available-for-sale debt securities totaled $2.2 million, versus accumulated unrealized gains of $0.2 million as of February 28, 2015.

Nine months ended November 30, 2015

Cash flows overview

At November 30, 2015, cash and cash equivalents totaled $942.0 million, a decrease of $105.4 million as compared to February 28, 2015. The decrease in cash and cash equivalents for the nine months ended November 30, 2015 is primarily the result of net purchases of available-for-sale debt securities of $194.4 million, business combinations which included net cash consideration paid of $126.7 million, the repurchase of 1,882,115 shares of our common stock for $148.3 million and payments made in return for common shares received from employees to satisfy employees minimum tax withholding obligations related to share awards vesting of $60.8 million. Partially offsetting cash used in investing and financing activities was cash provided by operations which generated $468.6 million for the nine months ended November 30, 2015.

Cash flows from operations

Cash provided by operations of $468.6 million during the nine months ended November 30, 2015 includes net income of $146.3 million, adjustments to exclude the impact of non-cash revenues and expenses, which totaled a $208.6 million net source of cash, and changes in operating assets and liabilities, which totaled a $113.7 million net source of cash. Cash provided by changes in operating assets and liabilities for the nine months ended November 30, 2015 was primarily the result of collections on our billings.

Cash flows from investing

Cash used in investing activities of $361.9 million for the nine months ended November 30, 2015 includes net purchases of available-for-sale debt securities of $194.4 million and net cash of $126.7 million used to acquire businesses. Investments in property and equipment totaled $29.5 million and primarily relate to information technology infrastructure and leasehold improvements. Investments in other intangible assets, primarily patents, totaled $8.1 million during the nine months ended November 30, 2015.

Cash flows from financing

Cash used in financing activities of $189.1 million for the nine months ended November 30, 2015 includes $148.3 million to repurchase 1,882,115 shares of our common stock and payments made in return for common shares received from employees to satisfy employees minimum tax withholding obligations related to restricted share awards vesting during the nine months ended November 30, 2015 of $60.8 million. Partially offsetting financing activities using cash were proceeds from excess tax benefits related to share-based employee compensation, which totaled $18.0 million and proceeds from employees exercise of common stock options, which totaled $3.3 million. Payments on other borrowings totaled $1.4 million for the nine months ended November 30, 2015.

Investments in debt securities

Our investments are comprised primarily of debt securities that are classified as available for sale and recorded at their fair market values. At November 30, 2015 and February 28, 2015, the vast majority of our investments were priced with the assistance of 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 values, 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 technologies, the expansion of our services operations and our acquisition activity. Our capital requirements during the fiscal year ending February 29, 2016 will depend on numerous factors, including the amount of resources we devote to:

- funding the continued development of our technology offerings;

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

pursuing strategic acquisitions and alliances;

investing in or acquiring businesses, products and technologies; and

investing in enhancements to the systems we use to run our business and the expansion of our office facilities.

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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 intangible assets (primarily patents) and mergers and acquisitions. Given our historically strong operating cash flow and the $1.87 billion of cash and investments held at November 30, 2015, 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. However, we may take advantage of favorable capital market conditions that may arise from time to time to raise additional capital.

We believe that cash flows from operations will continue to increase; however, there can be no assurances that we will increase our cash flows 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 or that cash may be located in or generated in the appropriate geographic region where we can effectively use such cash. 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 November 30, 2015, our cash, cash equivalents and available-for-sale investment securities totaled $1.87 billion, of which $761.5 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. From time to time, however, we may remit a portion of these earnings to the extent it is economically prudent. For further discussion related to geographic segments, see NOTE 11 Segment Reporting to our Consolidated Financial Statements.

With $1.11 billion, or 59.3%, of our available cash, cash equivalents and available-for-sale investments held within the U.S. as of November 30, 2015, 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 28, 2015, cumulative undistributed foreign earnings totaled $420.0 million. For further discussion, see NOTE 11 Income Taxes to our Consolidated Financial Statements contained in our Annual Report on Form 10-K for the year ended February 28, 2015.

Off-balance sheet arrangements

As of November 30, 2015 and February 28, 2015, 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 short-term and long-term investments in a variety of available-for-sale fixed and floating rate debt securities, including both government and corporate obligations and money market funds. Investments in both fixed rate and floating rate interest earning instruments carry a degree of interest rate risk. Fixed rate securities may have their fair market value adversely impacted due to a rise in prevailing interest rates, while floating rate securities may produce less income than expected if interest rates fall. Due in part to these factors, our future investment income related to these securities 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-half percentage point change in interest rates, assuming a parallel shift of all interest rates, would result in an approximate $0.5 million change in annual interest income derived from investments in our portfolio as of November 30, 2015. For further discussion related to our investments as of November 30, 2015 and February 28, 2015, see NOTE 6 Assets and Liabilities Measured at Fair Value on a Recurring Basis to our Consolidated Financial Statements.

Investment risk

The fair market value of our available-for-sale 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 $17.7 million decrease in the fair value of our available-for-sale investment securities as of November 30, 2015. For further discussion related to our investments as of November 30, 2015 and February 28, 2015, see NOTE 6 Assets and Liabilities Measured at Fair Value on a Recurring Basis to our Consolidated Financial Statements.

Credit risk

Investments in debt and equity securities

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.

Accounts receivable

As of November 30, 2015 and February 28, 2015, no individual customer accounted for 10% or more of our total accounts receivable.

Foreign currency risk

Approximately 41.4% of our revenue for the three months ended November 30, 2015 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 of 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.

Using the average foreign currency exchange rates from the third quarter of our prior fiscal year ended February 28, 2015, our revenue and operating expenses from non-U.S. operations for the three months ended November 30, 2015 would have been higher than we reported by approximately $28.5 million and $24.1 million, respectively, which would have resulted in income from operations being higher by $4.4 million.

Using the average foreign currency exchange rates for the nine months ended November 30, 2014, our revenue and operating expenses from non-U.S. operations for the nine months ended November 30, 2015 would have been higher than we reported by approximately $102.5 million and $78.5 million, respectively, which would have resulted in income from operations being higher by $24.0 million.

