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 May 31, 2009

OR

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

Commission File Number: 001-33162

RED HAT, INC.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of incorporation or organization)

06-1364380

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

1801 Varsity Drive, Raleigh, North Carolina 27606

(Address of principal executive offices, including zip code)

(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 ¨ No ¨

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

Large accelerated filer 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 June 30, 2009, there were 188,007,091 shares of common stock outstanding.

RED HAT, INC.

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RED HAT, INC.

CONSOLIDATED BALANCE SHEETS

(In thousands except share and per share amounts)

	May 31, 2009 (Unaudited)	February 28, 2009
ASSETS		
Current assets:		
Cash and cash equivalents	$ 510,616	$ 515,548
Investments in debt and equity securities, short-term	206,891	147,178
Accounts receivable, net of allowances for doubtful accounts of $2,758 and $2,387, respectively	106,639	128,669
Prepaid expenses and other current assets	95,387	99,437
Total current assets	919,533	890,832
Property and equipment, net of accumulated depreciation and amortization of $96,923 and $91,140, respectively	69,619	67,913
Goodwill	438,901	438,109
Identifiable intangibles, net	119,638	122,177
Investments in debt securities, long-term	167,028	183,363
Other assets, net	51,104	51,242
Total assets	$ 1,765,823	$ 1,753,636
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 13,089	$ 9,576
Accrued expenses	52,104	54,123
Deferred revenue	402,764	382,050
Other current obligations	878	900
Total current liabilities	468,835	446,649
Deferred lease credits	4,319	4,470
Long-term deferred revenue	164,576	161,032
Other long-term obligations	34,573	35,432
Commitments and contingencies		
Stockholders equity:		
Preferred stock, 5,000,000 shares authorized, none outstanding		
Common stock, $0.0001 per share par value, 300,000,000 shares authorized, 208,435,308 and 207,794,700 shares issued, and 187,937,113 and 189,998,611 shares outstanding at May 31, 2009 and February 28, 2009, respectively	21	21
Additional paid-in capital	1,295,305	1,281,469
Retained earnings	69,033	50,519
Treasury stock at cost, 20,498,267 and 17,796,089 shares at May 31, 2009 and February 28, 2009, respectively	(283,054)	(236,283)
Accumulated other comprehensive income	12,215	10,327
Total stockholders equity	1,093,520	1,106,053
Total liabilities and stockholders equity	$ 1,765,823	$ 1,753,636

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	
	May 31, 2009	May 31, 2008
Revenue:		
Subscriptions	$ 148,790	$ 130,694
Training and services	25,598	25,941
Total subscription and training and services revenue	174,388	156,635
Cost of subscription and training and services revenue:		
Cost of subscriptions	10,050	8,957
Cost of training and services	16,418	17,472
Total cost of subscription and training and services revenue	26,468	26,429
Gross profit	147,920	130,206
Operating expense:		
Sales and marketing	63,977	59,271
Research and development	35,102	28,911
General and administrative	23,785	22,114
Total operating expense	122,864	110,296
Income from operations	25,056	19,910
Other income, net	3,480	10,020
Interest expense	(53)	(1,586)
Income before provision for income taxes	28,483	28,344
Provision for income taxes	9,969	11,054
Net income	$ 18,514	$ 17,290
Basic net income per common share	$ 0.10	$ 0.09
Diluted net income per common share	$ 0.10	$ 0.08
Weighted average shares outstanding		
Basic	188,916	190,779
Diluted	194,382	218,853

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 May 31, 2009	Three Months Ended May 31, 2008
Cash flows from operating activities:		
Net income	$ 18,514	$ 17,290
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	10,810	9,097
Share-based compensation expense	10,676	10,561
Deferred income taxes	6,428	8,767
Excess tax benefits from share-based payment arrangements	(14,200)	(8,967)
Other	(124)	561
Changes in operating assets and liabilities net of effects of acquisitions:		
Accounts receivable	26,278	19,320
Prepaid expenses and other current assets	644	(5,003)
Accounts payable	2,997	(5,570)
Accrued expenses	(3,029)	1,986
Deferred revenue	2,361	15,454
Other assets, net	(152)	(134)
Net cash provided by operating activities	61,203	63,362
Cash flows from investing activities:		
Purchase of investment in debt securities available for sale	(157,034)	(305,646)
Proceeds from sales and maturities of investment in debt securities available for sale	122,449	216,534
Proceeds from sales of investment in equity securities available for sale	221	
Acquisitions of businesses, net of cash acquired		(43,750)
Purchase of developed software and other intangible assets	(989)	(1,615)
Purchase of property and equipment	(6,028)	(9,522)
Net cash used in investing activities	(41,381)	(143,999)
Cash flows from financing activities:		
Excess tax benefits from share-based payment arrangements	14,200	8,967
Proceeds from exercise of common stock options	4,400	11,447
Payments related to net settlement of employee share-based awards	(1,798)	
Purchase of treasury stock	(46,771)	(9,147)
Structured stock repurchase		1,989
Proceeds from other borrowings		66
Payments on other borrowings	(900)	(23)
Net cash provided by (used in) financing activities	(30,869)	13,299
Effect of foreign currency exchange rates on cash and cash equivalents	6,115	158
Net decrease in cash and cash equivalents	(4,932)	(67,180)
Cash and cash equivalents at beginning of period	515,548	677,720

Cash and cash equivalents at end of period	$ 510,616	$ 610,540

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

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RED HAT, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

NOTE 1 Company

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

NOTE 2 Summary of Significant Accounting Policies

Unaudited Interim Financial Information

The unaudited interim consolidated financial statements as of and for the three months ended May 31, 2009 have been prepared by the Company pursuant to the rules and regulations of the Securities and Exchange Commission (the SEC) for interim financial reporting. These consolidated statements are unaudited and, in the opinion of management, include all adjustments (consisting of normal recurring adjustments and accruals) necessary to present fairly the consolidated balance sheets, consolidated operating results and consolidated cash flows for the periods presented in accordance with accounting principles generally accepted in the United States of America. Operating results for the three months ended May 31, 2009 are not necessarily indicative of the results that may be expected for the fiscal year ending February 28, 2010. Certain information and footnote disclosures normally included in annual financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been omitted in accordance with the SEC s rules and regulations for interim reporting. For further information, see the Company s Consolidated Financial Statements, including notes thereto, included in the Company s Annual Report on Form 10-K for the fiscal year ended February 28, 2009.

Principles of Consolidation

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

Use of Estimates

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

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RED HAT, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Revenue Recognition

The Company establishes persuasive evidence of a sales arrangement for each type of revenue transaction based on either a signed contract with the end customer, a click-through contract on the Company s website whereby the customer agrees to the Company s standard subscription terms, signed or click-through distribution contracts with original equipment manufacturers (OEMs) and other resellers, or, in the case of individual training seats, through receipt of payment which indicates acceptance of the Company s training agreement terms.

Subscription Revenue

Subscription revenue is comprised of direct and indirect sales of Red Hat enterprise technologies. Accounts receivable and deferred revenue are recorded at the time a customer enters into a binding subscription agreement for the purchase of a subscription, subscription services are made available to the customer and the customer is billed. The deferred revenue amount is recognized as revenue ratably over the life of the subscription. Red Hat enterprise technologies are generally offered with either one or three-year base subscription periods; the majority of the Company s subscriptions have one-year terms. Under these subscription agreements, renewal rates are generally specified for one or three-year renewal terms. The base subscription generally entitles the end user to the technology itself and post-contract customer support (PCS) generally consisting of a specified level of customer support and security errata, bug fixes, functionality enhancements to the technology and upgrades to new versions of the technologies, each on a when-and-if available basis, during the term of the subscription. The Company sells its offerings through two principal channels: (1) direct, which includes sales by the Company s sales-force as well as web store sales, and (2) indirect, which includes distributors, resellers and OEMs. The Company recognizes revenue from the sale of Red Hat enterprise technologies ratably over the period of the subscription beginning on the commencement date of the subscription agreement.

