

RED HAT INC
Form 10-K
April 26, 2017
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the fiscal year ended February 28, 2017

OR

Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the transition period from to .

Commission File Number: 001-33162

RED HAT, INC.

(Exact name of registrant as specified in its charter)

Delaware

(State of Incorporation)

06-1364380

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

100 East Davie Street, Raleigh, North Carolina 27601

(Address of principal executive offices, including zip code)

(919) 754-3700

(Registrant's telephone number, including area code)

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

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

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

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

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

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

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

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

The aggregate market value of the common equity held by non-affiliates of the registrant as of August 31, 2016 was approximately \$11.1 billion based on the closing price of \$72.98 of our common stock as reported by the New York Stock Exchange on August 31, 2016. For purposes of the immediately preceding sentence, the term affiliate consists of each director, executive officer and greater than 10% stockholder of the registrant. There were 177,776,853 shares of common stock outstanding as of April 19, 2017.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of Red Hat, Inc.'s Definitive Proxy Statement to be filed with the Securities and Exchange Commission and delivered to stockholders in connection with its annual meeting of stockholders to be held on August 10, 2017 are incorporated by reference into Part III of this Form 10-K. With the exception of the portions of the Proxy Statement expressly incorporated into this Annual Report on Form 10-K by reference, such document shall not be deemed filed as part of this Annual Report on Form 10-K.

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CAUTIONARY NOTE ON FORWARD-LOOKING STATEMENTS

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

ITEM 1. BUSINESS

OVERVIEW

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

Our business model

Development. We employ an open source development model. The open source development model allows us to use the collective input, resources and knowledge of a global community of contributors who can collaborate to develop, maintain and enhance software because the human-readable source code for that software is publicly available and licenses permit modification.

Licensing. We typically distribute our software offerings under open source licenses that permit access to the software's human-readable source code.

Subscriptions. We provide our software offerings primarily under annual or multi-year subscriptions as well as on-demand through our certified cloud and service providers (CCSPs).

Our offerings

Our offerings are designed to provide customers with high-performing, scalable, flexible, reliable and secure infrastructure technologies that meet the information technology (IT) needs of enterprises and service providers. Our offerings enable our customers to optimize their IT environments to increase agility and flexibility

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while adding and managing hybrid cloud infrastructures and building modern applications. Hybrid cloud infrastructures enable customers to deploy their applications using off-premise (public cloud) and on-premise (private cloud, virtual or physical server) IT resources to create a hybrid cloud environment that is designed to enhance efficiency while providing increased security. Our offerings are designed to perform consistently across hybrid cloud environments to offer greater choices to our customers when deploying their applications.

Our offerings include:

Infrastructure-related Offerings

Red Hat Enterprise Linux an operating system platform that runs applications on a broad range of hardware and is used in hybrid cloud environments.

Red Hat Satellite a system management offering that is designed to make Red Hat infrastructure easier to deploy, scale and manage across hybrid cloud environments.

Red Hat Enterprise Virtualization software that allows customers to utilize and manage a common hardware infrastructure to run multiple operating systems and applications.

Application Development-related and Other Emerging Technology Offerings

Red Hat JBoss Middleware a suite of offerings used to develop, deploy and manage applications; integrate applications, data and devices; and automate business processes across hybrid cloud environments.

Red Hat cloud offerings software that enables customers to build and manage various cloud computing environments (virtualized and container-based), including Red Hat OpenStack Platform, Red Hat Cloud Infrastructure, Red Hat OpenShift, Red Hat CloudForms and Ansible Tower.

Red Hat Mobile Application Platform a software development platform that enables customers to develop, integrate, deploy and manage mobile applications for the enterprise.

Red Hat Storage software that enables customers to manage large, unstructured or semi-structured data at large scale using commodity hardware in hybrid cloud environments.

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

Red Hat, Inc. was incorporated in Connecticut in March 1993 as ACC Corp., Inc., which subsequently changed its name to Red Hat Software, Inc. Red Hat Software, Inc. reincorporated in Delaware in September 1998 and changed its name to Red Hat, Inc. in June 1999. Except as otherwise indicated, all references in this report to we, us, our, the Company, the registrant or Red Hat refer to Red Hat, Inc. and its subsidiaries. Our fiscal year ends on the last day of February, and we identify our fiscal years by the calendar years in which they end. For example, we refer to the fiscal year ended February 28, 2017 as fiscal 2017.

OUR BUSINESS

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

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Development and licensing of Red Hat's open source offerings

The open source software development model allows us to use the collective input, resources and knowledge of a global community of contributors who collaborate to develop, maintain and enhance software. We believe this model offers advantages to Red Hat because we are able to develop our offerings by integrating information and knowledge from this global community. We develop our offerings by working with open source development communities, often in a leadership role. Red Hat sponsors a number of open source communities, including the CentOS project, the Ceph community project, the Fedora Project, GlusterFS, the JBoss community projects and OpenShift Origin. We are also an active contributor in other communities such as Apache Camel, the Cloud Native Computing Foundation, Kubernetes, the Linux kernel, the Open Container Initiative, the OpenDaylight Project, Open Platform for NFV and OpenStack. Our role helps us to benefit from the efforts of these communities, which we believe enhances acceptance and support of our offerings and technologies. Additionally, the open and transparent nature of these communities provides our customers and potential customers, who may also be part of these open source communities, with access and insights into, and the ability to influence, the future direction of our offerings.

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

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

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

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

enabling a customer's in-house development team to collaborate and innovate with a global community of independent developers and testers;

providing a customer's in-house development team access to both binary and source code, and broader rights to copy, modify and redistribute the software;

offering a customer greater flexibility through open rather than proprietary protocols and formats;

enabling ongoing, quicker access to improvements and fixes; and

allowing a customer to inspect and help diagnose problems more easily and customize the software to suit its particular needs.

Subscription business model

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We provide our software offerings to our customers primarily under annual or multi-year subscriptions as well as on-demand through CCSPs. Our subscription business model is designed to provide customers with a

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comprehensive technology solution for the duration of their subscription. A subscription generally entitles a customer to, among other things, a specified level of support, as well as security updates, fixes, functionality enhancements, upgrades to the technologies, each if and when available, and compatibility with an ecosystem of certified hardware and software. A subscription also includes access to the Red Hat Customer Portal, which provides customers with services such as our knowledge base, product usage documentation and account management tools. We offer customers subscription options that provide varying levels of customer support. In addition, our customers are eligible to participate in Red Hat's Open Source Assurance program, which provides certain protections in the event of an intellectual property infringement claim based on our offerings.

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

Distribution of Red Hat offerings

We make Red Hat offerings available directly to customers and indirectly through various channels of distribution. Our direct sales channels include our sales force and our web store. Our indirect sales channels include CCSPs (such as public cloud providers and managed service providers), distributors, embedded technology partners, independent software vendors (ISVs), systems integrators (SIs) and value added resellers (VARs). In addition, hardware original equipment manufacturers (OEMs) pre-load and support Red Hat offerings on their hardware products and sell their hardware together with Red Hat offerings as part of pre-configured solutions.

With the support and tools we make available, many of these companies have engineered and certified that their technologies run on or with Red Hat offerings, and, in some cases, independent hardware vendors (IHVs) and ISVs have built their products and solutions using our offerings. Our offerings can also be used on an on-demand basis through our CCSPs, allowing our customers to utilize their subscriptions with increased flexibility. We believe widespread support from these companies helps to increase the level of market acceptance and adoption of our offerings.

Support by leading technology providers

To facilitate the widespread deployment of Red Hat offerings, we have focused on gaining broad support for our offerings from technology providers that are critical to enterprises. For example, leading ISVs with applications that run on, or with, our technologies include BMC Software, Inc. (BMC), CA, Inc. (CA), Cerner Corporation (Cerner), EMC Corporation (EMC), Hewlett Packard Enterprise Company (HPE), International Business Machines Corporation (IBM), Microsoft Corporation (Microsoft), Oracle Corporation (Oracle), SAP SE (SAP), SAS Institute Inc. (SAS), Symantec Corporation (Symantec) and VMware, Inc. (VMware). In addition, we have certification and pre-load arrangements with leading hardware vendors including Cisco Systems, Inc. (Cisco), Dell Inc. (Dell), Fujitsu Limited (Fujitsu), HPE, Hitachi, Ltd (Hitachi), IBM, Lenovo Group Limited (Lenovo), and NEC Corporation (NEC). We also have certification agreements with leading networking, storage and telecommunication companies including Big Switch Networks, Inc., Cisco, EMC, Ericsson Inc., F5 Networks, Inc., HPE, Huawei Technologies Co., Ltd., Juniper Networks, Inc., NetApp, Inc. (NetApp) and Nokia Corporation. We have strategic relationships with leading semiconductor and technology companies, such as Advanced Micro Devices, Inc., ARM Holdings plc, Dell, Intel Corporation and IBM, and CCSPs, such as Amazon.com, Inc. (Amazon), Fujitsu, Google Inc. (Google), IBM, Microsoft and Rackspace Hosting, Inc. We also have relationships with a number of global SIs such as Accenture plc (Accenture), Atos SE, Computer Sciences Corporation, HPE, IBM, Tata Consultancy Services Limited (TCS), Tech Mahindra Limited and Wipro Limited.