Convertible notes

In October 2014, we issued $805.0 million of 0.25% convertible notes due 2019. The convertible notes have a fixed annual interest rate of 0.25%, and therefore we do not have economic interest rate exposure on the convertible notes. However, the fair market value of the convertible notes is exposed to interest rate risk. Generally, the fair market value of the convertible notes will increase as interest rates fall and decrease as interest rates rise. For further discussion regarding the fair value of the convertible notes, see NOTE 15 Convertible Notes to our Consolidated Financial Statements.

In connection with the sale of the convertible notes, we entered into convertible note hedge transactions and warrant transactions. The convertible note hedge transactions are expected to offset the potential dilution with respect to shares of our common stock upon any conversion of the convertible notes and/or offset any cash payments that we are required to make in excess of the principal amount of the converted notes, as the case may be. The warrant transactions will have a dilutive effect with respect to our common stock to the extent that the market price per share of our common stock, as measured under the terms of the warrant transactions, exceeds the applicable strike price of the warrants. However, subject to certain conditions, we may elect to settle all of the warrants in cash. The initial strike price of the warrants is $101.65 per share. The number of shares of our common stock underlying the warrants is 10,965,630 shares, subject to anti-dilution adjustments. The convertible note hedge and warrants are both considered indexed to our common stock and classified as equity; therefore, the convertible note hedge and warrants are not accounted for as derivative instruments.

Derivative instruments

We transact business in various foreign countries and are, therefore, subject to risk of foreign currency exchange rate fluctuations. From time to time we 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. We have elected not to prepare and maintain the documentation required to qualify our forward contracts for hedge accounting treatment and, therefore, changes in fair value are recorded in our Consolidated Statements of Operations. For further discussion related to our management of foreign currency risk see NOTE 7 Derivative Instruments to our Consolidated Financial Statements.

The aggregate notional amount of outstanding forward contracts at November 30, 2015 was $38.1 million. The fair value of these outstanding contracts at November 30, 2015 was a gross $0.1 million asset and a gross $0.4 million liability, and is recorded in Other current assets and Accounts payable and accrued expenses, respectively, on our Consolidated Balance Sheets. The forward contracts generally expire within three months of the period ended November 30, 2015. The forward contracts will settle in Euros, Japanese yen, Norwegian krona, Singapore dollars, Swedish krona, Swiss francs and U.S. dollars.

The aggregate notional amount of outstanding forward contracts at February 28, 2015 was $108.1 million. The fair value of these outstanding contracts at February 28, 2015 was a gross $0.1 million asset and a gross $0.7 million liability, and is recorded in Other current assets and Accounts payable and accrued expenses, respectively, on our Consolidated Balance Sheets. The forward contracts generally expired within three months of the period ended February 28, 2015. The forward contracts settled in Australian dollars, Euros, Hong Kong dollars, Japanese yen, Norwegian krona, Singapore dollars, Swedish krona, Swiss francs and U.S. dollars.

RECENT ACCOUNTING PRONOUNCEMENTS

In November 2015, the FASB issued Accounting Standards Update 2015-17, *Income Taxes (Topic 740): Balance Sheet Classification of Deferred Taxes* (ASU 2015-17). ASU 2015-17 removes the requirement that deferred tax assets and liabilities be classified as either current or noncurrent in a classified statement of financial position and instead considers deferred tax assets and liabilities to be classified as noncurrent. This guidance is effective for us as of the first quarter of our fiscal year ending February 28, 2018. We do not believe that this updated standard will have a material impact on our consolidated financial statements.

In September 2015, the FASB issued Accounting Standards Update 2015-16, *Business Combinations (Topic 805): Simplifying the Accounting for Measurement-Period Adjustments* (ASU 2015-16). The FASB issued ASU 2015-16 to simplify US GAAP to require that the acquirer record, in the same period s financial statements, the effect of changes to provisional, measurement period amounts calculated as if the accounting had been completed at the acquisition date and disclose the portion of the amount recorded in current-period earnings by line item that would have been recorded in previous reporting periods if the adjustment to the provisional amounts had been recognized as of the acquisition date. This guidance is effective for us as of the first quarter of our fiscal year ending February 28, 2017. We do not believe that this updated standard will have a material impact on our consolidated financial statements.

In April 2015, the FASB issued Accounting Standards Update 2015-03, *Interest Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs* (ASU 2015-03). The FASB issued ASU 2015-03 to simplify the presentation of debt issuance costs related to a recognized debt liability to present the debt issuance costs as a direct deduction from the carrying value of the debt liability rather than showing the debt issuance costs as a deferred charge on the balance sheet. This guidance is effective for fiscal years, and interim periods within those years, beginning after December 15, 2015, and is effective for us as of the first quarter of the fiscal year ending February 28, 2017. We do not believe that this updated standard will have a material impact on the Company s consolidated financial statements.

In May 2014, the FASB issued Accounting Standards Update 2014-09, *Revenue from Contracts with Customers* (ASU 2014-09). The FASB issued ASU 2014-09 to clarify the principles for recognizing revenue and to develop a common revenue standard for GAAP and International Financial Reporting Standards. The standard outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes the most current revenue recognition guidance. This guidance is effective for fiscal years and interim periods within those years beginning after December 15, 2017, which is effective for us as of the first quarter of the fiscal year ending February 28, 2019. We are evaluating the impact that the implementation of this standard will have 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 Securities Exchange Act of 1934) or our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934) 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 event related to the following risk factors occurs, our business, financial condition, operating results and cash flows could be materially adversely affected.

RISKS RELATED TO BUSINESS UNCERTAINTY

We face intense competition.

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

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

Given the rapid evolving nature of the enterprise software industry, the competitive landscape and the nature of the competition is constantly changing. Industry consolidation may affect competition by creating larger and potentially stronger competitors in the markets in which we compete. Moreover, other companies may currently be planning to or are under pressure by stockholders to divest businesses. These divestitures may result in additional competitors that may have an advantage by focusing on a single product or service. We also compete in certain areas with our partners and potential partners, and this may adversely impact our relationship with an individual partner or a number of partners.

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

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

We operate in highly competitive markets that are characterized by rapid technological change and frequent new product and service announcements. Our continued success will depend on our ability to adapt to rapidly changing technologies, to adapt our offerings to evolving industry standards, to predict user preferences and industry changes and to improve the performance and reliability of our offerings. Our failure to adapt to such changes could harm our business. In addition, the widespread adoption of other technological changes could require substantial expenditures on our part to modify or adapt our offerings or infrastructure. Delays in developing, completing or delivering new or enhanced offerings and technologies could result in delayed or reduced revenue for those offerings and could also adversely affect customer acceptance of those offerings and technologies. The success of new and enhanced offering introductions depends on several factors, including our ability to invest significant resources in research and development in order to enhance our existing offerings and introduce new offerings in a timely manner, successfully promote the offerings, manage the risks associated with the offerings, make sufficient resources available to support the offerings and address any quality or other defects in the early stages of introduction.

