

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)

**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** **(I.R.S. Employer**  
**incorporation or organization)** **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  No

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, 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  Accelerated filer

Non-accelerated filer  Smaller reporting company

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

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

As of December 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 also constitute 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.

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

	<b>November 30, 2015</b>	<b>February 28,</b>
	<b>(Unaudited)</b>	<b>2015(1)</b>
<b>ASSETS</b>		
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
<b>Total current assets</b>	<b>\$ 1,773,941</b>	<b>\$ 1,970,239</b>
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
<b>Total assets</b>	<b>\$ 3,899,205</b>	<b>\$ 3,802,985</b>
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
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
<b>Total current liabilities</b>	<b>\$ 1,311,534</b>	<b>\$ 1,334,692</b>
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

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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)
<b>Total stockholders' equity</b>	<b>\$ 1,344,793</b>	<b>\$ 1,288,338</b>
<b>Total liabilities and stockholders' equity</b>	<b>\$ 3,899,205</b>	<b>\$ 3,802,985</b>

(1) Derived from audited financial statements.

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

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

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>November 30,</b>	<b>November 30,</b>	<b>November 30,</b>	<b>November 30,</b>
	<b>2015</b>	<b>2014</b>	<b>2015</b>	<b>2014</b>
<b>Revenue:</b>				
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
<b>Cost of subscription and training and services revenue:</b>				
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
<b>Operating expense:</b>				
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

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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.



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

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>November 30,</b>	<b>November 30,</b>	<b>November 30,</b>	<b>November 30,</b>
	<b>2015</b>	<b>2014</b>	<b>2015</b>	<b>2014</b>
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)

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<b>Cash flows from financing activities:</b>				
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

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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

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**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

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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

Table of Contents**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):

	<b>As of November 30, 2015</b>	<b>As of February 28, 2015</b>
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):

	<b>As of November 30, 2015</b>			<b>As of February 28, 2015</b>		
	<b>Gross Amount</b>	<b>Accumulated Amortization</b>	<b>Net Amount</b>	<b>Gross Amount</b>	<b>Accumulated Amortization</b>	<b>Net Amount</b>
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):

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>November 30,</b>	<b>November 30,</b>	<b>November 30,</b>	<b>November 30,</b>
	<b>2015</b>	<b>2014</b>	<b>2015</b>	<b>2014</b>
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
<b>Total amortization expense</b>	<b>\$ 7,324</b>	<b>\$ 6,986</b>	<b>\$ 19,972</b>	<b>\$ 21,303</b>



**Table of Contents****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):

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>November 30, 2015</b>	<b>November 30, 2014</b>	<b>November 30, 2015</b>	<b>November 30, 2014</b>
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

Table of Contents**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)
<b>Assets:</b>				
Money markets (1)	\$ 261,399	\$ 261,399	\$	\$
<b>Available-for-sale securities (1):</b>				
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	
<b>Liabilities:</b>				
Foreign currency derivatives (3)	(424)		(424)	
<b>Total</b>	<b>\$ 1,190,452</b>	<b>\$ 261,399</b>	<b>\$ 929,053</b>	<b>\$</b>

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- (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.

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

The following table summarizes the composition and fair value hierarchy of the Company's financial assets and liabilities at 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)
<b>Assets:</b>				
Money markets (1)	\$ 369,926	\$ 369,926	\$	\$
Interest-bearing deposits (1)	39		39	
<b>Available-for-sale securities (1):</b>				
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	
<b>Liabilities:</b>				
Foreign currency derivatives (3)	(738)		(738)	
<b>Total</b>	<b>\$ 1,160,526</b>	<b>\$ 369,926</b>	<b>\$ 790,600</b>	<b>\$</b>

- (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**

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	<b>Amortized Cost</b>	<b>Gross Unrealized</b>		<b>Aggregate Fair Value</b>	<b>Cash and cash equivalents</b>	<b>Investments in debt securities, short-term</b>	<b>Investments in debt securities, long-term</b>
		<b>Gains</b>	<b>Losses (1)</b>				
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	
<b>Total</b>	<b>\$ 1,193,030</b>	<b>\$ 798</b>	<b>\$ (3,010)</b>	<b>\$ 1,190,818</b>	<b>\$ 261,399</b>	<b>\$ 193,993</b>	<b>\$ 735,426</b>

(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.

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

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

	Amortized Cost	Gross Unrealized		Aggregate Fair Value	Balance Sheet Classification		
		Gains	Losses (1)		Cash and cash equivalents	Investments in debt securities, short-term	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	
<b>Total</b>	<b>\$ 1,161,005</b>	<b>\$ 1,291</b>	<b>\$ (1,106)</b>	<b>\$ 1,161,190</b>	<b>\$ 399,920</b>	<b>\$ 215,254</b>	<b>\$ 546,016</b>

(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.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(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)
<b>TOTAL</b>		<b>\$ (366)</b>	<b>\$ 38,116</b>		<b>\$ (423)</b>	<b>\$ (397)</b>

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)
<b>TOTAL</b>		<b>\$ (404)</b>	<b>\$ 21,423</b>		<b>\$ (763)</b>	<b>\$ (1,040)</b>

**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.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(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		Nine Months Ended	
	November 30, 2015		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

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

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):

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>November 30,</b>	<b>November 30,</b>	<b>November 30,</b>	<b>November 30,</b>
	<b>2015</b>	<b>2014</b>	<b>2015</b>	<b>2014</b>
Net income, basic and diluted	\$ 46,848	\$ 47,933	\$ 146,329	\$ 132,501