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Factors influencing our success

We believe our success is influenced by:

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

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

the extent to which adoption of our emerging technology offerings by enterprises and similar institutions continues to increase;

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

our ability to generate increasing revenue directly and through partners and other strategic relationships, including CCSPs, distributors, embedded technology partners, IHVs, ISVs, OEMs, SIs, and VARs;

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

the widespread and increasing deployment of open source technologies by enterprises and similar institutions;

our software, hardware, application and cloud service certification programs, which are intended to create an ecosystem of technologies that are compatible with our offerings and supported by us;

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

our ability to provide greater subscription value, enhance the experience of our customers and promote customer loyalty by focusing on ways in which we can help our customers succeed.

Geographic areas and segment reporting

As of February 28, 2017, Red Hat had more than 90 locations around the world, including offices in North America, South America, Europe, Asia and Australia. Red Hat has three geographic operating segments: the Americas (U.S., Canada and Latin America), EMEA (Europe, Middle East and Africa) and Asia Pacific. These segments are aggregated into one reportable segment due to the similarity in the nature of offerings, financial performance, economic characteristics (e.g., revenue growth and gross margin), methods of production and distribution and customer classes (e.g., CCSPs, distributors, resellers and enterprise). See NOTE 2 Summary of Significant Accounting Policies and NOTE 19 Segment Reporting to our Consolidated Financial Statements for further discussion of our operating segments. See Part I, Item 1A, Risk Factors, for a discussion of some of the risks attendant to our operations, including foreign operations.

Subscription revenue by product group

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Subscription revenue for our Infrastructure-related offerings (Red Hat Enterprise Linux, Red Hat Satellite, Red Hat Enterprise Virtualization and related offerings) as a percentage of our total revenue were 70.3%, 72.1% and 74.0% for fiscal 2017, fiscal 2016 and fiscal 2015, respectively. Subscription revenue for our Application Development-related offerings (Red Hat JBoss Middleware) and other emerging technology offerings (including our cloud offerings, Red Hat Mobile Application Platform and Red Hat Storage) as a percentage of our total revenue were 18.2%, 15.7% and 13.2% for fiscal 2017, fiscal 2016 and fiscal 2015, respectively. For additional financial information about our products and services, see NOTE 19 Segment Reporting to our Consolidated Financial Statements.

Customers

We sell our offerings to enterprises in a variety of industries, including financial services, government, healthcare, retail, technology and media, telecommunications and transportation. For fiscal 2017 and fiscal 2016,

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the U.S. government and its agencies represented in the aggregate approximately 10% of our total revenue. For fiscal 2015, no customer accounted for more than 10% of our total revenue.

Backlog

We define total backlog as the value of non-cancellable subscription and service agreements, including total deferred revenue, which is billed, plus the value of non-cancellable subscription and service agreements to be billed in the future and not reflected in our financial statements. The value of non-cancellable subscription and service agreements at February 28, 2017 included deferred revenue classified as a current liability of \$1.51 billion and long-term deferred revenue of \$557.2 million. The value of non-cancellable subscription and service agreements to be billed in the future and not reflected in our financial statements is in excess of \$650.0 million. The portion of total backlog at February 28, 2017 that we expect to be billed during the fiscal year ending February 28, 2018 is in excess of \$330.0 million. At February 29, 2016, the value of non-cancellable subscription and service agreements included deferred revenue classified as a current liability of \$1.27 billion and long-term deferred revenue of \$449.6 million. The value of non-cancellable subscription and service agreements to be billed in the future and not reflected in our financial statements at February 29, 2016 was in excess of \$410.0 million.

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

Seasonality

Our fourth fiscal quarter has historically been our strongest quarter for billing both new business and renewals. For a more detailed discussion, see Part II, Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations.

BUSINESS STRATEGY

Our business strategy is to partner with our customers as they optimize their existing IT environments; integrate applications, data and processes; add and manage cloud infrastructures; and build modern applications. We implement our business strategy through:

driving the widespread adoption of our offerings;

expanding our portfolio of technology offerings that enable hybrid cloud computing;

investing in the development of open source technologies and promoting the use of our technologies by software developers globally;

pursuing strategic acquisitions and alliances;

expanding relationships with our existing customers;

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

expanding routes to market; and

growing our presence in international markets.

Driving the widespread adoption of our offerings

We believe that our open source offerings are a catalyst for change in the IT industry, enabling new deployments and migrations, which encourage a larger ecosystem of compatible hardware and software

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solutions. We seek to drive further adoption of our offerings by enhancing the value of our offerings through frequent and continuing innovations, supporting new and emerging technologies such as OpenShift, OpenStack and containers, leveraging new delivery models such as on-demand consumption and encouraging modern software development processes such as CI/CD (continuous integration and continuous deployment) and DevOps. Additionally, we believe the increasing use of Linux, middleware and other open source technologies in cloud environments can provide us with a greater ability to penetrate existing, and generate new, customer and partner opportunities. We also seek to encourage users of free versions of our technologies to become paying customers by helping these users understand the value proposition of our subscription offerings.

Expanding our portfolio of technology offerings that enable hybrid cloud computing

We intend to continue to expand our offerings that enable customers to increase their deployments of public and private clouds in their enterprise environments. Additionally, we expect to continue to expand our management, orchestration and other technology offerings that help our customers to optimize resource allocation and enhance performance, agility and flexibility in hybrid cloud environments.

Investing in the development of open source technologies and promoting the use of our technologies by software developers globally

We intend to continue to invest significant resources in the development of open source technologies, capitalizing on our substantial experience working with open source development communities. We expect this continued investment to take the form of expenditures on internal development efforts, as well as continued funding of third-party open source projects and the expansion of our developer offerings. Additionally, we believe that by expanding and empowering the developers that use our technologies, we can enhance our technical leadership position and drive additional growth.

Pursuing strategic acquisitions and alliances

We expect to continue to pursue a selective acquisition strategy as opportunities arise to complement and expand our technology offerings and service capabilities. In fiscal 2017, we completed the acquisition of 3scale, Inc. (3scale), a provider of application programming interface (API) management technology. By adding 3scale to our existing portfolio, we strengthened our enablement of the API economy with simplified cloud integration and microservices-based architectures.

We also intend to create and extend our strategic alliances where it is beneficial to our business. To facilitate the widespread deployment of Red Hat offerings, we will continue efforts to build broader and deeper relationships with hardware and software providers and CCSPs critical to our customers.

Expanding relationships with our existing customers

We seek to build upon the relationships we have with our current customers by providing greater subscription value, enhancing the experience of our customers and promoting customer loyalty in an effort to generate additional revenue by renewing and increasing existing subscriptions and promoting our other technology offerings. We expect to continue to build more strategic relationships with our customers through vertical specialization of our go-to-market resources.

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

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

Expanding routes to market

We intend to continue to grow our direct sales channel as well as our CCSPs, distributors, embedded technology partners, IHVs, ISVs, OEMs, VARs and other channel partner networks on a global basis. In

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addition, we are enhancing our relationships with SIs in order to expand our reach to customers that traditionally rely on SIs for advice and recommendations regarding their technology purchases.

Growing our presence in international markets

We have operations in a number of countries in the Americas, EMEA and Asia Pacific, with more than 90 locations worldwide. We expect to continue to expand our operations geographically when appropriate. See NOTE 19 Segment Reporting to our Consolidated Financial Statements for a discussion of our revenue by geographic area.

PRODUCTS AND SERVICES

Our software offerings are designed to provide customers with high-performing, scalable, flexible, reliable and secure infrastructure technologies that meet customers' IT needs in hybrid cloud environments. Through our offerings, our customers and partners are able to take advantage of the quality and value of open source software that we help to develop, aggregate, integrate, test, certify, deliver, maintain, enhance and support. Customers can also take advantage of the flexibility of our software offerings to build a variety of deployment models on which to run their applications. Our service offerings include consulting, support and training.

Infrastructure-related offerings

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

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

Red Hat Enterprise Linux is also available in multiple variants that allow customers to obtain a version of Red Hat Enterprise Linux specifically for their use cases, applications, and hardware architectures. Variant options include Red Hat Enterprise Linux Atomic Host, Red Hat Enterprise Linux Server for High-Performance Computing, Red Hat Enterprise Linux for IBM z Systems, Red Hat Enterprise Linux for SAP Applications and Red Hat Enterprise Linux for SAP HANA.

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

High Availability provides failover services between nodes within a cluster intended to make applications more resistant to downtime.

Resilient Storage enables a shared storage or clustered file system to access the same storage device over a network.

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Load Balancer provides redundancy for web servers, databases, networking and storage, intended to maximize throughput, decrease response time and increase reliability and uptime.

Smart Management includes management and provisioning modules that allow a customer to provision, patch, configure and control Red Hat Enterprise Linux development, test and production systems.