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

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

Our success depends in part on our ability to continue to establish and maintain strategic relationships with industry-leading cloud service providers, hardware original equipment manufacturers, independent software vendors and system integrators, such as Amazon.com, Inc., Cisco Systems, Inc., Dell Inc., Fujitsu Limited, Hewlett-Packard Co., International Business Machines Corporation, NEC Corporation, Oracle Corporation, SAP AG and others. Many of these strategic partners have engineered and certified that their products and services run on or with our offerings, and in some cases have built their products using our offerings. We may not be able to maintain these relationships or replace them on attractive terms in the future. Some of our strategic partners offer competing products and services. As a result of these factors, many of the companies with which we have strategic alliances may choose to pursue alternative technologies and develop alternative products and services in addition to or in lieu of our offerings, either on their own or in collaboration with others, including our competitors. Moreover, we cannot guarantee that the companies with which we have strategic relationships will market our offerings effectively or continue to devote the resources necessary to provide us with effective sales, marketing and technical support. As our agreements with strategic partners terminate or expire, we may be unable to renew or replace these agreements on comparable terms, or at all.

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

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

We rely, to a significant degree, on each of our channel partners to select, screen and maintain relationships with its distribution network and to distribute our offerings in a manner that is consistent with applicable law and regulatory requirements and our quality standards. If our channel partners or a partner in its distribution network violate applicable law or regulatory requirements or misrepresent the functionality of our offerings, our reputation could be damaged and we could be subject to potential liability. Furthermore, our channel partners may offer their own products and services that are competitive with our offerings or may not distribute and market our offerings effectively. Moreover, our existing channel partner relationships do not, and any future channel partner relationships may not, afford us any exclusive marketing or distribution rights. In addition, if a channel partner is acquired by a competitor or its business units are reorganized or divested, our revenue derived from that partner may be adversely impacted.

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

A portion of our sales to government entities have been made indirectly through our channel partners. Government entities may have statutory, contractual, or other legal rights to terminate contracts with our channel partners for convenience or due to a default, and any such termination may adversely impact our future operating results. Governments routinely investigate and audit government contractors administrative processes, and any unfavorable audit could result in the government refusing to continue buying our offerings, a reduction of revenue or fines or civil or criminal liability if the audit uncovers improper or illegal activities.

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.

We have entered into and may continue to enter into or seek to enter into business combinations and acquisitions, which may be difficult to complete and integrate, disrupt our business, divert management s attention, adversely affect our business, financial condition, operating results and cash flows or 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:

- Identifying acquisition targets that complement our strategic direction and technology road map;

- Integrating the acquired business accounting, financial reporting, management, information and information security, human resource and other administrative systems to permit effective management and reporting, and the lack of control if such integration is delayed or not implemented;

- Gathering full information regarding a business or technology prior to a transaction, including the identification and assessment of liabilities, claims or other circumstances that could result in litigation or regulatory exposure, unfavorable accounting treatment, unexpected tax implications and other adverse effects on our business;

Increasing or additional operating expenses related to the acquired business or technology;

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

Disrupting of our ongoing business and distraction of management;

Impairing of relationships with our employees, partners or customers as a result of any integration of new management and other personnel, products or technology or as a result of the changes in the competitive landscape affected by the transaction;

Maintaining good relationships with customers or business partners of the acquired business;

- Effectively evaluating of talent at an acquired business or cultural challenges associated with integrating employees from the acquired business into our organization;

- Losing of key employees of the acquired business;

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

- Achieving the expected benefits of the transaction, which may include generating greater market acceptance of our technologies, increasing our revenues or integrating the assets acquired into one or more of our current offerings;

- Incurring expenses related to the transaction;

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

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

- Impairing of intangible assets and goodwill acquired in transactions; and

- For foreign transactions, managing additional risks related to the integration of operations across different cultures and languages, and the economic, political, compliance and regulatory risks associated with specific countries.

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

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

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

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

We have expanded our operations rapidly in recent years. For example, our total revenue increased from $1.53 billion for the fiscal year ended February 28, 2014 to $1.79 billion for the fiscal year ended February 28, 2015. Moreover, the total number of our employees increased from approximately 6,300 as of February 28, 2014 to approximately 7,300 as of February 28, 2015. In addition, we continue to explore ways to extend our offerings and geographic reach. Our growth has placed and will likely continue to place a strain on our management systems, information systems, resources and internal controls. Our ability to successfully provide our offerings and implement our business plan requires adequate information systems and resources, internal controls and oversight from our senior management. As we expand in international markets, these challenges increase as a result of the need to support a growing business in an environment of multiple languages, cultures, customs, legal systems, dispute resolution systems, regulatory systems and commercial practices. As we grow, (i) we may not be able to adequately screen and hire or adequately train, supervise, manage or develop sufficient personnel, and (ii) we may not be able to develop or effectively manage our controls, oversight functions or information systems. If we are unable to effectively manage our growth, our business, financial condition, operating results and cash flows could be adversely affected.

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

There has been a trend of both consolidation and divestitures in the technology industry. We expect these trends to continue as companies attempt to strengthen or hold their market positions in an evolving industry. For example, as the computing, networking, storage, and software technologies that comprise the enterprise data center converge, many companies seek to position themselves as key or single-source vendors providing end-to-end technology solutions for the data center. Also, some of our current and potential competitors have made acquisitions or announced new strategic alliances designed to position them as a key or single-source vendor. As a result of these developments, we face greater competition, including competition from entities that are among our key business partners. This increased competition could adversely affect our business, financial condition, operating results and cash flows.

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

One of the characteristics of open source software is that anyone may modify and redistribute the existing open source software and use it to compete with us. Such competition can develop without the degree of overhead and lead time required by traditional proprietary software companies. It is possible for competitors with greater resources than ours to develop their own open source solutions, potentially reducing the demand for, and putting price pressure on, our offerings. In addition, some competitors make their open source software available for free download and use on an ad hoc basis or may position their open source software as a loss leader. We cannot guarantee that we will be able to compete successfully against current and future competitors or that competitive pressure and/or the availability of open source software will not result in price reductions, reduced operating margins and loss of market share, any one of which could adversely affect our business, financial condition, operating results and cash flows.