Subscription arrangements with large enterprise customers often have contracts with multiple elements (e.g., software technology, maintenance, training, consulting and other services). The Company allocates revenue to each element of the arrangement based on vendor-specific objective evidence of each element s fair value when the Company can demonstrate sufficient evidence of the fair value of at least those elements that are undelivered. The fair value of each element in multiple element arrangements is created by either (i) providing the customer with the ability during the term of the arrangement to renew that element at the same rate paid for the element included in the initial term of the agreement or (ii) selling the services on a stand-alone basis.

Training and Services Revenue

Training and services revenue is comprised of revenue for consulting, engineering and customer training and education services. Consulting services consist of time-based arrangements, and revenue is recognized as these services are performed. Engineering services represent revenue earned under fixed fee arrangements with the Company s OEM partners and other customers to provide for significant modification and customization of the Company s Red Hat enterprise technologies. The Company recognizes revenue for these fixed fee engineering services using the percentage of completion basis of accounting, provided the Company has the ability to make reliable estimates of progress towards completion, the fee for such services is fixed or determinable and collection of the resulting receivable is probable. Under the percentage of completion method, earnings under the contract are recognized based on the progress toward completion as estimated using the ratio of labor hours incurred to total expected project hours. Changes in estimates are recognized in the period in which they are known. Revenue for customer training and education services is recognized on the dates the services are complete.

RED HAT, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Deferred Commissions

Deferred commissions are the incremental costs that are directly associated with non-cancelable subscription contracts with customers and consist of sales commissions paid to the Company s sales force. The commissions are deferred and amortized over a period that approximates the period of the subscription term. The commission payments are paid in full subsequent to the month in which the customer s service commences. The deferred commission amounts are recoverable through the future revenue streams under the non-cancelable customer contracts. In addition, the Company has the ability and intent under the commission plans with its sales force to recover commissions previously paid to its sales force in the event that customers breach the terms of their subscription agreements and do not fully pay for their subscription agreements. Amortization of deferred commissions is included in sales and marketing expense in the accompanying Consolidated Statements of Operations. Deferred commissions are included in prepaid expenses and other current assets on the accompanying Consolidated Balance Sheets.

Impairment of Goodwill and Other Long-Lived Assets

The Company tests goodwill for impairment annually and whenever events or circumstances indicate an impairment may exist. Accounting principles generally accepted in the U.S. require goodwill be tested at least annually using a two-step process that begins with identifying potential impairment. Potential impairment is identified if the fair value of the reporting unit to which goodwill applies is less than the recognized or book value of the related reporting entity, including such goodwill. Where the book value of a reporting entity, including related goodwill, is greater than the reporting entity s fair value, the second step of the goodwill impairment test is performed to measure the amount of impairment loss, if any. For the three months ended May 31, 2009 and May 31, 2008, the Company did not identify any potential impairment related to its goodwill.

The Company evaluates the recoverability of its property and equipment and other assets whenever events or changes in circumstances indicate an impairment may have occurred. An impairment loss is recognized when the net book value of such assets exceeds the estimated future undiscounted cash flows attributable to the assets or the business to which the assets relate. Impairment losses, if any, are measured as the amount by which the carrying value exceeds the fair value of the assets. For the three months ended May 31, 2009 and May 31, 2008, no potential impairment losses related to the Company s long-lived assets were identified.

Cash and Cash Equivalents

The Company considers liquid investments purchased with a maturity period of three months or less at the date of purchase to be cash equivalents.

Accounts Receivable and Allowance for Doubtful Accounts

Trade accounts receivable are recorded at the invoiced amount and do not bear interest. The allowance for doubtful accounts is the Company s estimate of the amount of probable credit losses in the Company s existing accounts receivable. The Company determines the allowance based on historical write-off experience. The Company reviews its allowance for doubtful accounts monthly. Past due balances over 90 days and over a specified amount are reviewed individually for collectibility. All other balances are reviewed on a pooled basis by type of receivable. Account balances are charged off against the allowance when the Company determines it is probable the receivable will not be recovered. The Company does not have off-balance-sheet credit exposure related to its customers.

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RED HAT, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Investments in Debt and Equity Securities

The Company s investments at May 31, 2009 and February 28, 2009 are in debt and equity securities which are classified as available for sale and carried at market value as described below. Investments in debt securities are classified as either a cash equivalent, current asset (Investments in debt and equity securities, short-term) or long-term asset (Investments in debt securities, long-term) based on the maturity date. Investments with a maturity date of one year or less from the balance sheet date are classified as a current asset and those with a maturity date of greater than one year are classified as a long-term asset. The weighted average maturity period of the Company s investment in debt securities was 0.4 years at May 31, 2009 and February 28, 2009.

The Company s investments are considered available for sale as these securities are available for sale at any time in response to needs for liquidity, changes in the availability of and the yield on alternative instruments or changes in funding sources or terms. The following table summarizes the Company s average total return and resulting unrealized gain or loss related to these investments which is recorded as other comprehensive income, a separate component of stockholders equity (in thousands):

	Three Months Ended May 31, 2009	Three Months Ended May 31, 2008
Debt securities:		
Unrealized gains (losses) on available-for-sale debt securities during the period	$ 2,556	$ (4,848)
Average rate of total return on investment in debt securities portfolio	1.8%	3.4%
Equity securities:		
Unrealized gains on available-for-sale equity securities during the period (1)	$ 6,734	$

(1) Investments in equity securities available for sale at May 31, 2009 consist of equity ownership in a company which underwent an initial public offering (IPO) in 2008. Prior to completing its IPO, the Company accounted for this investment on a cost basis, which totaled $2.2 million at May 31, 2008. At May 31, 2009 and February 28, 2009 this equity investment is carried at fair value which totaled $12.7 million and $6.0 million, respectively, and is classified as available for sale and included in investments in debt and equity securities, short-term on the Company s Consolidated Balance Sheets.

Fair Value Measurements

Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the 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 that are significant to the fair value of the assets or liabilities.

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RED HAT, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

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

Unrealized gains and temporary losses on investments classified as available for sale are included within accumulated other comprehensive income, net of any related tax effect. Upon realization, such amounts are reclassified from accumulated other comprehensive income to investment income. Realized gains and losses and other than temporary impairments, if any, are reflected in the statements of operations as other income, net. The Company does not recognize changes in the fair value of its investments in income unless a decline in value is considered other-than-temporary. At May 31, 2009 and February 28, 2009, the vast majority of the Company s investments were priced by pricing vendors. These pricing vendors use the most recent observable market information in pricing these securities or, if specific prices are not available for these securities, use other observable inputs. In the event observable inputs are not available, 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.

Assets and Liabilities Measured at Fair Value on a Recurring Basis

The following table summarizes the composition and fair value hierarchy of the Company s financial assets and liabilities at May 31, 2009 (in thousands):

	As of May 31, 2009	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)	$ 396,468	$ 396,468	$	$
Available-for-sale securities (1):				
Treasuries	17,198	17,198		
Certificate of deposit	51,618		51,618	
Commercial paper	1,999		1,999	
Agencies	192,992		192,992	
Corporates	132,831		132,831	
Equities (1)	12,733	12,733		
Foreign currency derivatives (2)	49		49	
Total	$ 805,888	$ 426,399	$ 379,489	$

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RED HAT, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(1) Included in either cash and cash equivalents or investments in debt and equity securities in the Company s Consolidated Balance Sheet at May 31, 2009, in addition to $78.7 million of cash.

(2) Included in prepaid expenses and other current assets in the Company s Consolidated Balance Sheet at May 31, 2009.