Extended Lifecycle Support provides software maintenance and support after Red Hat's published end of life date for certain versions of Red Hat Enterprise Linux.

Extended Update Support extends the software maintenance and support period of certain eligible Red Hat Enterprise Linux subscriptions for up to 24 months to give customers more flexibility with their resource and deployment cycles.

Red Hat Insights provides a hosted service that is designed to help customers proactively identify and resolve technical and security issues in their Red Hat Enterprise Linux and Red Hat Cloud Infrastructure environments.

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

Red Hat Satellite. Red Hat Satellite is a system management offering that is designed to make Red Hat infrastructure easier to deploy, scale and manage across hybrid cloud environments. Red Hat Satellite provides broad capabilities for systems provisioning, configuration management, content management and subscription management.

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

Application Development-related and other emerging technology offerings

Red Hat JBoss Middleware. Red Hat JBoss Middleware is a suite of offerings for developing, deploying and managing applications; integrating applications, data and devices; and automating business processes across hybrid cloud environments. Red Hat JBoss Middleware offerings can also be deployed on Red Hat OpenShift to provide middleware functionality as a service. Red Hat JBoss Middleware integrates, tests and refines enterprise-ready features from JBoss and other community projects into supported, stable, enterprise-class middleware platforms.

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

Red Hat JBoss Enterprise Application Platform provides an environment for building, hosting and deploying applications and services. It includes features such as clustering, caching, messaging, transaction and a full web services stack.

Red Hat JBoss Web Server provides an enterprise-class web server solution for large-scale websites and lightweight web applications that utilize Apache Tomcat and Apache Web Server.

Red Hat JBoss Data Grid provides a scalable, distributed in-memory data grid that permits cost-effective scaling of big data tiers.

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Red Hat JBoss Fuse and Red Hat JBoss A-MQ provides customers messaging and integration tools for distributed applications.

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Red Hat 3scale API Management Platform provides centralized API management features through a distributed, cloud hosted layer.

Red Hat JBoss Data Virtualization provides a solution for integration of distributed data sources.

Red Hat JBoss BRMS provides a platform for business rules management and complex event processing.

Red Hat JBoss BPM Suite provides a business process management platform that combines business rules management and complex event processing with a business process management system to help customers model and encode business processes, policies and rules and measure the results of business activities.

Red Hat JBoss Developer Studio provides an integrated development environment for developing, testing and deploying rich web applications, enterprise applications and service-oriented architecture services.

Red Hat JBoss Operations Network provides built-in management and monitoring capabilities to administer JBoss application environments.

Red Hat cloud offerings. Utilizing the interoperability of our software technologies, we provide a number of offerings to assist users in creating cloud computing environments:

Red Hat OpenStack Platform an infrastructure as a service offering that provides an enterprise-ready cloud foundation built on OpenStack technologies optimized for and integrated with Red Hat Enterprise Linux and Red Hat Enterprise Virtualization.

Red Hat Cloud Infrastructure an offering that combines and integrates Red Hat Satellite, Red Hat Enterprise Virtualization, Red Hat CloudForms, Red Hat OpenStack Platform and Red Hat Insights. Red Hat Cloud Infrastructure allows users to build and manage a private or hybrid infrastructure as a service cloud.

Red Hat OpenShift a container-based cloud application platform (also called platform as a service or PaaS) that allows developers to develop, host and scale applications in a cloud environment. It automates the hosting, configuration, deployment and administration of application stacks in an elastic cloud environment utilizing Linux containers. OpenShift gives application developers self-service access so they can more easily deploy applications on demand. Customers can use OpenShift Container Platform in a private cloud environment and in certain public cloud environments, OpenShift Online in a public cloud environment for on-demand consumption, or OpenShift Dedicated in a public cloud environment using their own OpenShift instance managed by Red Hat. Customers can also use Red Hat JBoss Middleware services for OpenShift to enable enterprise application development, deployment and integration capability with OpenShift.

We also provide offerings to help our customers manage their increasingly complex IT environments. Along with Red Hat Satellite and Red Hat Insights, we offer Red Hat CloudForms, which is a hybrid cloud management solution that allows users to deploy, monitor and manage services across cloud providers and virtualized and container-based solutions. We also offer Ansible Tower, which is an IT automation platform that is designed to provide simplified provisioning, configuration management and application deployment as well as a broad range of IT automation activities across hybrid cloud environments.

Red Hat Mobile Application Platform. Red Hat Mobile Application Platform enables customers to develop, integrate, deploy and manage mobile applications for the enterprise. The Red Hat Mobile Application Platform offers flexibility in choosing front-end development tools while providing mobile backend as a service functionality, which is intended to provide more secure integration of mobile applications with back-end systems.

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Red Hat Storage. Red Hat Storage technologies enable customers to build storage platforms at large-scale using commodity hardware. Red Hat Gluster Storage enables distributed file storage across hybrid cloud

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environments. Red Hat Ceph Storage offers a block and object storage platform for enterprises deploying on public or private clouds. Users of enterprise OpenStack deployments and container application platforms often use Red Hat Storage technologies for their storage needs.

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

Red Hat consulting, support, and training services

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

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

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

Training. Our training services consist of an array of interactive courses and certification exams designed to meet the diverse needs of our customers. We deliver courses and exams worldwide in on-site, classroom and online settings. Courses span topics such as system administration, deployment, management and security, and enterprise application development and integration. Certifications include Red Hat Certified Architect, Red Hat Certified Engineer, Red Hat Certified JBoss Administrator, Red Hat Certified JBoss Developer, Red Hat Certified System Administrator, Red Hat Certified System Administrator in Red Hat OpenStack, Red Hat Certified Virtualization Administrator and Red Hat Certificates of Expertise in a variety of specialties. We also offer training through our Red Hat Learning Subscription, which is a tiered, subscription-based offering that includes access to all of our online courses and labs and can be delivered on demand at each user's own pace.

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

COMPETITION

The rapidly evolving and intensely competitive enterprise software industry is characterized by new and evolving industry standards, disruptive technology developments and frequent new product introductions by both new and established IT companies. We compete with a number of large and well-established companies that have significantly greater financial resources, larger development staffs and more extensive marketing and distribution capabilities. We also compete with emerging start-up companies that may be able to innovate and provide products and services faster than we can. No assurance can be given that our efforts to compete effectively will be sufficient.

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

the name and reputation of the vendor or competitive offering;

the product price, performance, reliability, security and functionality;

the partnerships of the vendor with major industry hardware and/or software providers;

the channel strength and number of channel partners of the vendor;

the financial and value relationship of subscription services;

the availability of third-party enterprise applications that are compatible with the technology;

the speed with which customers transition to cloud computing environments and the type of cloud computing environments utilized (public, private or hybrid);

the breadth of hardware and software ecosystem compatibility, including the ability to move IT workloads among various cloud offerings;

the number of cloud service providers;

the management framework for administering the software technologies;

the quality of consulting and support services;

the number of customer and company reference accounts;

the ability to attract and retain qualified technical and other employees;

the ability to influence enterprise software developers to write more applications that are compatible with our technologies;

the ability of the vendor to quickly diagnose software issues and provide patches and other solutions; and

the strength of the vendor's relationships and reputation in the open source community.

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

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

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

With respect to our cloud technologies, we compete with companies that provide tools for enterprises to create private clouds, such as HPE, Microsoft, Mirantis Inc., Oracle, Pivotal and VMware, companies that

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provide platform as a service offerings, such as IBM, Oracle, Pivotal and SAP, and companies that provide public clouds with, and that allow users to consume, computing resources as a service without the need to purchase equipment or software, such as Amazon, Google and Microsoft.

With respect to our mobile offerings, our competitors include IBM, Oracle, salesforce.com, inc. (Salesforce) and SAP as well as more mobile-focused companies such as AnyPresence, Inc., Kinvey, Inc. and Kony, Inc. Increasingly, cloud service providers are also offering mobile development services as part of their enterprise cloud offerings.

With respect to our storage offerings, we compete with companies that provide storage products, such as EMC and NetApp. Public cloud service providers, such as Amazon, Google and Microsoft, also offer storage capabilities.

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

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

There are significantly more enterprise applications available for competing operating systems technologies, such as Windows, than there are for Red Hat Enterprise Linux. An integral part of our strategy has been to help address these shortcomings by, among other methods, strengthening our existing strategic and channel partner relationships and entering into new ones to expand our marketing and distribution capabilities and by attracting more attention to the open source movement. Also, increasing the adoption of Red Hat technologies as well as the .Net infrastructure becoming available to the open source community can create additional opportunities and incentives for software developers to write more applications that are compatible with Red Hat technologies.