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

Our future success depends on the continued services and effectiveness of a number of key management personnel, including our CEO. The loss of these individuals, particularly to a competitor, some of which may be in a position to offer greater compensation, could adversely affect our business or stock price.

Our ability to retain key management personnel or hire capable new management personnel as we grow may be challenged to the extent that other companies are able to offer more attractive opportunities to the individuals we seek to hire or retain. In addition, historically we have used share-based compensation as a key component of our compensation packages. Changes in the accounting for share-based compensation could adversely affect our earnings or make it more beneficial for us to use more cash compensation to attract and retain capable personnel. If the price of our common stock falls, the value of our share-based awards to recipients is reduced. Such events, or if we are unable to secure stockholder approval for increases in the number of shares eligible for share-based compensation grants, could adversely affect our ability to successfully attract and retain key management personnel. Effective succession planning is also important to our long-term success. Failure to ensure effective transfer of knowledge and smooth transitions involving key management personnel could hinder our strategic planning and execution.

We depend on our key non-management employees, and our inability to attract and retain such employees could adversely affect our business or diminish our brands.

Competition in our industry for qualified employees, especially technical employees, is intense and our competitors directly target our employees. Our inability to attract and retain key employees could hinder our influence in open source projects and seriously impede our success. Moreover, the loss of these individuals, particularly to a competitor, some of which may be in a position to offer greater compensation, and any resulting loss of customers could reduce our market share and diminish our brands. We have from time to time in the past experienced, and we may experience in the future, difficulty in hiring and retaining highly skilled employees with appropriate qualifications. Also, to the extent we hire personnel from competitors, we may be subject to allegations that they have been improperly solicited, that they have divulged proprietary or other confidential information, or that their former employers own their inventions or other work product.

A number of our key employees have become, or will become, vested in a significant amount of their equity compensation awards. Employees may be more likely to leave us after a significant portion of their equity compensation awards fully vest, especially if the shares underlying the equity awards have significantly appreciated in value. Additionally, as we grow, there may be less equity compensation to award per employee. If we do not succeed in attracting and retaining key personnel, our business, financial performance, operating results and cash flows may be adversely affected.

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

We believe that a critical contributor to our success has been our corporate culture, which we believe fosters innovation, creativity and collaboration. As our organization grows, our employees (including remote workers) and our resources become more globally dispersed and our organizational management structures become more complex, we may find it increasingly difficult to maintain these beneficial aspects of our corporate culture. If we are unable to maintain our corporate culture, we may find it difficult to attract and retain motivated employees, continue to perform at current levels or execute on our business strategy. As a result, our business, financial condition, operating results and cash flows could be adversely affected.

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

We provide Red Hat enterprise technologies primarily under annual or multi-year subscriptions. A subscription generally entitles a customer to, among other things, a specified level of support, as well as new versions of the software, security updates, fixes, functionality enhancements and upgrades to the technology, if and when available, and compatibility with an ecosystem of certified hardware and software. While we believe this practice complies with the requirements of the GNU General Public License, and while we have reviewed this practice with the Free

Software Foundation, the organization that maintains and provides interpretations of the GNU General Public License, we may still encounter customer resistance to this distribution model or customers may fail to honor the terms of our subscription agreements. To the extent we are unsuccessful in promoting or defending this distribution model, our business, financial condition, operating results and cash flows could be adversely affected.

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

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

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

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

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

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

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

The competitive position of our offerings is dependent on their compatibility with products and services of third-party enterprise hardware and software companies. To the extent that a hardware or software vendor might have or develop products and services that compete with ours, the vendor may have an incentive to seek to limit the performance, functionality or compatibility of our offerings when used with one or more of the vendor s offerings. In addition, these vendors may fail to support or issue statements of compatibility or certification of our offerings when used with their offerings. We intend to encourage the development of additional applications that operate on both current and new versions of our offerings by, among other means, attracting third-party developers to our offerings, providing open source tools to create these applications and maintaining our existing developer relationships through marketing and technical support. We intend to encourage the compatibility of our software with various third-party hardware and software offerings by maintaining and expanding our relationships, both business and technical, with relevant independent hardware and software vendors. If we are not successful in achieving these goals, however, our offerings may not be competitive and our business, financial condition, operating results and cash flows may be adversely affected.

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

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

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

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

In addition, errors in our technologies could cause system failures, loss of data or other adverse effects for our customers who may assert warranty and other claims for substantial damages against us. Although our agreements with our customers often contain provisions which seek to limit our exposure to potential product liability claims, it is possible that these provisions may not be effective or enforceable under the laws of some jurisdictions. While we seek to insure against these types of claims, our insurance policies may not adequately limit our exposure to such claims. These claims, even if unsuccessful, could be costly and time-consuming to defend and could adversely affect our business, financial conditions, operating results and cash flows.

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

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

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

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

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

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

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

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

Our business involves the production and distribution of enterprise software technologies, as well as hosting applications. As part of our business, we (or third parties with whom we contract) receive, store and process our data, as well as our customers and partners data. While we take security and testing measures relating to our offerings and operations, those measures may not prevent security breaches and data loss that could harm our business or the businesses of our customers and partners. Advances in computer capabilities, new discoveries in the field of cryptography, inadequate technology or facility security measures or other factors may result in data loss or a compromise or breach of our systems and the data we receive, store and process (or systems and the data received, stored and processed by third parties with whom we contract). These security measures may be breached or data lost as a result of actions by third parties, employee error (such as weak passwords or unencrypted devices), malfeasance or vulnerabilities or security bugs found in software code. A party who is able to circumvent security measures or exploit inadequacies in security measures, could, among other things, misappropriate proprietary information (including information about our employees, customers and partners, our customers information, financial data and data that others could use to compete against us), cause the loss or disclosure of some or all of this information, cause interruptions or denial of service in our or our customers operations, cause delays in development efforts or expose customers (and their customers) to computer viruses or other disruptions or vulnerabilities. A compromise to these systems could remain undetected for an extended period of time, exacerbating the impact of that compromise. These risks may increase as we continue to grow our cloud and services offerings and as we receive, store and process more of our customers data. Actual or perceived vulnerabilities may lead to regulatory investigations, claims against us by customers, partners or other third parties, or costs, such as those related to providing customer notifications and fraud monitoring. While our customer agreements typically contain provisions that seek to limit our liability, there is no assurance these provisions will be enforceable and effective under applicable law. In addition, the cost and operational consequences of implementing further data protection measures could be significant. Moreover, because the techniques used to obtain unauthorized access, disable or degrade service or sabotage systems change frequently and often are not recognized until launched against a target, we may be unable to anticipate these techniques or to implement adequate preventative measures. Any loss of data or compromise of our systems or the data we receive, store or process (or systems and the data received, stored and processed by third parties with whom we contract) could result in a loss of confidence in the security of our offerings, damage our reputation, loss of channel or strategic partners, lead to legal liability and adversely affect our business, financial condition, operating results and cash flows.