The following table summarizes the composition and fair value hierarchy of the Company s financial assets and liabilities at February 28, 2009 (in thousands):

	As of February 28, 2009	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)	$ 417,632	$ 417,632	$	$
Available-for-sale securities (1):				
Treasuries	17,163	17,163		
Certificate of deposit	27,133		27,133	
Agencies	183,636		183,636	
Corporates	122,899		122,899	
Equities (1)	6,022	6,022		
Foreign currency derivatives (3)	30		30	
Liabilities:				
Foreign currency derivatives (2)	(64)		(64)	
Total	$ 774,451	$ 440,817	$ 333,634	$

(1) Included in either cash and cash equivalents or investments in debt and equity securities in the Company s Consolidated Balance Sheet at February 28, 2009, in addition to $71.6 million of cash.

(2) Included in accrued expenses in the Company s Consolidated Balance Sheet at February 28, 2009.

(3) Included in prepaid expenses and other current assets in the Company s Consolidated Balance Sheet at February 28, 2009.

The following table represents the Company s investments measured at fair value as of May 31, 2009 (in thousands):

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

					Securities		
Money Markets	$ 396,468	$	$	$ 396,468	$ 396,468	$	$
Treasury	17,043	155		17,198		15,342	1,856
Certificate of Deposit	51,618			51,618	35,452	16,166	
Commercial Paper	1,999			1,999		1,999	
Agencies	192,139	906	(53)	192,992		93,643	99,349
Corporates	131,013	2,342	(524)	132,831		67,008	65,823
Equities	1,283	11,450		12,733		12,733	
Total	$ 791,563	$ 14,853	$ (577)	$ 805,839	$ 431,920	$ 206,891	$ 167,028

RED HAT, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(1) Accumulated unrealized losses related to investments that have been in a continuous unrealized loss position for 12 months or longer totaled $0.5 million at May 31, 2009.

The following table represents the Company s investments measured at fair value as of February 28, 2009 (in thousands):

		Gross Unrealized			Balance Sheet Classification		
	Amortized Cost	Gains	Losses (1)	Aggregate Fair Value	Cash Equivalent Marketable Securities	Short-term Marketable Securities	Long-term Marketable Securities
Money Markets	$ 417,632	$	$	$ 417,632	$ 417,632	$	$
Treasury	16,873	290		17,163		15,316	1,847
Certificate of Deposit	27,133			27,133	26,312	821	
Commercial Paper							
Agencies	182,683	989	(36)	183,636		70,364	113,272
Corporates	123,874	784	(1,759)	122,899		54,655	68,244
Equities	1,307	4,715		6,022		6,022	
Total	$ 769,502	$ 6,778	$ (1,795)	$ 774,485	$ 443,944	$ 147,178	$ 183,363

(1) Accumulated unrealized losses related to investments that have been in a continuous unrealized loss position for 12 months or longer totaled $0.3 million at February 28, 2009.

Internal Use Software

The Company capitalized $2.7 million in costs related to the development of internal use software for its website, enterprise resource planning system and systems management applications during each of the three months ended May 31, 2009 and May 31, 2008. The Company amortizes the costs of computer software developed for internal use on a straight-line basis over an estimated useful life of five years. The carrying value of internal use software is included in property and equipment on the Company s Consolidated Balance Sheets.

Capitalized Software Costs

Capitalization of software development costs for products to be sold to third parties begins upon the establishment of technological feasibility and ceases when the product is available for general release. The establishment of technological feasibility and the ongoing assessment of recoverability of capitalized software development costs require considerable judgment by management concerning certain external factors including, but not limited to, technological feasibility, anticipated future gross revenue, estimated economic life and changes in software and hardware technologies. As a result of the Company s practice of releasing source code that it has developed on a weekly basis for unrestricted download on the Internet, there is generally no passage of time between achievement of technological feasibility and the availability of the Company s product for general release. Therefore, at May 31, 2009 and February 28, 2009, the Company had no internally developed capitalized software costs for products to be sold to third parties.

Property and Equipment

Property and equipment is primarily comprised of furniture, computer equipment, computer software and leasehold improvements which are recorded at cost and depreciated or amortized using the straight-line method over their estimated useful lives as follows: furniture and fixtures, seven years; computer equipment, four years;

RED HAT, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

computer software, five years; leasehold improvements, over the lesser of the estimated remaining useful life of the asset or the remaining term of the lease. Expenditures for maintenance and repairs are charged to operations as incurred; major expenditures for renewals and betterments are capitalized and depreciated. Property and equipment acquired under capital leases are depreciated over the lesser of the estimated remaining useful life of the asset or the remaining term of the lease.

Share-Based Compensation

The following summarizes share-based compensation expense recognized in the Company s Consolidated Financial Statements for the three months ended May 31, 2009 and May 31, 2008 (in thousands):

	Three Months Ended May 31, 2009	Three Months Ended May 31, 2008
Cost of revenue	$ 800	$ 681
Sales and marketing	3,110	3,996
Research and development	3,274	2,508
General and administrative	3,492	3,376
Total share-based compensation	$ 10,676	$ 10,561

Share-based compensation expense qualifying for capitalization was insignificant for each of the three months ended May 31, 2009 and May 31, 2008. Accordingly, no share-based compensation expense was capitalized during the three months ended May 31, 2009 and May 31, 2008.

During the three months ended May 31, 2009, the Company granted the following share-based awards:

	Three Months Ended May 31, 2009	
	Shares and Shares Underlying Awards	Weighted Average Per Share Fair Value
Options	6,481	$ 7.04
Nonvested shares and share units	123,835	$ 18.28
Performance share units target (1)	171,667	$ 19.73
Deferred share units	813	$ 19.86
Total awards	302,796	$ 18.87

(1) On May 13, 2009, the Compensation Committee of the Company s Board of Directors approved a Performance Share Unit Agreement for use with certain grants of performance share units (PSUs) to executive officers under the Red Hat, Inc. 2004 Amended and Restated Long-Term Incentive Plan, as Amended and Restated, in FY2010. During the three months ended May 31, 2009, certain executive officers were awarded a target number of PSUs, and depending on the Company s financial performance relative to a specified peer group of companies, these executive officers may earn up to a maximum of 200% of the target number of PSUs over a performance period with three separate performance segments noted below. In respect of the first performance segment, which is the period from March 1, 2009 through February 28, 2010, up to 25% of the maximum number of PSUs may be earned. In respect of the second performance segment,

which is the period from March 1, 2009 through February 28, 2011, up to 50% of the maximum number of PSUs (less the amount of PSUs earned in respect of the first performance segment) may be earned. In respect of the third and final performance segment, which is the period from March 1, 2009 through February 29, 2012, up to 100% of the maximum number of PSUs (less the aggregate amount of PSUs earned in respect of the first and second performance segments) may be earned.

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RED HAT, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Sales and Marketing Expenses

Sales and marketing expenses consist of costs, including salaries, sales commissions and related expenses, such as travel, of all personnel involved in the sales and marketing process. Sales and marketing expenses also include costs of advertising, sales lead generation programs, cooperative marketing arrangements and trade shows. Payments made to resellers or other customers are reported in accordance with Emerging Issues Task Force Issue Number 01-09, Accounting for Consideration Given by a Vendor to a Customer (Including a Reseller of the Vendor s Products) (EITF 01-09). All costs of advertising, to the extent allowable by EITF 01-09, are expensed as incurred. Advertising expense totaled $5.3 million and $4.9 million for the three months ended May 31, 2009 and May 31, 2008, respectively.

Research and Development Expenses

Research and development expenses include all direct costs, primarily salaries for Company personnel and outside consultants, related to the development of new software products, significant enhancements to existing software products, and the portion of costs of development of internal use software required to be expensed. Research and development costs are charged to operations as incurred with the exception of those software development costs that may qualify for capitalization.