SOFTWARE ENGINEERING AND DEVELOPMENT

We have invested, and intend to continue to invest, significant resources in research and development. We expended \$480.7 million, \$413.3 million and \$367.9 million in fiscal 2017, fiscal 2016 and fiscal 2015, respectively, in research and development costs. We focus and modify our research and development efforts based on our business strategy, the needs of users and changes in the marketplace. Our development efforts are currently focused on adding new or improved functionality to our offerings that is needed by customers or that supports the expansion of our third-party hardware and software ecosystem. However, any upgrades and enhancements are offered on an if-and-when-available basis. Red Hat is also investing in developing new software offerings and enabling new forms of development that are aimed at customers who seek hybrid, private and public cloud computing solutions. Our software engineers collaborate with open source software development teams working through open source communities, such as Apache Camel, the CentOS project, the

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Ceph community project, the Cloud Native Computing Foundation, the Fedora Project, GlusterFS, the JBoss community projects, Kubernetes, the Linux kernel, the Open Container Initiative, the OpenDaylight Project, Open Platform for NFV, OpenShift Origin and OpenStack. This involvement enables us to remain abreast of, and in some instances lead, certain technical advances, plans for development of new features and timing of releases, as well as other information related to the management of open source projects.

Our software engineers make development contributions to many components comprising Red Hat software offerings and provide leadership within the various open source communities across many of the core components. Our software engineers also perform extensive testing of Red Hat technologies. We use various industry recognized methods of quality assurance testing to seek to ensure that our technologies are ready for use by our customers when delivered. We also work closely with leading hardware and software vendors to seek to ensure that their hardware and applications will operate effectively with Red Hat platforms.

INTELLECTUAL PROPERTY

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

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

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

Red Hat also seeks patent protection for some of the innovative ideas of our software developers and other employees. Some of these inventions are applicable to our current technologies, while others provide protection to new and other technologies. Moreover, our principal objectives in seeking patent protection are to provide a measure of deterrence against the potential patent infringement claims of third parties and to a more limited extent to help ensure that new technologies and innovations covered by our patents remain open. As part of Red Hat's commitment to the open source community, we provide our Patent Promise, an undertaking, subject to certain limitations, not to enforce our patent rights against users of open source software covered by certain open source licenses. This permits the development and distribution of open source applications by third parties that could otherwise infringe on our patents. For these reasons, it is unlikely that our patents will, of themselves, provide us substantial revenue.

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

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

EMPLOYEES

As of February 28, 2017, Red Hat had approximately 10,500 employees.

AVAILABLE INFORMATION

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

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ITEM 1A. RISK FACTORS

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

RISKS RELATED TO BUSINESS UNCERTAINTY

We face intense competition.

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

Our current and potential competitors range from large and well-established companies to emerging start-ups. Some of our competitors have significantly greater financial resources and name recognition, larger development and sales staffs and more extensive marketing and distribution capabilities. Certain competitors also bundle hardware and software offerings, making it more difficult for us to penetrate their customer bases, while other competitors may be able to innovate and provide products and services faster than we can. As the enterprise software industry evolves, the competitive pressure for us to innovate encompasses a wider range of products and services, including new offerings that require different expertise than our current offerings. Moreover, if we are unable to effectively communicate the value of our subscription model, we may not compete effectively in attracting new, and maintaining existing, customers.

Given the rapid evolving nature of the enterprise software industry, the competitive landscape and the nature of the competition is constantly changing. Consolidation and divestitures in the technology industry are trends that we expect to continue as companies attempt to strengthen or maintain market positions as the technology industry evolves. Industry consolidation may affect competition by creating larger and potentially stronger competitors in the markets in which we compete or competitors that position themselves as key or single-source vendors providing end-to-end technology solutions for the data center. Moreover, other companies may currently be planning to or are under pressure by stockholders to divest businesses. These divestitures may result in additional competitors that may have an advantage by focusing on a single product or service. We also compete in certain areas with our partners and potential partners, some of which may form from time to time new strategic alliances designed to position one or more of them as a key or single-source vendor, and this may adversely impact our relationship with an individual partner or a number of partners.

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

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

We operate in highly competitive markets that are characterized by rapid technological change, such as the transition of many of our enterprise customers to cloud computing environments and frequent new product and service announcements. Our continued success will depend on our ability to adapt to rapidly changing technologies and user preferences, to adapt our offerings to evolving industry standards, to predict user

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preferences and industry changes in order to continue to provide value to our customers and to improve the performance and reliability of our offerings. Our failure to adapt to such changes could harm our business, and our efforts to adapt to such changes could require substantial expenditures on our part to modify our offerings or infrastructure. Delays in developing, completing or delivering new or enhanced offerings and technologies could result in delayed or reduced revenue for those offerings and could also adversely affect customer acceptance of those offerings and technologies. The success of new and enhanced offering introductions depends on several factors, including our ability to invest significant resources in research and development in order to enhance our existing offerings and introduce new offerings in a timely manner, successfully promote the offerings, manage the risks associated with the offerings, make sufficient resources available to support the offerings and address any quality or other defects in the early stages of introduction. Even if we are able to enhance our existing offerings or introduce new offerings that are well perceived by the market, if our marketing or sales efforts do not generate interest in or sales for these offerings, they may be unsuccessful.

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

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

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

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

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

We rely, to a significant degree, on each of our channel partners to select, screen and maintain relationships with its distribution network and to distribute our offerings in a manner that is consistent with applicable law and regulatory requirements and our quality standards. If our channel partners or a partner in its distribution network

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violate applicable law or regulatory requirements or misrepresent the functionality of our offerings, our reputation could be damaged and we could be subject to potential liability. Furthermore, our channel partners may offer their own products and services or the products and services of other companies that compete with our offerings or may not distribute and market our offerings effectively. Moreover, our existing channel partner relationships do not, and any future channel partner relationships may not, provide for any exclusivity regarding marketing or distribution. In addition, if a channel partner is acquired by a competitor, its business units are reorganized or divested or its financial conditions were to weaken, our revenue derived from that partner may be adversely impacted.

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

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

If our indirect distribution channel is disrupted, we may be required to devote more resources to distribute our offerings directly and support our customers, which may not be as effective and could lead to higher costs, reduced revenue and growth that is slower than expected.

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

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

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

We have expanded our operations significantly in recent years. For example, our total revenue increased from \$2.05 billion for the fiscal year ended February 29, 2016 to \$2.41 billion for the fiscal year ended February 28, 2017 (fiscal 2017). Moreover, the total number of our employees increased from approximately

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8,800 as of February 29, 2016 to approximately 10,500 as of February 28, 2017. In addition, we continue to explore ways to extend our offerings and geographic reach. Our growth has placed and will likely continue to place a strain on our management systems, information systems, resources and internal controls. Our ability to successfully provide our offerings and implement our business plan requires adequate information systems and resources, internal controls and oversight from our senior management. As we expand in international markets, these challenges increase as a result of the need to support a growing business in an environment of multiple languages, cultures, customs, legal systems, dispute resolution systems, regulatory systems and commercial practices. As we grow, (i) we may not be able to adequately screen and hire or adequately train, supervise, manage or develop sufficient personnel, and (ii) we may not be able to develop or effectively manage our controls, oversight functions or information systems. If we are unable to effectively manage our growth, our business, financial condition, operating results and cash flows could be adversely affected.

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

As part of our business strategy, we have in the past entered into business combinations and acquisitions, and we may continue to do so in the future. These types of transactions can increase the expense of running our business and present significant challenges and risks, including:

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

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

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

increasing or adding operating expenses related to the acquired business or technology;

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

disrupting our ongoing business and distracting management;

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

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

effectively evaluating talent at an acquired business or identifying cultural challenges associated with integrating employees from the acquired business into our organization;

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losing key employees of the acquired business;

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

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

incurring expenses related to the transaction;

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assuming claims and liabilities from the acquired business or technology, or that are otherwise related to the transaction;

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

impairing of intangible assets and goodwill acquired in transactions; and

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

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

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

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

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

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

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

Our ability to retain key management personnel or hire capable new management personnel as we grow may be challenged to the extent that other companies are able to offer more attractive opportunities to the individuals we seek to hire or retain. In addition, historically we have used share-based compensation as a key component of our compensation packages. If the price of our common stock falls, the value of our share-based awards to recipients is reduced. Such events, or if we are unable to secure stockholder approval for increases in the number

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of shares eligible for share-based compensation grants, could adversely affect our ability to successfully attract and retain key management personnel. Effective succession planning is also important to our long-term success. Failure to ensure effective transfer of knowledge and smooth transitions involving key management personnel could hinder our strategic planning and execution.

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

One of the characteristics of open source software is that anyone may modify and redistribute the existing open source software and use it to compete with us. Such competition can develop without the degree of overhead and lead time required by traditional proprietary software companies. It is possible for competitors with greater resources than ours to develop their own open source solutions or acquire a smaller business that has developed open source offerings that compete with our offerings, potentially reducing the demand for, and putting price pressure on, our offerings. In addition, some competitors make their open source software available for free download and use on an ad hoc basis or may position their open source software as a loss leader. We cannot guarantee that we will be able to compete successfully against current and future competitors or that competitive pressure and/or the availability of open source software will not result in price reductions, reduced operating margins and loss of market share. Additionally, any failure by us to provide high-quality technical support, or the perception that we do not provide high-quality technical support, could harm our reputation and negatively impact our ability to sell subscriptions for our open source offerings to existing and prospective customers. If we are unable to differentiate our open source offerings from those of our competitors or compete effectively with other open source offerings, our business, financial condition, operation results and cash flows could be adversely affected.