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

We rely on our technology infrastructure, and the technology infrastructure of third parties, for many functions, including selling our offerings, supporting our partners, fulfilling orders and billing, collecting and making payments. This technology infrastructure may be vulnerable to damage or interruption from natural disasters, power loss, telecommunication failures, terrorist attacks, computer intrusions, vulnerabilities and viruses, software errors, computer denial-of-service attacks and other events. A significant number of the systems making up this infrastructure are not redundant, and our disaster recovery planning may not be sufficient for every eventuality. This technology infrastructure may fail or be vulnerable to damage or interruption because of actions by third parties or employee error or malfeasance. We may not carry business interruption insurance sufficient to protect us from all losses that may result from interruptions in our services as a result of technology infrastructure failures or to cover all contingencies. Any interruption in the availability of our websites and on-line interactions with customers or partners may cause a reduction in customer or partner satisfaction levels, which in turn could cause additional claims, reduced revenue or loss of customers or partners. Despite any precautions we may take, such problems could result in, among other consequences, a loss of data, loss of confidence in the stability and reliability of our offerings, damage to our reputation, and legal liability, all of which may adversely affect our business, financial condition, operating results and cash flows interruptions.

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

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

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

We do not exercise control over many aspects of the development of open source technology. Different groups of open source software programmers compete with one another to develop new technology. Typically, the technology developed by one group will become more widely used than that developed by others. If we acquire or adopt new technology and incorporate it into our offerings but competing technology becomes more widely used or accepted, the market appeal of our offerings may be reduced and that could harm our reputation, diminish our brands and adversely affect our business, financial condition, operating results and cash flows.

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

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

RISKS RELATED TO LEGAL UNCERTAINTY

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

We regularly commit to our subscription customers that if portions of our offerings are found to infringe 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 its use is non-infringing; or (iii) replace the infringing component with a non-infringing component, and indemnify them against specified infringement claims. Although we cannot predict whether we will need to satisfy these commitments and we often have limitations on these commitments, satisfying the commitments could be costly, be time-consuming, divert the attention of technical and management personnel, and adversely affect our business, financial condition, operating results and cash flows. In addition, our insurance policies would likely not adequately cover our exposure to this type of claim. Finally, because we have agreed to indemnify our subscription customers against specified infringement claims arising from the use of our offerings, we could become involved in litigation brought against such customers if our services and technology are allegedly implicated.

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

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

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

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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 disadvantageous to us. Similarly, if any litigation to which we are a party is resolved adversely, we may be subject to an unfavorable judgment that may not be reversed upon appeal. The terms of such a settlement or judgment may require us to cease offering certain of our technologies or pay substantial amounts to the other party. In addition, we may have to seek a license to continue offering technologies found to be in violation of a third party s rights, which may not be available on reasonable terms, or at all, and may significantly increase our operating costs and expenses. As a result, we may also be required to develop alternative non-infringing technology or practices or discontinue the practices. The development of alternative non-infringing technology or practices could require significant effort and expense or may not be feasible.

An unfavorable legal decision regarding the intellectual property in and to our technology and other offerings could adversely affect our business, financial condition, operating results and cash flows. See Part II, Item 1, Legal Proceedings for additional information.

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

In many foreign countries, particularly in certain developing economies, it is not uncommon to engage in business practices that are prohibited by regulations that may apply to us, such as the U.S. Foreign Corrupt Practices Act and similar laws. Although we have policies and procedures designed to help promote compliance with these laws, our employees, contractors, partners and agents, as well as those companies to which we outsource certain of our business operations, may take actions in violation of our policies and procedures. Any violation of these laws and regulations could result in fines, criminal sanctions against us, our officers, or our employees, prohibitions on the conduct of our business, and damage to our reputation.

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

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

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

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

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

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

Our Patent Promise on software patents limits our ability to enforce our patent rights in certain circumstances.

As part of our commitment to the open source community, we provide our Patent Promise on software patents. Under our Patent Promise, we agree, subject to certain limitations, not to enforce our patent rights against users of open source software covered by certain open source licenses, including the GNU General Public License version 2.0 and version 3.0, GNU Lesser General Public License version 2.1 and version 3.0, IBM Public License version 1.0, Common Public License version 1.0, Q Public License version 1.0, Open Software License version 3.0 and any other open source license granted by Red Hat. While we may be able to claim protection of our intellectual property under other rights, such as trade secrets or contractual rights, our Patent Promise effectively limits our ability to assert our patent rights against these third parties (even if we were to conclude that their use infringes our patents with competing offerings), unless any such third party asserts its patent rights against us. This limitation on our ability to assert our patent rights against others could harm our business and ability to compete.

We are, and may become, involved in disputes and lawsuits that could adversely affect our business.

Lawsuits or legal proceedings may be commenced against us. These disputes and proceedings may involve significant expense and divert the attention of management and other employees. If we do not prevail in these matters, we could be required to pay substantial damages or settlement costs, which could adversely affect our business, financial condition, operating results and cash flows. See Part II, Item 1, Legal Proceedings for additional information.

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

Our business is subject to federal, state and international laws regarding privacy and protection of user data. We post, on our website, our privacy policies and practices concerning the use and disclosure of user data. As Internet commerce continues to evolve, increasing regulation by federal, state or foreign agencies becomes more likely. The introduction of new offerings by us may cause new and different regulations to apply to our business. New or increased laws and regulations applying to the solicitation, collection, processing, protection, use or other treatment of information could affect our ability to use and share data, or the adoption of our cloud offerings by customers.