Deferred Taxes

The Company accounts for income taxes using the liability method in accordance with Statement of Financial Accounting Standard 109, Accounting for Income Taxes as modified by FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes (FIN 48), which requires the recognition of deferred tax assets or liabilities for the temporary differences between financial reporting and tax bases of the Company s assets and liabilities and for tax carryforwards at enacted statutory tax rates in effect for the years in which the differences are expected to reverse.

The Company continues to assess the realizability of its deferred tax assets, which primarily consist of share-based compensation expense deductions, including net operating loss (NOL) carryforwards related to such share-based compensation expense deductions and deferred revenue. In assessing the realizability of these deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will be realized. As of May 31, 2009, the net deferred tax asset balance was $87.8 million, of which $12.5 million is offset by a valuation allowance. The Company continues to maintain a valuation allowance against its deferred tax assets with respect to certain foreign NOLs, an acquired NOL carryforward that is subject to a limitation under Section 382 of the Internal Revenue Code and NOLs attributable to certain share-based compensation expense deductions related to excess benefits recognized prior to the adoption of SFAS 123R.

With respect to foreign earnings, it is the Company s policy to invest the earnings of foreign subsidiaries indefinitely outside the U.S. From time to time however, the Company may remit a portion of these earnings to the extent it incurs no additional U.S. tax and it is otherwise feasible.

With respect to share-based compensation expense, in accordance with the provisions of SFAS 123R, the benefit of the deferred tax asset attributable to U.S. NOL carryforwards from share-based compensation expense deductions, generated prior to adoption of SFAS 123R, are being recognized as and only to the extent that taxes payable are reduced. As these deferred tax assets attributable to NOLs from share-based compensation expense deductions are realized, the benefit of the deferred tax asset is recorded in additional paid-in capital.

RED HAT, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Because tax laws are complex and subject to different interpretations, significant judgment is required. As a result, the Company makes certain estimates and assumptions, in (i) calculating its income tax expense, deferred tax assets and deferred tax liabilities, (ii) determining any valuation allowance recorded against deferred tax assets and (iii) evaluating the amount of unrecognized tax benefits, as well as the interest and penalties related to such uncertain tax positions. The Company s estimates and assumptions may differ significantly from tax benefits ultimately realized.

Foreign Currency Translation

The Euro has been determined to be the primary functional currency for the Company s European operations and local currencies have been determined to be the functional currencies for the Company s Asia Pacific and South American operations.

Foreign exchange gains and losses, which result from the process of remeasuring foreign currency transactions into the appropriate functional currency, are included in other income, net in the Company s Consolidated Statements of Operations. Net foreign exchange losses included in other income were less than $0.1 million for the three months ended May 31, 2009 and $0.5 million for the three months ended May 31, 2008. The impact of changes in foreign currency exchange rates resulting from the translation of foreign currency financial statements into U.S. Dollars for financial reporting purposes is included in other comprehensive income, which is a separate component of stockholders equity. Assets and liabilities are translated into U.S. dollars at exchange rates in effect at the balance sheet date. Income and expense items are translated at average rates for the period.

Significant Customers and Credit Risk

Financial instruments which potentially subject the Company to concentrations of credit risk consist principally of temporary cash, cash equivalents, investments and trade receivables. The Company primarily places its temporary cash, cash equivalents and investments with high-credit quality financial institutions which invest predominantly in U.S. Government instruments, investment grade corporate bonds and certificates of deposit guaranteed by banks which are members of the FDIC. Cash deposits are primarily in financial institutions in the United States. However, cash for monthly operating costs of international operations are deposited in banks outside the United States.

The Company performs credit evaluations to reduce credit risk and generally requires no collateral from its customers. Management estimates the allowance for uncollectible accounts based on their historical experience and credit evaluation. The Company s standard credit terms are net 30 days in the U.S., net 30 to 45 days in EMEA, and range from net 30 to net 60 days in Asia Pacific. One customer accounted for 18% and 12% of the Company s accounts receivable at May 31, 2009 and February 28, 2009, respectively.

For the three months ended May 31, 2009 and May 31, 2008, there were no individually significant customers from which the Company generated revenue.

Net Income Per Common 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 adjusted for interest expense and amortization of debt issuance costs associated with the convertible debentures, by the weighted average number of common shares and dilutive potential common share equivalents then outstanding. Potential common share equivalents consist of shares

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RED HAT, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

issuable upon the exercise of stock options or vesting of share-based awards and convertible securities such as the Company s convertible debentures. Diluted net income per share for the three months ended May 31, 2008, assumes the conversion of the convertible debentures using the if converted method. The Company had no convertible debentures outstanding during the three months ended May 31, 2009.

The following table reconciles the numerators and denominators of the earnings per share calculation for the three months ended May 31, 2009 and May 31, 2008 (in thousands, except per share amounts):

	Three Months Ended	
	May 31, 2009	May 31, 2008
Diluted net income per share computation:		
Net income	$ 18,514	$ 17,290
Interest expense on convertible debt, net of related tax		435
Amortization of debt issuance costs, net of related tax		459
Net income diluted	$ 18,514	$ 18,184
Weighted average common shares outstanding	188,916	190,779
Incremental shares attributable to assumed vesting or exercise of outstanding equity awards	5,466	5,801
Incremental shares attributable to assumed conversion of convertible debentures		22,273
Diluted shares	194,382	218,853
Diluted net income per share	$ 0.10	$ 0.08

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

	Three Months Ended	
	May 31, 2009	May 31, 2008
Number of shares considered anti-dilutive for calculating diluted EPS	9,058	8,103

Segment Reporting

The Company is organized primarily on the basis of three geographic business units: the Americas, EMEA (Europe, Middle East and Africa) and Asia Pacific. These business units are aggregated into one reportable segment due to the similarity in nature of products provided, financial performance economics (e.g., revenue growth and gross margin), methods of distribution (direct and indirect) and customer classification and base (e.g., distributors, resellers and enterprise).

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RED HAT, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

The Company has offices in more than 65 locations around the world. The Company manages its international business on an Americas-wide, EMEA-wide and Asia Pacific-wide basis. The following summarizes revenue, net income (loss) and total assets by geographic segment at and for the three months ended May 31, 2009 and May 31, 2008 (in thousands):

				1,314
Common stock equivalent shares representing shares as-if conversion of preferred shares				294
Weighted average number of shares used in calculation of diluted (loss) income per common share		167,306		84,219
Diluted (loss) earnings per common share	$	(0.12)	$	0.39

The following common stock equivalents were not included in the computation for diluted net (loss) earnings per common share because their effects would be antidilutive:

	Three Months Ended March 31,	
	2007	2006
	(In thousands)	
Common Stock Equivalents:		
Options and stock appreciation rights	887	958
Warrants	18	
	905	958

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PETROHAWK ENERGY CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)

11. ADDITIONAL FINANCIAL STATEMENT INFORMATION

Certain balance sheet amounts are comprised of the following:

	March 31, 2007	December 31, 2006
	(In thousands)	
Accounts receivable:		
Oil and gas sales	$ 104,928	$ 107,003
Joint interest accounts	43,230	37,056
Income taxes receivable	5,570	5,453
Other	1,069	6,070
	$ 154,797	$ 155,582
Accounts payable and accrued liabilities:		
Trade payables	33,808	$ 31,565
Revenues and royalties payable to others	72,707	69,383
Accrued capital costs	87,511	111,252
Accrued interest expense	27,231	40,906
Operator prepayment liability	13,675	5,839
Accrued lease operating expenses	7,468	10,601
Accrued ad valorem taxes payable	2,515	7,086
Accrued employee compensation	2,663	2,649
Other	18,784	16,670
	$ 266,362	$ 295,951

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Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

The following review of operations for the three months ended March 31, 2007 and 2006 should be read in conjunction with our condensed consolidated financial statements and the notes thereto included in this Form 10-Q and with the consolidated financial statements, notes and management s discussion and analysis included in our Form 10-K, as amended, for the year-ended December 31, 2006.