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

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

Our emerging technology offerings are based on developing technologies and business models, and the potential market for these offerings remains uncertain.

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

Adoption of emerging technologies may occur more slowly or less pervasively than we expect and the revenue growth associated with these offerings may be slower than currently expected. Moreover, even if

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emerging technologies are adopted widely by enterprises, our offerings in these areas may not attract a sufficient number of users or generate attractive financial results. We incur expenses associated with these offerings in advance of our ability to generate associated revenue. Demand for our emerging technology offerings may unfavorably impact demand for our other offerings, including software subscriptions and related professional services. If the market for our emerging technologies offerings fails to develop adequately, it could have an adverse effect on our business, financial condition, operating results and cash flows.

We may experience a decline in the demand for our offerings.

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

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

If demand for our offerings declines, our business, financial condition, operating results and cash flows could be adversely affected.

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

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

Our business model may encounter customer resistance.

We provide Red Hat enterprise technologies primarily under annual or multi-year subscriptions. A subscription generally entitles a customer to, among other things, a specified level of support, as well as security updates, fixes, functionality enhancements, upgrades to the technologies, each, if and when available, and compatibility with an ecosystem of certified hardware and software. While we believe this practice complies with the requirements of the GNU General Public License, and while we have reviewed this practice with the Free Software Foundation, the organization that maintains and provides interpretations of the GNU General Public License, customers may fail to honor the terms of our subscription agreements.

As technologies and the markets for our enterprise offerings change, our annual or multi-year subscription-based business model may no longer meet the needs of our customers. For example, a business model based on

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annual or multi-year subscriptions may no longer be competitive in an environment where disruptive technologies (such as cloud computing) enable customers to consume competitive offerings available from companies such as Amazon, Google Inc. and Microsoft on an hourly basis or for free. We also develop and offer these disruptive technologies with consumption-based pricing, which may have an effect on the demand for our subscription-based offerings.

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

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

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

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

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

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

Despite our testing procedures, errors have been and may continue to be found in our offerings after deployment. This risk is increased by the fact that much of the code in our offerings is developed by independent parties over whom we exercise no supervision or control. If errors are discovered, we may have to make

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significant expenditures of capital and devote significant technical resources to analyze, correct, eliminate or work around them, and we may not be able to successfully do so in a timely manner or at all. Errors and failures in our offerings could result in a loss of, or delay in, market acceptance of our enterprise technologies, loss of existing or potential customers and delayed or lost revenue and could damage our reputation and our ability to convince enterprise users of the benefits of our technologies.

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

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

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

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

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

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unable to anticipate these techniques or to implement adequate preventative measures. Any loss of data or compromise of our systems or the data we receive, store or process (or systems and the data received, stored and processed by third parties with whom we contract) could result in a loss of confidence in the security of our offerings, damage our reputation, loss of channel or strategic partners, lead to legal liability and adversely affect our business, financial condition, operating results and cash flows.

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

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

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

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

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

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

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

We utilize various types of software licensed from unaffiliated third parties in our offerings. Aspects of our business could be disrupted if any of the software we license from others or functional equivalents of this software were no longer available to us, no longer offered to us on commercially reasonable terms or changed in ways or included defects that make the third-party software unsuitable for our use. In these cases, we would be

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required to either redesign our technologies to function with software available from other parties, develop these components ourselves or eliminate the functionality, which could result in increased costs, the need to mitigate customer issues, delays in delivery of our offerings and the release of new offerings and limit the features available in our current or future offerings.

RISKS RELATED TO LEGAL UNCERTAINTY

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

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

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

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

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

Defending patent and other intellectual property claims, even claims without significant merit, can be time-consuming, costly and can divert the attention of technical and management personnel. We may receive unfavorable preliminary or interim rulings in the course of litigation, and there can be no assurances that

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

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

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

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

Governmental regulations affecting the import or export of software could adversely impact our business.

Due to the global nature of our business, we are subject to import and export restrictions and regulations, including the Export Administration Regulations administered by the U.S. Commerce Department's Bureau of Industry and Security ("BIS") and the trade and economic sanctions regulations administered by the U.S. Treasury Department's Office of Foreign Assets Control ("OFAC"). The U.S., through the BIS and OFAC, places restrictions on the sale or export of certain products and services to certain countries and persons ("denied parties"). Violators of these export control and sanctions laws may be subject to significant penalties, which may include significant monetary fines, criminal proceedings against them and their officers and employees, a denial of export privileges, and suspension or debarment from selling products or services to the federal government. Any such penalties could have an adverse effect on our business, financial condition, operating results and cash flows. In addition, the political and media scrutiny surrounding any governmental investigation of us could cause us significant expense and reputational harm and distract senior executives from managing our normal day-to-day operations.

Our products could also be shipped to denied parties by third parties, including our channel partners. Even though we take precautions to ensure that our channel partners comply with all relevant import and export regulations, any failure by our channel partners to comply with such regulations could have negative consequences for us, including reputational harm, government investigations and penalties.

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

A number of our offerings, including Red Hat Enterprise Linux, have been developed and licensed under the GNU General Public License and similar open source licenses. These licenses state that any program licensed under them may be liberally copied, modified and distributed. It is possible that a court would hold these licenses

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to be unenforceable or that someone could assert a claim for proprietary rights in a program developed and distributed under them. Additionally, if any of the open source components of our offerings may not be liberally copied, modified or distributed, then our ability to distribute or develop all or a portion of our offerings could be adversely impacted. In addition, licensors of open source software employed in our offerings may, from time to time, modify the terms of their license agreements in such a manner that those license terms may become incompatible with other open source licenses in our offerings or our end user license agreement, and thus could, among other consequences, prevent us from distributing the software code subject to the modified license.

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

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

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

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

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

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

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

Lawsuits or legal proceedings may be commenced against us. These disputes and proceedings may involve significant expense and divert the attention of management and other employees. If we do not prevail in these

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matters, we could be required to pay substantial damages or settlement costs, which could adversely affect our business, financial condition, operating results and cash flows. See Part I, Item 3, Legal Proceedings for additional information.

If we fail to comply with laws and regulations regarding data privacy and protection, our business could be adversely affected.

Our business is subject to a variety of federal, state and international laws and regulations that apply to the collection, use, retention, protection, disclosure, transfer and processing of personal data. These data privacy- and protection-related laws and regulations are evolving, with new or modified laws and regulations proposed and implemented frequently and existing laws and regulations subject to new or different interpretations.

Any failure by us to comply with data privacy- and protection-related laws and regulations could result in enforcement actions, significant penalties or other legal actions against us or our customers or suppliers. An actual or alleged failure to comply, which could result in negative publicity, reduce demand for our offerings, increase the cost of compliance, require changes in business practices that result in reduced revenue, restrict our ability to provide our offerings in certain locations, result in our customers inability to use our offerings and prohibit data transfers or result in other claims, liabilities or sanctions, including fines, could have an adverse effect on our business, financial condition, operating results and cash flows.

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

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

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

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

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RISKS RELATED TO FINANCIAL UNCERTAINTY

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

Due to the unpredictability of the IT spending environment, among other reasons, our revenue and operating results have fluctuated and may continue to fluctuate. We base our current and projected future expense levels, in part, on our estimates of future revenue. Our expenses are, to a large extent, fixed in the short term. Accordingly, we may not be able to adjust our spending quickly enough to protect our projected operating results for a quarter if our revenue in that quarter falls short of our expectations.

Our fourth fiscal quarter has historically been our strongest quarter for sales. This pattern has become more pronounced as the number of customers with renewal dates occurring in the last half of our fiscal year has continued to increase. Additionally, a significant portion of our quarterly sales typically occur during the last weeks of the quarter and our operating results may be adversely impacted if we do not have sufficient time to bill and collect from our customers in the same quarter or fiscal year. Some of our customers may wait until the end of the quarter to negotiate their contracts in the hope of obtaining more favorable terms, which can also impede our ability to execute these contracts within the same quarter. Moreover, as an increasing number of customers enter into larger, multi-year transactions with us, such transactions tend to have longer sales cycles and can involve customers choosing to pay annually, which may impact our quarterly operating results. If, among other considerations, our future financial performance falls below the expectations of securities analysts or investors or we are unable to increase or maintain profitability, the market price of our common stock may decline.

We may not be able to meet the financial and operational challenges that we will encounter as our international operations, which represented approximately 41.9% of our total revenue for fiscal 2017, continue to expand.