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

Any failure or perceived failure by us to comply with our posted privacy policies or other federal, state or international privacy-related or data protection laws, government regulations or directives, or industry self-regulatory principles, or a requirement to change our data practices could have an adverse effect on our business, financial condition, operating results and cash flows.

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

Our contracts with our customers may include specialized performance requirements. In particular, our contracts with federal, state, provincial and local governmental customers are subject to various government certification requirements, procurements regulations, contract provisions and other requirements relating to their formation, administration and performance. Any failure by us or our channel partners to comply with the specific provisions in our customer contracts or any violation of government contracting regulations by us or our channel partners 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, if we are unable to meet government certification requirements, or if our ability to compete for new contracts is adversely affected, we could suffer an adverse effect on our business, financial condition, operating results and cash flows.

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

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

RISKS RELATED TO FINANCIAL UNCERTAINTY

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

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

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We may not be able to meet the financial and operational challenges that we will encounter as our international operations, which represented approximately 42.8% of our total revenue for the fiscal year ended February 28, 2015, continue to expand.

Our international operations accounted for approximately 42.8% of total revenue for the fiscal year ended February 28, 2015. As we expand our international operations, we may have difficulty managing and administering a globally dispersed business and we may need to expend additional funds to, among other activities, reorganize our sales force and technical support services team, outsource or supplement general and administrative functions, staff key management positions, obtain additional information technology infrastructure and successfully localize offerings for a significant number of international markets, which may adversely affect our operating results. Additional challenges associated with the conduct of our business globally that may adversely affect our operating results include:

- Fluctuations in exchange rates;
- Pricing environments;
- Longer payment cycles and less financial stability of customers;
- Economic, political, compliance and regulatory risks associated with specific countries;
- Laws and policies of the U.S. and other jurisdictions affecting trade, foreign investment, loans, and taxes;
- Difficulty selecting and monitoring channel partners;
- Lower levels of availability or use of the Internet, through which our software is often delivered;
- Difficulty protecting our intellectual property rights globally due to, among other reasons, the uncertainty of laws and enforcement in certain countries relating to the protection of intellectual property rights;
- Difficulty in staffing, developing and managing foreign operations as a result of distance, language, legal, cultural and other differences;
- Different employee/employer relationships and the existence of works councils and labor unions;
- Difficulty maintaining quality standards consistent with the our brands;

- Export and import laws and regulations that could prevent us from delivering our offerings into and from certain countries;

- Public health risks and natural disasters, particularly in areas in which we have significant operations;

- Limitations on the repatriation and investment of funds and foreign currency exchange restrictions;

- Changes in import/export duties, quotas or other trade barriers that could affect the competitive pricing of our offerings and reduce our market share in some countries; and

- Economic or political instability or terrorist acts in some international markets that could adversely affect our business in those markets or result in the loss or forfeiture of some foreign assets and the loss of sums spent developing and marketing those assets and the revenue associated with them.

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

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

During our fiscal year ended February 28, 2015, a substantial portion of our subscription revenue was derived from our Red Hat Enterprise Linux offerings. 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. Moreover, as data centers become more virtualized and move to cloud environments, we may experience a decline in growth if we are unsuccessful in adapting our business model and offerings accordingly. Due to the concentration of our revenue from Red Hat Enterprise Linux, our business, financial condition, operating results and cash flows could be adversely affected by a decline in demand for Red Hat Enterprise Linux.

We 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 may affect our revenue, operating expenses and operating margins, which are reported in U.S. dollars. We cannot predict the impact of future exchange rate fluctuations. As we expand international operations, our exposure to exchange rate fluctuations may increase. We use financial instruments, primarily forward purchase contracts, to economically hedge currency commitments arising from trade accounts receivable, trade accounts payable and fixed purchase obligations. If these hedging activities are not successful or we change or reduce these hedging activities in the future, we may experience significant unexpected expenses from fluctuations in exchange rates. For information regarding our hedging activity, see Part I, Item 3, Quantitative and Qualitative Disclosures About Market Risk .

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. Economic and political pressures to increase tax revenue in various jurisdictions may make resolving tax disputes more difficult. The results of an audit or litigation could adversely affect our financial statements in the period or periods for which that determination is made.

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

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

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

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

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

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

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

If we fail to maintain an effective system of disclosure controls or internal control over financial reporting, including satisfaction of the requirements of the Sarbanes-Oxley Act, we may not be able to accurately or timely report on our financial results or adequately identify and reduce fraud. As a result, the financial condition of our business could be adversely affected; current and potential future stockholders 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 Securities and Exchange Commission and various bodies formed to interpret and create appropriate accounting principles and guidance. A change in these principles or guidance, or in their interpretations, may have a significant effect on our reported results and may retroactively affect previously reported results.

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

We maintain an investment portfolio of various holdings, types and maturities. Our portfolio as of February 28, 2015 consisted primarily of money market funds, U.S. government and agency securities, European sovereign and agency securities with a rating of AA or higher, certificates of deposit, and corporate securities. Although we follow an established investment policy and seek to minimize the risks associated with our investments by investing primarily in investment grade, highly liquid securities and by limiting the amounts invested with any one institution, type of security or issuer, we cannot give assurances that the assets in our investment portfolio will not lose value or become impaired, or that our interest income will not decline.

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

Future fluctuations and uncertainty in economic and market conditions could adversely affect the market value of our investments, and we could record additional impairment charges and lose some or all of the principal value of investments in our portfolio. A total loss of an investment or a significant decline in the value of our investment portfolio could adversely affect our financial condition and operating results. For information regarding the sensitivity of and risks associated with the market value of portfolio investments and interest rates, see Part I, Item 3, 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.

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

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

RISKS RELATED TO THE CONVERTIBLE NOTES

The convertible notes are effectively subordinated to any secured debt we incur in the future and to any liabilities of our subsidiaries.

In October 2014, we issued $805.0 million of 0.25% Convertible Senior Notes due 2019 (the convertible notes). The convertible notes will rank senior in right of payment to any of our indebtedness that is expressly subordinated in right of payment to the convertible notes; equal in right of payment to any of our existing and future indebtedness and other liabilities that are not so subordinated; effectively junior in right of payment to any of our secured indebtedness to the extent of the value of the assets securing such indebtedness; and structurally junior to all existing and future indebtedness and other liabilities of our subsidiaries (including trade payables). In the event of our bankruptcy, liquidation, reorganization or other winding up, our assets that secure debt ranking senior in right of payment to the convertible notes will be available to pay obligations on the convertible notes only after the secured debt has been repaid in full from these assets, and the assets of our subsidiaries will be available to pay obligations on the convertible notes only after all claims senior to the convertible notes have

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been repaid in full. There may not be sufficient assets remaining to pay amounts due on any or all of the convertible notes then outstanding.