Overview

We are an independent oil and natural gas company engaged in the acquisition, development, production and exploration of oil and natural gas properties located in onshore North America. Our properties are concentrated in East Texas/North Louisiana, onshore Gulf Coast, and in the Permian, Anadarko and Arkoma basins. We have increased our proved reserves and production through acquisitions and the exploitation of acquired properties. In 2006 we acquired approximately 537 billion cubic feet of natural gas equivalent (Bcfe) of proved reserves for approximately $2.2 billion in conjunction with our acquisitions in North Louisiana and our merger with KCS Energy, Inc. (KCS). In addition, we sold an estimated 80 Bcfe of proved reserves for approximately $200 million.

In the first three months of 2007, we produced 29.0 Bcfe compared to production of 12.2 Bcfe for the comparable period of the prior year. Natural gas production was 24.5 billion cubic feet (Bcf) and oil production was 748 thousand barrels of oil (Mbbls) for the first three months of 2007. Natural gas equivalent production increased 16.8 Bcfe from the same period in 2006. This increase was primarily attributable to the completion of our merger with KCS in July 2006, the completion of certain acquisitions in North Louisiana, which we refer to collectively as the North Louisiana Acquisitions, in January of 2006, as well as our continued drilling success. We drilled 81 wells during the first three months of 2007, 75 of which were successful for a success rate of 93%. We reported oil and gas revenues for the three months ended March 31, 2007 of $209.2 million. This represents an increase of $106.2 million as compared to the prior year. The increase in our production and oil and natural gas revenues was principally through acquisitions complemented by our continued drilling success.

Our financial results depend upon many factors, particularly the price of oil and natural gas and our ability to market our production. Commodity prices are affected by changes in market demands, which are impacted by overall economic activity, weather, pipeline capacity constraints, inventory storage levels, basis differentials and other factors. As a result, we cannot accurately predict future oil and natural gas prices, and therefore, we cannot determine the effect increases or decreases in future prices will have on our capital program, production volumes and future revenues. Finding and developing oil and natural gas reserves at economical costs are also critical to our long-term success.

Capital Resources and Liquidity

Our primary sources of cash for the three months ended March 31, 2007 and 2006 were from operating and financing activities. Proceeds from the issuance of long-term debt and cash received from operations were offset by cash used in investing activities to fund our drilling program and complete our acquisition activities, net of any divestiture activities. Operating cash flow fluctuations were substantially driven by changes in commodity prices and changes in our production volumes. Prices for oil and natural gas have historically been subject to seasonal influences characterized by peak demand and higher prices in the winter heating season; however, the impact of other risks and uncertainties have influenced prices throughout recent years. Working capital was substantially influenced by these variables. Fluctuation in cash flow may result in an increase or decrease in our capital and exploration expenditures. See *Results of Operations* below for a review of the impact of prices and volumes on sales.

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Net decrease in cash is summarized as follows:

	Three Months Ended March 31, 2007	2006
	(In thousands)	
Cash flows provided by operating activities	$ 135,272	$ 53,921
Cash flows used in investing activities	(226,332)	(239,998)
Cash flows provided by financing activities	91,411	176,808
Net increase (decrease) in cash	$ 351	$ (9,269)

Operating Activities. Net cash provided by operating activities for the three months ended March 31, 2007 and 2006 were $135.3 million and $53.9 million, respectively. Net cash flows provided by operating activities increased in 2007 primarily due to our 137.2% increase in production volumes as a result of our recent acquisition activities as well as our continued drilling success. Also contributing to this increase was our continued success in reducing our operating costs on a per unit basis. These reductions in operating costs were partially offset by a 14.2% decrease in our realized natural gas equivalent price compared to the same period in the prior year. We expect 2007 production to increase, but we are unable to predict future commodity prices. As a result, we cannot provide any assurance about future levels of net cash provided by operating activities.

Investing Activities. The primary driver of cash used in investing activities is capital spending, inclusive of acquisitions and net of dispositions. Cash used in investing activities was $226.3 million and $240.0 million for the three months ended March 31, 2007 and 2006, respectively.

During the first quarter of 2007, we spent $224.5 million on capital expenditures in conjunction with our drilling program. We participated in the drilling of 81 wells in 2007, of which six were dry holes, for a success rate of 93%. In 2006, we spent $51.3 million on capital expenditures in conjunction with our participation in the drilling of 66 wells.

During the first quarter of 2006, we completed the acquisition of Winwell for $208 million in cash after closing adjustments, as well as the acquisition of certain oil and gas properties for $86 million in cash after closing adjustments. In conjunction with these acquisitions, we deposited a total of $22.5 million in earnest money that was included in other non-current assets at December 31, 2005 and applied to the overall purchase price in January of 2006.

We closed the previously announced $52.5 million divestment of substantially all of our properties in the Gulf of Mexico on March 21, 2006. The net proceeds received in this transaction were used to pay down a portion of our debt facilities.

During the second quarter of 2007, we increased our capital budget to $600 million from $575 million to fund additional drilling in the Fayetteville Shale as well as additional offsets to recent Gulf Coast discoveries. Higher revenues from increased production supported by our current view of commodity prices are expected to fund the incremental capital spending. We establish the budget for these amounts based on our current estimate of future commodity prices. Due to the volatility of commodity prices, our budget may be periodically adjusted.

Financing Activities. Net cash flows provided by financing activities were $91.4 million and $176.8 million for the three months ended March 31, 2007 and 2006, respectively. Cash flows provided by financing activities in 2007 were the result of increased borrowings, primarily to fund our drilling activities.

In connection with the North Louisiana Acquisitions, on February 1, 2006, we issued and sold 13 million shares of our common stock for $14.50 per share, for an aggregate offering amount of approximately $188.5

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million. Additionally, we repurchased approximately 3.3 million shares of common stock for $46.2 million from EnCap Investments, L.P. and certain of its affiliates. We incurred a total of $10.3 million of offering costs during the three months ended March 31, 2006.

We strive to maintain excess availability under our debt facilities. Excess cash flow and non-core asset sales are used to repay debt to the extent available. During the first three months of 2007, we had net borrowings of $87.6 million primarily due to the cash requirements of our drilling program. During the first three months of 2006, we had net borrowings of $50 million primarily due to the funding requirements to close the North Louisiana Acquisitions. At March 31, 2007, the borrowing base under our senior revolving credit facility was $710 million. The Company and the lenders completed a redetermination on May 8, 2007 and the borrowing base was increased to $750 million. Also, on May 8, 2007 the Company entered into an amendment to its senior revolving credit facility that would permit it to refinance the 2012 Notes.

Financing activities in 2007 and 2006 included $2.4 million of cash received and $4.5 million of cash paid on settled derivative contracts that were acquired in conjunction with our acquisition activities.

During the first three months of 2006, we paid our previously accrued fourth quarter of 2005 dividends of $0.1 million on our 8% cumulative convertible preferred stock.

Contractual Obligations

We have no material long-term commitments associated with our capital expenditure plans or operating agreements. Consequently, we believe we have a significant degree of flexibility to adjust the level of such expenditures as circumstances warrant. Our level of capital expenditures will vary in future periods depending on the success we experience in our acquisition, developmental and exploration activities, oil and natural gas price conditions and other related economic factors. Currently no sources of liquidity or financing are provided by off-balance sheet arrangements or transactions with unconsolidated, limited-purpose entities.

During the three months ended March 31, 2007, drilling rig commitments increased by $8.3 million from the $78.9 million figure reported in our Form 10-K, as amended, for the year ended December 31, 2006. This increase was due to a new three year long-term rig commitment that we plan to utilize in North Louisiana.