Our international operations accounted for approximately 41.9% of total revenue for fiscal 2017. As we expand our international operations, we may have difficulty managing and administering a globally dispersed business and we may need to expend additional funds to, among other activities, reorganize our sales force and technical support services team, outsource or supplement general and administrative functions, staff key management positions, obtain additional information technology infrastructure and successfully localize offerings for a significant number of international markets, which may adversely affect our operating results. Additional challenges associated with the conduct of our business globally that may adversely affect our operating results include:

fluctuations in exchange rates;

pricing environments;

longer payment cycles and less financial stability of customers;

economic, political, compliance and regulatory risks associated with specific countries;

laws and policies of the U.S. and other jurisdictions affecting trade, foreign investment, loans, immigration and taxes, including any adverse effects that may result from the recent changes in U.S. government and the United Kingdom's vote to exit the European Union;

difficulty selecting and monitoring channel partners;

differing technology standards and customer requirements;

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lower levels of availability or use of the Internet, through which our software is often delivered;

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

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

different employee/employer relationships and the existence of works councils and labor unions;

difficulty maintaining quality standards consistent with our brands;

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

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

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

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

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

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

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

During fiscal 2017, a substantial portion of our subscription revenue was derived from our Red Hat Enterprise Linux offerings. Although we are continuing to develop other offerings, we expect that revenue from Red Hat Enterprise Linux will constitute a majority of our revenue for the foreseeable future. Declines and variability in demand for Red Hat Enterprise Linux could occur as a result of:

competitive products and pricing;

failure to release new or enhanced versions of Red Hat Enterprise Linux on a timely basis, or at all;

maturity of the market for Red Hat Enterprise Linux;

technological change that we are unable to address with Red Hat Enterprise Linux; or

future economic conditions.

Additionally, as more customers and potential customers virtualize their data centers and move computing projects to cloud environments, demand for operating systems such as Red Hat Enterprise Linux may decline. Moreover, as data centers become more virtualized and move to cloud environments, we may experience a decline in growth if we are unsuccessful in adapting our business model and offerings accordingly. Due to the concentration of our revenue from Red Hat Enterprise Linux, our business, financial condition, operating results and cash flows could be adversely affected by a decline in demand for Red Hat Enterprise Linux.

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

A portion of our business is conducted in currencies other than the U.S. dollar. Changes in exchange rates among other currencies and the U.S. dollar may affect our revenue, operating expenses and operating margins, which are reported in U.S. dollars. We cannot predict the impact of future exchange rate fluctuations. As we expand international operations, our exposure to exchange rate fluctuations may increase. We may use financial instruments, primarily forward purchase contracts, to economically hedge currency commitments arising from trade accounts receivable, trade accounts payable and fixed purchase obligations. If these hedging activities are not successful or we change or reduce these hedging activities in the future, we may experience significant unexpected expenses from fluctuations in exchange rates. For information regarding our hedging activity, see Part II, Item 7A, Quantitative and Qualitative Disclosures About Market Risk .

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

As the markets for our offerings mature and the scale of our business increases, our rate of revenue, deferred revenue and operating cash flow growth may be lower than the growth rates we experienced in earlier periods. In addition, to the extent that the adoption of our offerings occurs more slowly or is less pervasive than we expect, our growth rates may slow or decline, which could adversely affect our stock price. Historical period-to-period comparisons of our revenue, deferred revenue and operating cash flow may not be meaningful and are not guarantees of our future performance.

We may be subject to greater tax liabilities.

We are subject to income and other taxes in the U.S. and in numerous foreign jurisdictions. Our domestic and foreign tax liabilities are dependent on the jurisdictions in which profits are determined to be earned and taxed. Additionally, the amount of taxes paid is subject to our interpretation of applicable tax laws in the jurisdictions in which we operate. Changes in tax laws, or in judicial or administrative interpretations of tax laws, could have an adverse effect on our business, financial condition, operating results and cash flows. Significant judgment, knowledge and experience are required in determining our worldwide provision for income taxes. Our future effective tax rate is impacted by a number of factors including changes in the valuation of our deferred tax assets and liabilities, increases in expenses not deductible for tax, including impairment of goodwill in connection with acquisitions, and changes in available tax credits. In the ordinary course of our business, there are many transactions and calculations where the ultimate tax determination is uncertain. We are regularly subject to audits by tax authorities. Although we believe our tax estimates are reasonable, the final determination of tax audits and any related litigation could be materially different from our historical income tax provisions and accruals. Economic and political pressures to increase tax revenue in various jurisdictions may make resolving tax disputes more difficult. The results of an audit or litigation could adversely affect our financial statements in the period or periods for which that determination is made.

We earn a significant amount of our operating income from outside the U.S., and any repatriation of funds currently held in foreign jurisdictions may result in higher effective tax rates for the company. In addition, there have been proposals to change U.S. tax laws that would significantly impact how U.S. multinational corporations are taxed on foreign earnings, including recent proposals to change a number of international tax practices and principles recently recommended by the Organization for Economic Co-operation and Development (OECD) Base Erosion and Profit Shifting (BEPS) project. Although we cannot predict whether or in what form any legislation based on such proposals may be adopted by the countries in which we do business, future tax reform based on such proposals may increase the amount of taxes we pay and adversely affect our operating results and cash flows.

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

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

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

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

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

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

If we fail to maintain an effective system of disclosure controls or internal control over financial reporting, including satisfaction of the requirements of the Sarbanes-Oxley Act, we may not be able to accurately or timely report on our financial results or adequately identify and reduce fraud. As a result, the financial condition of our business could be adversely affected, current and potential future stockholders could lose confidence in us and/or our reported financial results, which may cause a negative effect on our trading price, and we could be exposed to litigation or regulatory proceedings, which may be costly or divert management attention.

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

We prepare our consolidated financial statements in accordance with accounting principles generally accepted in the U.S. These principles are subject to interpretation by the U.S. Securities and Exchange Commission and various bodies formed to create and interpret appropriate accounting principles and guidance. A change in these principles or guidance, or in their interpretations, may have a significant effect on our reported results, as well as our processes and related controls, and may retroactively affect previously reported results. For example, in May 2014, the Financial Accounting Standards Board issued Accounting Standards Update 2014-09, *Revenue from Contracts with Customers* (ASU 2014-09). This guidance is effective for us beginning the first quarter of our fiscal year ending February 28, 2019. For a discussion of the potential impact that the implementation of ASU 2014-09 will have on our consolidated financial statements and related disclosures, see NOTE 2 Summary of Significant Accounting Policies to our Consolidated Financial Statements in Part II, Item 8, Financial Statements and Supplementary Data .

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

We maintain an investment portfolio of various holdings, types and maturities. Our portfolio as of February 28, 2017 consisted primarily of money market funds, U.S. government and agency securities, European

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sovereign and agency securities with a rating of AA or higher, certificates of deposit, and corporate securities. Although we follow an established investment policy and seek to minimize the risks associated with our investments by investing primarily in investment grade, highly liquid securities and by limiting the amounts invested with any one institution, type of security or issuer, we cannot give assurances that the assets in our investment portfolio will not lose value or become impaired, or that our interest income will not decline.

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

Future fluctuations and uncertainty in economic and market conditions could adversely affect the market value of our investments, and we could record additional impairment charges and lose some or all of the principal value of investments in our portfolio. A total loss of an investment or a significant decline in the value of our investment portfolio could adversely affect our financial condition and operating results. For information regarding the sensitivity of and risks associated with the market value of portfolio investments and interest rates, see Part II, Item 7A, Quantitative and Qualitative Disclosures About Market Risk .

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

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

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

RISKS RELATED TO THE CONVERTIBLE NOTES

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

In October 2014, we issued \$805.0 million of 0.25% Convertible Senior Notes due 2019 (the convertible notes). The convertible notes will rank senior in right of payment to any of our indebtedness that is expressly subordinated in right of payment to the convertible notes; equal in right of payment to any of our existing and future indebtedness and other liabilities that are not so subordinated; effectively junior in right of payment to any of our secured indebtedness to the extent of the value of the assets securing such indebtedness; and structurally junior to all existing and future indebtedness and other liabilities of our subsidiaries (including trade payables). In

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the event of our bankruptcy, liquidation, reorganization or other winding up, our assets that secure debt ranking senior in right of payment to the convertible notes will be available to pay obligations on the convertible notes only after the secured debt has been repaid in full from these assets, and the assets of our subsidiaries will be available to pay obligations on the convertible notes only after all claims senior to the convertible notes have been repaid in full. There may not be sufficient assets remaining to pay amounts due on any or all of the convertible notes then outstanding.

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

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

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

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

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

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

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

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outstanding principal of the convertible notes as a current rather than long-term liability, which would result in a material reduction of our net working capital.

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

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

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

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

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

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

We do not make any representation or prediction as to the direction or magnitude of any potential effect that the transactions described above may have on the price of the convertible notes or our common stock. In

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addition, we do not make any representation that the option counterparties or their respective affiliates will engage in these transactions or that these transactions, once commenced, will not be discontinued without notice.

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

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

RISKS RELATED TO OWNERSHIP OF OUR COMMON STOCK

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

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

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

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

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

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

In addition, a substantial number of shares of our common stock are reserved for instruments issued under our equity compensation plans, including for the issuance upon the exercise of stock options and the vesting of performance share units, restricted stock, restricted stock units and deferred stock units. A substantial number of shares of our common stock are also reserved in relation to the convertible notes, the convertible note hedge and

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warrant transactions and our employee stock purchase plan. We may not be able to predict the size of future issuances or the effect, if any, that they may have on the market price for our common stock. The issuance and sale of substantial amounts of common stock, or the perception that such issuances and sales may occur, could adversely affect the market price of our common stock and impair our ability to raise capital through the sale of equity or equity-linked securities.