We may still incur substantially more debt or take other actions that could diminish our ability to make payments on the convertible notes.

We and our subsidiaries may be able to incur substantial additional debt in the future, subject to the restrictions contained in our future debt instruments, some of which may be secured debt. We are not restricted under the terms of the indenture governing the convertible notes from incurring additional debt, securing existing or future debt, recapitalizing our debt or taking a number of other actions that are not limited by the terms of the indenture governing the convertible notes that could have the effect of diminishing our ability to make payments on the convertible notes when due.

We may not have the ability to raise the funds necessary to settle conversions of the convertible notes in cash, repay the convertible notes at maturity or repurchase the convertible notes upon a fundamental change, and our future debt may contain limitations on our ability to pay cash upon conversion or repurchase of the convertible notes.

Holders of the convertible notes will have the right to require us to repurchase all or a portion of their convertible notes upon the occurrence of a fundamental change at a repurchase price equal to 100% of the principal amount of the convertible notes to be repurchased, plus accrued and unpaid interest, if any. In addition, upon conversion of the convertible notes, unless we elect to deliver solely shares of our common stock to settle such conversion (other than paying cash in lieu of delivering any fractional share), we will be required to make cash payments in respect of the convertible notes being converted. However, we may not have enough available cash or be able to obtain financing at the time we are required to make repurchases of the convertible notes surrendered therefor or pay cash with respect to the convertible notes being converted or at their maturity.

In addition, our ability to repurchase or to pay cash upon conversions of the convertible notes may be limited by law, regulatory authority or agreements governing our future indebtedness and is dependent on our future performance, which is subject to economic, financial, competitive and other factors beyond our control. Our failure to repurchase the convertible notes at a time when the repurchase is required by the indenture or to pay any cash payable on future conversions of the convertible notes as required by the indenture would constitute a default under the indenture. A fundamental change under the indenture or a default under the indenture could also lead to a default under agreements governing our future indebtedness. If the repayment of the related indebtedness were to be accelerated after any applicable notice or grace periods, we may not have sufficient funds to repay the indebtedness and repurchase the convertible notes or make cash payments upon conversions thereof.

The conditional conversion feature of the convertible notes, if triggered, may adversely affect our financial condition and operating results.

In the event the conditional conversion feature of the convertible notes is triggered, holders of the convertible notes will be entitled to convert the convertible notes at any time during specified periods at their option. If one or more holders elect to convert their convertible notes, unless we elect to satisfy our conversion obligation by delivering solely shares of our common stock (other than paying cash in lieu of delivering any fractional share), we would be required to settle a portion or all of our conversion obligation through the payment of cash, which could adversely affect our liquidity. In addition, even if holders do not elect to convert their convertible notes, we could be required under applicable accounting rules to reclassify all or a portion of the outstanding principal of the convertible notes as a current rather than long-term liability, which would result in a material reduction of our net working capital.

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The accounting method for convertible debt securities that may be settled in cash, such as the convertible notes, could have a material effect on our reported financial results.

Accounting Standards Codification Subtopic 470-20, Debt with Conversion and Other Options (ASC 470-20), requires an entity to separately account for the liability and equity components of convertible debt instruments (such as the convertible notes) that may be settled entirely or partially in cash upon conversion in a manner that reflects the issuer s non-convertible debt interest rate. Accordingly, the equity component of the convertible notes is required to be included in the additional paid-in capital section of stockholders equity on our consolidated balance sheet, and the value of the equity component is treated as original issue discount for purposes of accounting for the debt component of the convertible notes. As a result, we are required to recognize a greater amount of non-cash interest expense in our consolidated income statements in the current and future periods presented as a result of the amortization of the discounted carrying value of the convertible notes to their principal amount over the term of the convertible notes. We will report lower net income (or greater net losses) in our consolidated financial results because ASC 470-20 will require interest to include both the current period s amortization of the original issue discount and the instrument s non-convertible interest rate. This could adversely affect our reported or future consolidated financial results, the trading price of our common stock and the trading price of the convertible notes.

In addition, under certain circumstances, in calculating earnings per share, convertible debt instruments (such as the convertible notes) that may be settled entirely or partly in cash are currently accounted for utilizing the treasury stock method, the effect of which is that the shares of common stock issuable upon conversion of the convertible notes, if any, are not included in the calculation of diluted earnings per share except to the extent that the conversion value of the convertible notes exceeds their principal amount. Under the treasury stock method, diluted earnings per share is calculated as if the number of shares of common stock that would be necessary to settle such excess, if we elected to settle such excess in shares, were issued. We cannot be sure that the accounting standards in the future will continue to permit the use of the treasury stock method. If we are unable to use the treasury stock method in accounting for the shares issuable upon conversion of the convertible notes, if any, then our diluted consolidated earnings per share would be adversely affected.

The convertible note hedge and warrant transactions may affect the value of our common stock.

In connection with the sale of the convertible notes, we entered into convertible note hedge transactions with institutions that we refer to as the option counterparties. We also entered into warrant transactions with the option counterparties pursuant to which we sold warrants for the purchase of our common stock. The convertible note hedge transactions are expected to offset the potential dilution to our common stock upon any conversion of convertible notes and/or offset any cash payments we are required to make in excess of the principal amount upon conversion of any convertible notes. The warrant transactions could separately have a dilutive effect to the extent that the market price per share of our common stock exceeds the strike price of the relevant warrants, unless, subject to certain conditions, we elect to settle the warrants in cash.

The option counterparties or their respective affiliates may modify their hedge positions by entering into or unwinding various derivatives with respect to our common stock and/or purchasing or selling our common stock or other securities of ours in secondary market transactions prior to the maturity of the convertible notes (and are likely to do so during any observation period related to a conversion of convertible notes or following any repurchase of convertible notes by us in connection with any fundamental change repurchase date or otherwise). This activity could suppress or inflate the market price of our common stock.