Critical Accounting Policies and Estimates

Our discussion and analysis of our financial condition and results of operation are based upon the condensed consolidated financial statements, which have been prepared in accordance with accounting principals generally accepted in the United States of America. Preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses. There have been no changes to our critical accounting policies from those described in the 2006 Form 10-K, as amended.

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Results of Operations

Quarters ended March 31, 2007 and 2006

We reported a net loss of $19.4 million for the three months ended March 31, 2007 compared to net income of $32.9 million for the comparable period in 2006. The decrease in net income of $52.4 million from the three months ended March 31, 2006, was primarily driven by the decrease in oil and gas prices which resulted in a net decrease of $83.7 million on derivative contracts and a decrease in our averages equivalent sales price of $1.19 per Mcfe. These decreases were offset by an increase in sales volumes of 16.8 Bcfe due to our acquisitions and successful drilling.

In thousands (except per unit and per Mcfe amounts)	Three Months Ended March 31, 2007	Three Months Ended March 31, 2006	Increase (Decrease)
Net (loss) income	$ (19,415)	$ 32,939	$ (52,354)
Oil and gas sales	209,243	103,006	106,237
Expenses:			
Production:			
Lease operating	15,876	11,549	4,327
Workover and other	2,177	719	1,458
Taxes other than income	13,650	8,298	5,352
Gathering, transportation and other	7,424	1,872	5,552
General and administrative:			
General and administrative	12,713	6,044	6,669
Stock-based compensation	2,888	644	2,244
Depletion, depreciation and amortization:			
Depletion Full cost	94,700	36,751	57,949
Depreciation Other	694	261	433
Accretion expense	444	438	6
Net (loss) gain on derivative contracts	(58,933)	24,803	(83,736)
Interest expense and other	(30,750)	(9,072)	(21,678)
Income tax benefit (provision)	11,591	(19,222)	30,813
Production:			
Natural Gas Mmcf	24,526	8,658	15,868
Crude Oil Mbbl	748	596	152
Natural Gas Equivalent Mmcfe	29,014	12,234	16,780
Average Daily Production Mmcfe	322	136	186
Average price per unit(1):			
Gas price per Mcf	$ 6.82	$ 7.75	$ (0.93)
Oil price per Bbl	56.11	59.90	(3.79)
Equivalent per Mcfe	7.21	8.40	(1.19)
Average cost per Mcfe:			
Production:			
Lease operating	0.55	0.94	(0.39)
Workover and other	0.08	0.06	0.02
Taxes other than income	0.47	0.68	(0.21)
Gathering, transportation and other	0.26	0.15	0.11
General and administrative:			
General and administrative	0.44	0.49	(0.05)
Stock-based compensation	0.10	0.05	0.05
Depletion	3.26	3.00	0.26

(1) *Amounts exclude the impact of cash paid on settled contracts.*

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For the three months ended March 31, 2007, oil and natural gas sales increased $106.2 million, from the same period in 2006, to $209.2 million. The increase was primarily due to the increase in production of 16,780 Mmcfe, of which 16,038 Mmcfe related to our merger with KCS. The remaining increase in volumes was due to the inclusion of a full three months of production for of the North Louisiana Acquisitions as well as our successful drilling program. Increased production led to a $141 million increase in revenues from the three months ended March 31, 2006. This was partially offset by certain divestitures made in 2006, which are discussed in Note 2, *Acquisitions and Divestitures* within Item 1. *Condensed Consolidated Financial Statements*. Our realized average price per Mcfe decreased $1.19 in 2007 to $7.21.

Lease operating expenses increased $4.3 million for the three months ended March 31, 2007. The increase was primarily due to an increase in production volumes as a result of our acquisition activities, as well as our successful drilling activities in 2007. We drilled 81 gross wells during the three months ended March 31, 2007 compared to 66 gross wells in 2006. On a per unit basis, lease operating expenses decreased from $0.94 per Mcfe in 2006 to $0.55 per Mcfe in 2007. The decrease on a per unit basis is primarily due to our continued cost control efforts. We continue to identify divestment prospects which tend to be outlying, higher operating cost properties as evident by the transactions that closed during the fourth quarter of 2006. Also contributing to the decrease on a per unit basis was our acquisition of lower cost properties in conjunction with our merger with KCS and properties acquired in the North Louisiana Acquisitions.

Taxes other than income increased $5.4 million for the three months ended March 31, 2007 as compared to the same period in 2006. The largest components of taxes other than income are production and severance taxes which are generally assessed as a percentage of gross oil and natural gas sales. On a per unit basis, taxes other than income decreased $0.21 per Mcfe to $0.47 in 2007 as compared to $0.68 in 2006. As a percentage of oil and gas sales, taxes other than income decreased 1% to 7% in 2007 from 8% in 2006.

Gathering, transportation and other expense increased $5.6 million for the three months ended March 31, 2007 as compared to the same period in 2006. This increase was due to our recent acquisition activities including the completion of our merger with KCS as well as the North Louisiana Acquisitions.

General and administrative expense for the three months ended March 31, 2007 increased $6.7 million to $12.7 million compared to $6.0 million in the same period in 2006. This increase was due to our continued growth over the past two years. In 2006, we completed the North Louisiana Acquisitions as well as our merger with KCS which increased compensation and other costs associated with increased staffing levels to meet the demands of our expanding operations. General and administrative expense has decreased on a per Mcfe basis from $0.49 per Mcfe in 2006 to $0.44 per Mcfe in 2007 as production increases have exceeded our administrative expense increases. Operating in concentrated areas helps us better control our overhead by enabling us to manage a greater amount of acreage with fewer employees and minimize incremental costs of increased drilling and production.

Stock-based compensation increased $2.2 million for the three months ended March 31, 2007 as compared to the same period in the prior year. This increase was primarily related to additional stock options and restricted stock grants assumed as part of our merger with KCS in July 2006, as well as stock appreciation rights and restricted stock grants to employees during the first quarter of 2007 and a full quarter of amortization for those grants that were issued during 2006.

Depletion expense increased $57.9 million for the three months ended March 31, 2007 from the same period in 2006 to $94.7 million. Depletion for oil and natural gas properties is calculated using the unit of production method, which essentially depletes the capitalized costs associated with the evaluated properties plus future development costs based on the ratio of production volume for the current period to total remaining reserve volume for the evaluated properties. On a per unit basis, depletion expense increased $0.26 per Mcfe to $3.26 from $3.00 per Mcfe. This increase was due to our merger with KCS in July 2006 and the North Louisiana Acquisitions in January 2006 which substantially increased our future development costs.

We enter into derivative commodity instruments to hedge our exposure to price fluctuations on our anticipated oil and natural gas production. Consistent with the prior year, we have elected not to designate any positions as cash flow hedges for accounting purposes, and accordingly, we recorded the net change in the mark-to-market valuation of these derivative contracts in the consolidated statement of operations. At March 31, 2007, the Company had a $13.6 million derivative asset, $11.9 million of which was classified as current, and a $33.2 million derivative liability, $19.3 million of which was classified as current. The Company recorded a net derivative loss of $58.9 million ($74.9 million unrealized loss net of $16.0 gain for cash received on settled contracts) for the three months ended March 31, 2007 compared to a net derivative gain of $24.8 million in the prior year. The net derivative loss for three months ended March 31, 2007 was due to the change in the fair value of derivative instruments from December 31, 2006.

Interest expense and other increased $21.7 million for the three months ended March 31, 2007 compared to the same period in 2006. This increase was due to additional debt we incurred in conjunction with our merger with KCS in July 2006 and, to a lesser extent, the North Louisiana Acquisitions in January 2006.