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

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

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

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

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

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

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

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

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

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

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ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

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

In addition to our headquarters, we have leased office facilities in over 35 countries and more than 90 locations. Significant locations in North America include Ann Arbor, Michigan; Atlanta, Georgia; Chicago, Illinois; Durham, North Carolina; Mahwah, New Jersey; McLean, Virginia; Montreal, Canada; Mountain View, California; New York, New York; Plano, Texas; Toronto, Canada and Westford, Massachusetts. Significant locations in Latin America include Bogota, Colombia; Buenos Aires, Argentina; Mexico City, Mexico; Santiago, Chile and Sao Paulo, Brazil. Significant locations in EMEA include Amsterdam, Netherlands; Barcelona, Spain; Brno, Czech Republic; Cork, Ireland; Farnborough, United Kingdom; Frankfurt, Germany; London, United Kingdom; Madrid, Spain; Milan, Italy; Munich, Germany; Paris, France; Ra'anana, Israel; Rome, Italy; Stockholm, Sweden; Stuttgart, Germany and Waterford, Ireland. Significant locations in Asia Pacific include Beijing, China; Bengaluru, India; Brisbane, Australia; Canberra, Australia; Hong Kong; Melbourne, Australia; Mumbai, India; New Delhi, India; Pune, India; Seoul, South Korea; Singapore; Sydney, Australia and Tokyo, Japan. We believe that in all material respects our properties have been satisfactorily maintained, are in good condition and are suitable for our operations.

ITEM 3. LEGAL PROCEEDINGS

The Company experiences routine litigation in the normal course of its business, including patent litigation. The Company presently believes that the outcome of this routine litigation will not have a material adverse effect on its financial position, results of operations or cash flows.

ITEM 4. MINE SAFETY DISCLOSURES

This Item is not applicable.

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Our common stock trades on the New York Stock Exchange under the symbol RHT. The chart below sets forth the high and low sales price for each of the quarters of fiscal 2017 and fiscal 2016.

Quarter	FY 2017		FY 2016	
	High	Low	High	Low
First	\$ 77.56	\$ 65.43	\$ 79.35	\$ 65.00
Second	\$ 81.81	\$ 70.09	\$ 81.49	\$ 67.01
Third	\$ 82.73	\$ 71.52	\$ 83.00	\$ 68.36
Fourth	\$ 85.01	\$ 68.54	\$ 84.44	\$ 59.59

Holdings

As of April 19, 2017, we estimate that there were 1,195 registered stockholders of record of our common stock.

Dividends

We have never declared or paid any cash dividends on our common stock. We currently anticipate that we will retain future earnings for the development, operation and expansion of our business and do not anticipate declaring or paying any cash dividends for the foreseeable future.

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Stock Performance Graph

The following graph shows a comparison of cumulative total return (equal to dividends plus stock appreciation) during the period from February 29, 2012 through February 28, 2017 for:

Red Hat, Inc.;

a peer group consisting of Adobe Systems Incorporated, Akamai Technologies, Inc., ANSYS, Inc., Autodesk, Inc., Cadence Design Systems, Inc., Citrix Systems, Inc., Intuit Inc., Jack Henry & Associates, Inc., NetApp, Nuance Communications, Inc., Open Text Corporation, PTC Inc., Salesforce, Symantec, Synopsys, Inc., Verint Systems Inc., Verisign, Inc. and VMware (the Stock Performance Peer Group); and

the S&P 500 Index.

We are required to provide a line-graph presentation comparing cumulative, five-year stockholder returns on an indexed basis with a broad equity market index and either a published industry index or an index of peer companies selected by Red Hat. In our index of peer group companies, we have selected peer companies considered to be peers for purposes of benchmarking executive compensation during fiscal 2017.

COMPARISON OF FIVE-YEAR CUMULATIVE

TOTAL RETURN AMONG RED HAT,

STOCK PERFORMANCE PEER GROUP AND S&P 500 INDEX

	2/29/2012	2/28/2013	2/28/2014	2/28/2015	2/29/2016	2/28/2017
RED HAT, INC.	\$ 100.00	\$ 102.73	\$ 119.27	\$ 139.75	\$ 132.13	\$ 167.43
PEER GROUP	\$ 100.00	\$ 99.66	\$ 129.60	\$ 141.56	\$ 129.86	\$ 180.67
S&P 500 INDEX	\$ 100.00	\$ 113.46	\$ 142.25	\$ 164.30	\$ 154.13	\$ 192.63

Notes:

Assumes initial investment of \$100.00 on February 29, 2012. Total return includes reinvestment of dividends.

If the annual interval, based on the fiscal year-end, ends on a day that is not a trading day, the preceding trading day is used.

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The information included under the heading "Stock Performance Graph" in Item 5 of this Annual Report on Form 10-K is furnished and not filed and shall not be deemed to be soliciting material or subject to Regulation 14A, shall not be deemed filed for purposes of Section 18 of the Securities Exchange Act or otherwise subject to the limitations of that section, and shall not be deemed incorporated by reference in any filing of the Company under the Securities Act of 1933, as amended, or the Securities Exchange Act, whether made before or after the date of this report and irrespective of any general incorporation by reference language in any such filing.

The stock price performance shown in the graph is not necessarily indicative of future price performance.

Issuer Purchases of Equity Securities

The table below sets forth information regarding the Company's purchases of its common stock during its fourth fiscal quarter ended February 28, 2017:

Issuer Purchases of Equity Securities

Period	Total Number of Shares Purchased (1)	Weighted Average Price Paid per Share	Total Number of Shares	Approximate Dollar Value of Shares that May Yet Be Purchased
			Purchased as Part of Publicly Announced Plans or Programs (2)	Under the Plans or Programs (2)
December 1, 2016 – December 31, 2016	772,075	\$ 70.06	772,075	\$ 721.1 million
January 1, 2017 – January 31, 2017	1,050,041	\$ 73.60	1,005,049	\$ 647.1 million
February 1, 2017 – February 28, 2017	147,693	\$ 77.14	147,693	\$ 635.7 million
Total	1,969,809		1,924,817	

- (1) During the three months ended February 28, 2017, the Company withheld an aggregate of 44,992 shares of its common stock (with a weighted average share price of \$72.99) from employees to satisfy minimum tax withholding obligations relating to the vesting of restricted share awards. These shares were not withheld pursuant to the programs described in Note (2) below.
- (2) On June 22, 2016, the Company announced that its Board authorized the repurchase of up to \$1.0 billion of Red Hat's common stock from time to time on the open market or in privately negotiated transactions. The program, which replaced a previous repurchase program, commenced on July 1, 2016, and will expire on the earlier of (i) June 30, 2018 or (ii) a determination by the Board, Chief Executive Officer or Chief Financial Officer to discontinue the program.

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The following table sets forth selected financial data for each of the Company's fiscal years in the five-year period ended February 28, 2017. The selected balance sheet data as of February 28, 2017 and February 29, 2016 and the selected statement of operations data for the fiscal years ended February 28, 2017, February 29, 2016, and February 28, 2015 are derived from our Consolidated Financial Statements contained in this Annual Report on Form 10-K and should be read in conjunction with the Consolidated Financial Statements, related notes and other financial information included herein. The selected statement of operations data for the fiscal years ended February 28, 2014 and February 28, 2013 is derived from our Consolidated Financial Statements contained in the Annual Report on Form 10-K for the fiscal year ended February 28, 2014, and the selected balance sheet data as of February 28, 2015, February 28, 2014 and February 28, 2013 is presented including the effects of retrospective application of relevant adopted Accounting Standards Updates.