We do not make any representation or prediction as to the direction or magnitude of any potential effect that the transactions described above may have on the price of the convertible notes or our common stock. In addition, we do not make any representation that the option counterparties or their respective affiliates will engage in these transactions or that these transactions, once commenced, will not be discontinued without notice.

We are subject to counterparty risk with respect to the convertible note hedge transactions.

The option counterparties are financial institutions or affiliates of financial institutions, and we will be subject to the risk that these option counterparties may default under the convertible note hedge transactions. Our exposure to the credit risk of the option counterparties will not be secured by any collateral. If one or more of the option counterparties to one or more of our convertible note hedge transactions becomes subject to insolvency proceedings, we will become an unsecured creditor in those proceedings with a claim equal to our exposure at the time under those transactions. Our exposure will depend on many factors but, generally, the increase in our exposure will be correlated to the increase in the market price of our common stock and in the volatility of the market price of our common stock. In addition, upon a default by one of the option counterparties, we may suffer dilution with respect to our common stock as well as adverse financial consequences. We can provide no assurances as to the financial stability or viability of any of the option counterparties.

RISKS RELATED TO OWNERSHIP OF OUR COMMON STOCK

Our stock price has been volatile historically and may continue to be volatile.

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

The sale of our common stock by significant stockholders may cause the price of our common stock to decrease.

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 issue additional shares of our common stock or instruments convertible into shares of our common stock and thereby materially and adversely affect the market price of our common stock.

We are not restricted from issuing additional shares of our common stock or other instruments convertible into, or exchangeable or exercisable for, shares of our common stock. If we issue additional shares of our common stock or instruments convertible into shares of our common stock, it may materially and adversely affect the market price of our common stock.

In addition, a substantial number of shares of our common stock is reserved for instruments issued under our equity compensation plans, including for the issuance upon the exercise of stock options and the vesting of performance share units, restricted stock, restricted stock units and deferred stock units, upon conversion of the convertible notes, and in relation to the convertible note hedge and warrant transactions entered into in connection with the convertible notes. We may not be able to predict the size of future issuances or the effect, if any, that they may have on the market price for our common stock. The issuance and sale of substantial amounts of common stock, or the perception that such issuances and sales may occur, could adversely affect the market price of our common stock and impair our ability to raise capital through the sale of equity or equity-linked securities.

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We do not currently expect to pay dividends on our common stock, so any returns may be limited to changes in the value of our common stock.

We have never declared or paid any cash dividends on our common stock. We currently anticipate that we will retain future earnings for the development, operation and expansion of our business and do not anticipate declaring or paying any cash dividends for the foreseeable future. In addition, our ability to pay cash dividends on our common stock may be prohibited or limited by the terms of any future debt financing arrangement. Any return to stockholders will therefore be limited to the increase, if any, of our stock price.

Conversion of the convertible notes may dilute the ownership interest of existing stockholders, including holders who had previously converted their convertible notes, or may otherwise depress the price of our common stock.

The conversion of the convertible notes into shares of our common stock, to the extent that we choose not to deliver all cash for the conversion value, will dilute the ownership interests of existing stockholders. Any sales in the public market of the common stock issuable upon conversion of the convertible notes could adversely affect prevailing market prices of our common stock. In addition, the existence of the convertible notes may encourage short selling by market participants due to this dilution or may facilitate trading strategies involving the convertible notes and our common stock.

Provisions of our certificate of incorporation, by-laws, Delaware law and the convertible notes may have anti-takeover effects that could prevent a change in control even if the change in control would be beneficial to our stockholders.

Provisions of our certificate of incorporation, by-laws and Delaware law could make it more difficult for a third party to acquire us, even if doing so would be beneficial to our stockholders. These provisions include:

- our Board of Directors has the right to elect directors to fill a vacancy created by the expansion of the Board of Directors or the resignation, death or removal of a director, which prevents stockholders from being able to fill vacancies on our Board of Directors;

- stockholders must provide advance notice to nominate individuals for election to the Board of Directors or to propose matters that can be acted upon at a stockholders meeting; such provisions may discourage or deter a potential acquirer from conducting a solicitation of proxies to elect the acquirer s own slate of directors or otherwise attempting to obtain control of our company; and

- our Board of Directors may issue, without stockholder approval, shares of undesignated preferred stock; the ability to issue undesignated preferred stock makes it possible for our Board of Directors to issue preferred stock with voting or other rights or preferences that could impede the success of any attempt to acquire us.

Further, as a Delaware corporation, we are also subject to certain Delaware law anti-takeover provisions. Under Delaware law, a corporation may not engage in a business combination with any holder of 15% or more of its capital stock unless the holder has held the stock for three years or, among other things, the Board of Directors has approved the transaction. Our Board of Directors could rely on Delaware law to prevent or delay an acquisition of us. Additionally, certain provisions of the convertible notes could make it more difficult or more expensive for a third party to acquire us or could also have the effect of delaying or reducing the likelihood of a change in control of us even if such acquisition or change of control may be favorable to our stockholders.

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

The table below sets forth information regarding the Company s purchases of its common stock during its third fiscal quarter ended November 30, 2015:

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)	Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs (2)
September 1, 2015 September 30, 2015		$		$ 429.9 million
October 1, 2015 October 31, 2015	767,325	$ 77.68	409,400	$ 398.2 million
November 1, 2015 November 30, 2015	577,800	$ 80.40	577,800	$ 351.7 million
Total	1,345,125		987,200	

(1) During the three months ended November 30, 2015, the Company withheld an aggregate of 357,925 shares of its common stock (with a weighted average share price of $77.89) from employees to satisfy minimum tax withholding obligations relating to the vesting of share awards. These shares were not withheld pursuant to the program described in Note (2) below.

(2) On March 25, 2015, the Company announced that its Board of Directors has authorized the repurchase of up to $500.0 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, 2015, and will expire on the earlier of (i) March 31, 2017, or (ii) a determination by the Board, 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
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

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SIGNATURES

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

	RED HAT, INC.	
Date: January 8, 2016	By:	/S/ JAMES M. WHITEHURST
		James M. Whitehurst
		President and Chief Executive Officer
		(Duly Authorized Officer on Behalf of the Registrant)
	RED HAT, INC.	
Date: January 8, 2016	By:	/S/ FRANK A. CALDERONI
		Frank A. Calderoni
		Executive Vice President, Operations and
		Chief Financial Officer
		(Principal Financial Officer)