Income tax expense for the three months ended March 31, 2007 decreased $30.8 million from the prior year. The decrease in income tax expense from prior year was primarily due to our pre-tax loss of $31.0 million for the three months ended March 31, 2007 compared to pre-tax income of $52.2 million in 2006. The effective tax rates for the three months ended March 31, 2007 and 2006 were 37.4% and 36.9%, respectively. The increase in our effective tax rate was primarily due to changes in state apportionment percentages due to the merger of KCS properties with historical Petrohawk properties. Also adding to this increase was an increase in our effective tax rate for the recognition of a change in the Texas state franchise tax rate due to a change in the tax law. In May 2006, the State of Texas enacted substantial changes to its tax structure beginning in 2007 by imposing a new tax based upon modified gross revenue referred to as the Margin Tax. We determined the Margin Tax to be an income tax as defined under Statement of Financial Accounting Standards No. 109, *Accounting for Income Taxes.*

Recently Issued Accounting Pronouncements

We discuss recently adopted and issued accounting standards in Item 1. *Condensed Consolidated Financial Statements* Note 1, *Financial Statement Presentation*.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Derivative Instruments and Hedging Activity

We are exposed to various risks including energy commodity price risk. We expect energy prices to remain volatile and unpredictable. If energy prices were to decline significantly, revenues and cash flow would significantly decline, and our ability to borrow to finance our operations could be adversely impacted. We have designed our hedging policy to reduce the risk of price volatility for our production in the natural gas and crude oil markets. Our risk management policy provides for the use of derivative instruments to manage these risks. The types of derivative instruments that we utilize include futures, swaps and options. The volume of derivative instruments that we may utilize is governed by the risk management policy and can vary from year to year, but under most circumstances will apply to only a portion of our current and anticipated production and provide only partial price protection against declines in oil and natural gas prices. We are exposed to market risk on our open contracts, to the extent of changes in market prices of oil and natural gas. However, the market risk exposure on these hedged contracts is generally offset by the gain or loss recognized upon the ultimate sale of the commodity that is hedged. Further, if our counterparties defaulted, this protection might be limited as we might not receive the benefits of the hedges. Please refer to Item 1. *Condensed Consolidated Financial Statements* Note 7, *Derivative Activities* for additional information.

Interest Sensitivity

We are also exposed to market risk related to adverse changes in interest rates. Our interest rate risk exposure results primarily from fluctuations in short-term rates, which are LIBOR and ABR based and may result in reductions of earnings or cash flows due to increases in the interest rates we pay on these obligations.

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At March 31, 2007, total debt excluding related discounts and premiums was $1.4 billion, of which approximately 73.2%, or $1.0 billion, bears interest at a weighted average fixed interest rate of 8.6% per year. The remaining 26.8% of our total debt balance at March 31, 2007, or $384.0 million, bears interest at floating or market interest rates that at our option are tied to the prime interest rate or LIBOR. Fluctuations in market interest rates will cause our annual interest costs to fluctuate. At March 31, 2007, the interest rate on our variable rate debt was 6.9% per year. If the balance of our bank debt at March 31, 2007 were to remain constant, a 10% change in market interest rates would impact our cash flow by approximately $0.7 million per quarter.

Item 4. Controls and Procedures

In accordance with Exchange Act Rule 13a-15 and 15d-15, we carried out an evaluation, under the supervision and with the participation of management, including our Chief Executive Officer and our Chief Financial Officer, of the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of March 31, 2007 to provide reasonable assurance that information required to be disclosed in our reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission s rules and forms. Our disclosure controls and procedures include controls and procedures designed to ensure that information required to be disclosed in reports filed or submitted under the Exchange Act is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

There were no changes in the Company s internal control over financial reporting that occurred during the most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, the Company s internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

A description of our legal proceedings is included in Item 1. *Condensed Consolidated Financial Statements* Note *6, Commitments and Contingencies,* and is incorporated herein by reference.

Item 1A. Risk Factors

There have been no changes to the Company s identified risk factors from those described in the 2006 Form 10-K, as amended.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

None.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Submission of Matters to a Vote of Security Holders

None.

Item 5. Other Information

None.

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Item 6. Exhibits

The following documents are included as exhibits to this Form 10-Q. Those exhibits incorporated by reference are so indicated by the information supplied with respect thereto. Those exhibits which are not incorporated by reference are attached hereto.

Exhibit No	Description
2.1	Agreement and Plan of Merger, dated April 3, 2005 (and as amended through June 8, 2005), by and among Petrohawk Energy Corporation, Petrohawk Acquisition Corporation, and Mission Resources Corporation (Incorporated by reference to Annex A of our Registration Statement on Form S-4/A filed on June 22, 2005).
2.2	Agreement and Plan of Merger, dated October 13, 2004, among Petrohawk Energy Corporation, Wynn-Crosby Energy, Inc., Ronald W. Crosby and Paige L. Crosby (Incorporated by reference to Exhibit 2.1 of our Current Report on Form 8-K filed on November 24, 2004).
2.3	Agreement and Plan of Mergers, dated October 13, 2004, among Petrohawk Energy Corporation, Wynn-Crosby Energy, Inc., Wynn-Crosby 1994, Ltd.; Wynn-Crosby 1995, Ltd.; Wynn-Crosby 1996, Ltd.; Wynn-Crosby 1997, Ltd.; Wynn-Crosby 1998, Ltd.; Wynn-Crosby 1999, Ltd.; Wynn-Crosby 2000, Ltd.; Wynn-Crosby 2002, Ltd.; WCOG Properties, Ltd.; Kara Nicole Limited; Kristen Lee Limited; Eric Wynn Limited; Christopher David Limited; Paige Lee Limited; Bernadien Wynn Limited; Roger Lee Limited; and George Heaps Limited, and Ronald W. Crosby (Incorporated by reference to Exhibit 2.2 of our Current Report on Form 8-K filed on November 24, 2004).
2.4	Amendment to Agreement and Plan of Mergers among Petrohawk Energy Corporation, Wynn-Crosby Energy, Inc., Wynn-Crosby 1994, Ltd.; Wynn-Crosby 1995, Ltd.; Wynn-Crosby 1996, Ltd.; Wynn-Crosby 1997, Ltd.; Wynn-Crosby 1998, Ltd.; Wynn-Crosby 1999, Ltd.; Wynn-Crosby 2000, Ltd.; Wynn-Crosby 2002, Ltd.; WCOG Properties, Ltd.; Kara Nicole Limited; Kristen Lee Limited; Eric Wynn Limited; Christopher David Limited; Paige Lee Limited; Bernadien Wynn Limited; Roger Lee Limited; and George Heaps Limited, and Ronald W. Crosby, dated October 26, 2004 (Incorporated by reference to Exhibit 2.3 of our Current Report on Form 8-K filed on November 24, 2004).
2.5	Stock Purchase Agreement among Winwell Resources, Inc. and all of its Shareholders, as Sellers, and Petrohawk Energy Corporation, as Buyer, dated as of December 14, 2005 (Incorporated by reference to Exhibit 2.1 of our Current Report on Form 8-K filed December 20, 2005).
2.6	Asset Purchase Agreement among Redley Company, Burris Run Company and Red Clay Minerals, collectively as Seller, and Petrohawk Energy Corporation, as Buyer, dated as of December 14, 2005 (Incorporated by reference to Exhibit 2.2 of our Current Report on Form 8-K filed December 20, 2005).
2.7	First Amendment to Asset Purchase Agreement among Redley Company, Burris Run Company and Red Clay Minerals, collectively as Seller, and Petrohawk Energy Corporation, as Buyer, effective as of December 14, 2005 (Incorporated by reference to Exhibit 2.7 to our Annual Report on Form 10-K filed March 14, 2006).
2.8	Assignment Agreement between Petrohawk Properties, L.P. and Petrohawk Energy Corporation effective January 27, 2006 (Incorporated by reference to Exhibit 2.8 to our Annual Report on Form 10-K filed March 14, 2006).
2.9	Purchase and Sale Agreement executed January 14, 2005, by and between Wynn-Crosby 1994, Ltd., et al and Noble Royalties, Inc. d/b/a Brown Drake Royalties (Incorporated by reference to Exhibit 2.1 to our Current Report on Form 8-K filed on March 3, 2005).
2.10	Amendment to Purchase and Sale Agreement executed on February 15, 2005, by and between Wynn-Crosby 1994, Ltd., et al and Noble Royalty, Inc. d/b/a Brown Drake Royalties (Incorporated by reference to Exhibit 2.2 to our Current Report on Form 8-K filed on March 3, 2005).

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Exhibit No	Description
2.11	Stock Purchase Agreement dated February 4, 2005 by and among Petrohawk Energy Corporation and Proton Oil & Gas Corporation, et al (Incorporated by reference to Exhibit 2.3 to our Current Report on Form 8-K filed on March 3, 2005).
2.12	Purchase and Sale Agreement between Petrohawk Energy Corporation and Petrohawk Properties, LP, together, as Seller, and Northstar GOM, LLC, as Buyer, dated February 3, 2006 (Incorporated by reference to Exhibit 2.1 to our Current Report on Form 8-K filed February 9, 2006).
2.13	Amended and Restated Agreement and Plan of Merger executed as of May 16, 2006, and effective as of April 20, 2006 by and among KCS Energy, Inc., Petrohawk Energy Corporation and Hawk Nest Corporation (Incorporated by reference to Exhibit 2.1 of our Current Report on Form 8-K filed May 18, 2006).
3.1	Certificate of Incorporation for Petrohawk Energy Corporation (Incorporated by reference to Exhibit 3.1 to our Form S-8 filed on July 29, 2004).
3.2	Certificate of Amendment to Certificate of Incorporation for Petrohawk Energy Corporation (Incorporated by reference to Exhibit 3.1 of our Current Report on Form 8-K filed on November 24, 2004).
3.3	Certificate of Amendment of Certificate of Incorporation of Petrohawk Energy Corporation (Incorporated by reference to Exhibit 3.1 of our Current Report on Form 8-K filed on August 3, 2005).
3.4	Amended and Restated Bylaws of Petrohawk Energy Corporation effective as of July 12, 2006 (Incorporated by reference to Exhibit 3.2 of our Current Report on Form 8-K filed on July 17, 2006)
3.5	Certificate of Amendment to Certificate of Incorporation of Petrohawk Energy Corporation (Incorporated by reference to Exhibit 3.1 of our Current Report on Form 8-K filed on July 17, 2006).
4.1	Indenture dated as of April 8, 2004, among Mission Resources Corporation, the Guarantors named therein and The Bank of New York, as Trustee, relating to Petrohawk Energy Corporation s 9 7/8% Senior Notes due 2011 (Incorporated by reference to Exhibit 4.1 to Mission Resources Corporation s Current Report on Form 8-K/A filed on April 15, 2004).
4.2	First Supplemental Indenture dated as of July 28, 2005, among Petrohawk Energy Corporation, the successor by way of merger to Mission Resources Corporation, the parties named therein as Existing Subsidiary Guarantors, the parties named therein as Additional Subsidiary Guarantors, and The Bank of New York Trust Company, N.A., as successor trustee to The Bank of New York (Incorporated by reference to Exhibit 4.2 to our Current Report on Form 8-K filed on August 3, 2005).
4.3	Second Supplemental Indenture dated as of July 12, 2006, among Petrohawk Energy Corporation, as successor by merger to Mission Resources Corporation, the parties named therein as subsidiary guarantors, and The Bank of New York Trust Company, N.A., as trustee (Incorporated by reference to Exhibit 4.2 of our Current Report on Form 8-K filed on July 17, 2006).
4.4	Indenture dated April 1, 2004 among KCS Energy, Inc., U.S. Bank National Association, as trustee, and the subsidiary guarantors named therein, relating to KCS Energy, Inc. s 7 1/8% senior notes due 2012 (Incorporated by reference to Exhibit 4.1 to KCS Energy, Inc. s Quarterly Report on Form 10-Q filed n May 10, 2004).
4.5	First Supplemental Indenture, dated as of April 8, 2005, to Indenture dated as of April 1, 2004, among KCS Energy, Inc., certain of its subsidiaries and U.S. Bank National Association (Incorporated by reference to Exhibit 4.1 of KCS Energy, Inc. s Form 8-K filed on April 11, 2005).

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Exhibit No	Description
4.6	Second Supplemental Indenture dated July 12, 2006 among Petrohawk Energy Corporation, the successor by way of merger to KCS Energy, Inc., the parties named therein as guarantors, and U.S. Bank National Association, as trustee (Incorporated by reference to Exhibit 4.4 to our Current Report on Form 8-K filed July 17, 2006).
4.7	Third Supplemental Indenture dated as of July 12, 2006 among Petrohawk Energy Corporation, the successor by way of merger to KCS Energy, Inc., the parties named therein as existing guarantors, the parties named therein as new guarantors, and U.S. Bank National Association, as trustee (Incorporated by reference to Exhibit 4.5 to our Current Report on Form 8-K filed July 17, 2006).
4.8	Indenture dated July 12, 2006 among Petrohawk Energy Corporation, U.S. Bank National Association, as trustee, and the subsidiary guarantors named therein, relating to Petrohawk Energy Corporation s 9 1/8% senior notes due 2013 (Incorporated by reference to Exhibit 4.6 to our Current Report on Form 8-K filed July 17, 2006).
4.9	First Supplemental Indenture dated July 12, 2006 among Petrohawk Energy Corporation, U.S. Bank National Association, as trustee, and the subsidiary guarantors named therein (Incorporated by reference to Exhibit 4.7 to our Current Report on Form 8-K filed July 17, 2006).
10.1*	The Petrohawk Energy Corporation Third Amended and Restated 2004 Employee Incentive Plan
10.2*	Amendment No. 3 to the KCS Energy, Inc. 2005 Employee and Directors Stock Plan
10.3*	Form of Stock Appreciation Rights Agreement Annual Vesting Awards under the Petrohawk Energy Corporation Third Amended and Restated 2004 Employee Incentive Plan
10.4*	Form of Restricted Stock Award Certificate under the KCS Energy, Inc. 2005 Employee and Directors Stock Plan
10.5*	Form of Restricted Stock Award Agreement pursuant to the KCS Energy, Inc. 2005 Employee and Directors Stock Plan
10.6*	Form of Stock Appreciation Rights Agreement Annual Vesting Awards under the KCS Energy, Inc. 2005 Employee and Directors Stock Plan
12.1*	Computation of Ratio of Earnings to Combined Fixed Charges and Preference Dividends
31.1*	Certificate of Chief Executive Officer under Section 302 of the Sarbanes-Oxley Act of 2002
31.2*	Certificate of Chief Financial Officer under Section 302 of Sarbanes-Oxley Act of 2002
32.1*	Certificate of Chief Executive Officer and Chief Financial Officer under Section 906 of the Sarbanes-Oxley Act of 2002

* Attached hereto.

The registrant has not filed with this report copies of the instruments defining rights of all holders of long-term debt of the registrant and its consolidated subsidiaries based upon the exception set forth in Item 601 (b)(4)(iii)(A) of Regulation S-K. Copies of such instruments will be furnished to the Securities and Exchange Commission upon request.

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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.

PETROHAWK ENERGY CORPORATION

Date: May 9, 2007	By:	/s/ FLOYD C. WILSON **Floyd C. Wilson** **Chairman of the Board, President and Chief Executive Officer**
	By:	/s/ SHANE M. BAYLESS **Shane M. Bayless** **Executive Vice President, Chief Financial Officer and Treasurer**
	By:	/s/ MARK J. MIZE **Mark J. Mize** **Vice President, Chief Accounting Officer and Controller**

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