	February 28, 2017	February 29, 2016	Fiscal Years Ended		
			February 28, 2015	February 28, 2014	February 28, 2013
	(in thousands, except per share data)				
SELECTED STATEMENT OF OPERATIONS DATA					
Revenue:					
Subscriptions	\$ 2,135,780	\$ 1,803,449	\$ 1,561,234	\$ 1,336,771	\$ 1,148,341
Training and services	276,023	248,781	228,255	197,844	180,476
Total subscription and training and services revenue	\$ 2,411,803	\$ 2,052,230	\$ 1,789,489	\$ 1,534,615	\$ 1,328,817
Gross profit	\$ 2,057,425	\$ 1,742,601	\$ 1,516,290	\$ 1,302,015	\$ 1,128,217
Income from operations	\$ 332,245	\$ 288,048	\$ 249,994	\$ 232,289	\$ 201,038
Interest income	\$ 13,921	\$ 11,673	\$ 8,336	\$ 6,645	\$ 8,245
Interest expense	\$ 23,822	\$ 23,121	\$ 9,394	\$ 160	\$ 267
Other income (expense), net	\$ (2,164)	\$ (1,735)	\$ 6,562	\$ 774	\$ 736
Net income	\$ 253,703	\$ 199,365	\$ 180,201	\$ 178,282	\$ 150,204
Net income per share:					
Basic	\$ 1.41	\$ 1.09	\$ 0.97	\$ 0.94	\$ 0.78
Diluted	\$ 1.39	\$ 1.07	\$ 0.95	\$ 0.93	\$ 0.77
Weighted average shares outstanding:					
Basic	179,642	182,817	186,529	189,920	193,147
Diluted	182,961	186,119	189,246	192,036	195,804

	February 28, 2017	February 29, 2016	As of		
			February 28, 2015	February 28, 2014	February 28, 2013
	(in thousands)				
SELECTED BALANCE SHEET DATA					
Total cash, cash equivalents and available-for-sale investment securities	\$ 2,133,231	\$ 1,995,390	\$ 1,808,743	\$ 1,487,429	\$ 1,318,373
Working capital	\$ 424,629	\$ 313,256	\$ 549,410	\$ 315,502	\$ 294,272
Total assets	\$ 4,535,185	\$ 4,155,099	\$ 3,784,569	\$ 3,079,070	\$ 2,807,942
Total deferred revenue (current and long-term)	\$ 2,069,956	\$ 1,722,544	\$ 1,482,328	\$ 1,289,197	\$ 1,089,952
Convertible notes	\$ 745,633	\$ 723,942	\$ 702,939	\$	\$
Stockholders' equity	\$ 1,247,320	\$ 1,334,432	\$ 1,288,338	\$ 1,551,165	\$ 1,520,161

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

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

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

We market our offerings primarily to customers in the form of annual or multi-year subscriptions, and we recognize revenue over the period of the subscription agreements with our customers. Our technologies are also offered by certified cloud and service providers (CCSPs) as a service available on demand, and this revenue is recognized by us upon delivery.

We derive our revenue and generate cash from customers primarily from two sources: (i) subscription revenue and (ii) training and services revenue. These arrangements typically involve subscriptions to Red Hat technologies. Our revenue is affected by, among other factors, corporate, government and consumer spending levels. In evaluating the performance of our business, we consider a number of factors, including total revenue, deferred revenue, operating income, operating margin and cash flows from operations. The arrangements with our customers that produce this revenue and cash are explained in further detail in this Part II, Item 7 under Critical Accounting Estimates and in NOTE 2 Summary of Significant Accounting Policies to our Consolidated Financial Statements.

We believe our success is influenced by: (i) the extent to which we can expand the breadth and depth of our offerings, (ii) our ability to enhance the value of our offerings through frequent and continuing innovation while maintaining platforms designed to be stable and secure over multi-year periods, (iii) the extent to which adoption of our emerging technology offerings by enterprises and similar institutions continues to increase, (iv) our involvement and leadership in key open source communities, which enable us to develop, enhance and maintain our offerings, (v) our ability to generate increasing revenue directly and through partners and other strategic relationships, including CCSPs, distributors, embedded technology partners, independent hardware vendors, independent software vendors, original equipment manufacturers (OEMs), systems integrators and value added resellers, (vi) our ability to generate new and recurring revenue for our offerings, (vii) the widespread and increasing deployment of open source technologies by enterprises and similar institutions, (viii) our software, hardware, application and cloud service certification programs, which are intended to create an ecosystem of technologies that are compatible with our offerings and supported by us, (ix) our ability to provide customers with consulting and training services that generate additional subscription revenue, and (x) our ability to provide greater subscription value, enhance the experience of our customers and promote customer loyalty by focusing on ways in which we can help our customers succeed.

In fiscal 2017 we focused on, and in fiscal 2018 we expect to focus on, among other things: (i) driving the widespread adoption of our offerings, (ii) expanding our portfolio of technology offerings that enable hybrid cloud computing, (iii) investing in the development of open source technologies and promoting the use of our

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technologies by software developers globally, (iv) pursuing strategic acquisitions and alliances, (v) expanding relationships with our existing customers, (vi) increasing revenue by promoting a range of services to help our customers derive additional value, (vii) expanding routes to market, and (viii) growing our presence in international markets.

Non-GAAP disclosures

In accordance with accounting principles generally accepted in the U.S. (U.S. GAAP), the income statements of our non-U.S. operations are translated into U.S. dollars using the average exchange rates for each month in an applicable period. To the extent the U.S. dollar weakens against foreign currencies, the translation of transactions denominated in foreign currencies results in increased revenue, as stated in U.S. dollars, for our non-U.S. operations. Similarly, revenue, as stated in U.S. dollars, for our non-U.S. operations decreases if the U.S. dollar strengthens against foreign currencies. In this Part II, Item 7, we disclose non-GAAP amounts and growth rates that exclude the impact of foreign currency exchange rate fluctuations for fiscal 2017 in an effort to provide a comparable framework for assessing how our business performed when compared to fiscal 2016. To compute the non-GAAP impact of foreign currency exchange rate fluctuations, we translate amounts from our non-U.S. operations for fiscal 2017 using the average foreign currency exchange rate for the twelve months ended February 29, 2016.

Revenue

For fiscal 2017, total revenue increased 17.5%, or \$359.6 million, to \$2.41 billion from \$2.05 billion for fiscal 2016. Excluding the impact of foreign currency exchange rate fluctuations, total revenue increased by 17.1% for fiscal 2017. The growth rates of subscription revenue by offering type, training and services revenue and total revenue, as reported and excluding the impact of foreign currency exchange rate fluctuations, for fiscal 2017 versus fiscal 2016 are as follows (in thousands):

	Fiscal Year Ended		
	February 28, 2017	February 29, 2016	Year-Over- Year Growth Rate
Infrastructure-related subscription revenue, as reported	\$ 1,696,443	\$ 1,480,463	14.6%
Adjustment for foreign currency exchange rates	(8,895)		
Infrastructure-related subscription revenue, excluding foreign currency impact	1,687,548	1,480,463	14.0%
Application Development-related and other emerging technology subscription revenue, as reported	439,337	322,986	36.0%
Adjustment for foreign currency exchange rates	(1,330)		
Application Development-related and other emerging technology subscription revenue, excluding foreign currency impact	438,007	322,986	35.6%
Total subscription revenue, as reported	2,135,780	1,803,449	18.4%
Adjustment for foreign currency exchange rates	(10,225)		
Total subscription revenue, excluding foreign currency impact	2,125,555	1,803,449	17.9%
Total training and services revenue, as reported	276,023	248,781	11.0%
Adjustment for foreign currency exchange rates	2,582		
Total training and services revenue, excluding foreign currency impact	278,605	248,781	12.0%
Total subscription and training and services revenue, as reported	2,411,803	2,052,230	17.5%
Adjustment for foreign currency exchange rates	(7,643)		

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Total subscription and training and services revenue, excluding foreign currency impact	\$ 2,404,160	\$ 2,052,230	17.1%
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Subscription revenue

Our enterprise technologies are delivered primarily under subscription agreements. These agreements typically have a one- or three-year subscription period. A subscription generally entitles a customer to, among other things, a specified level of support, as well as security updates, fixes, functionality enhancements, upgrades to the technologies, each if and when available, and compatibility with an ecosystem of certified hardware and software. Subscription revenue increased sequentially for each quarter of fiscal 2017, fiscal 2016 and fiscal 2015 and was driven primarily by the increased use of our offerings by customers and our expansion of sales channels and geographic footprint during these periods.

Subscription revenue increased 18.4%, or \$332.3 million, for fiscal 2017 compared to fiscal 2016. Excluding the impact of foreign currency exchange rate fluctuations, subscription revenue increased by 17.9% for fiscal 2017. The increase in subscription revenue is driven primarily by additional subscriptions related to our principal Red Hat Enterprise Linux and Red Hat JBoss Middleware offerings, which continue to gain broader market acceptance in mission-critical areas of computing, and our expansion of sales channels and our geographic footprint. The increase is, in part, a result of the continued migration of enterprises in industries such as financial services, government, technology and telecommunications to our open source solutions from proprietary technologies.

Training and services revenue

Training and services revenue increased 11.0%, or \$27.2 million, for fiscal 2017 as compared to fiscal 2016. Excluding the impact of foreign currency exchange rate fluctuations, training and services revenue increased by 12.0%. The increase is driven primarily by customer interest in new products and increased demand for our open source solutions.

Deferred revenue, billings proxy, seasonality and backlog

Deferred revenue

Our deferred revenue, current and long-term, balance at February 28, 2017 was \$2.07 billion. Total deferred revenue at February 28, 2017 increased 20.2%, or \$347.4 million, as compared to the balance of \$1.72 billion at February 29, 2016. Excluding the impact of foreign currency exchange rate fluctuations, total deferred revenue increased by 20.3%, or \$348.9 million, from February 29, 2016 to February 28, 2017. Because of our subscription model and revenue recognition policies, deferred revenue improves predictability of future revenue. For example, current deferred revenue provides a baseline for revenue to be recognized over the next twelve months. Similarly, long-term deferred revenue provides a baseline for revenue to be recognized beyond twelve months. Revenue derived from CCSPs for the delivery of our technologies as a service available on demand is recognized by us in the period earned and billed in arrears. As a result, revenue derived from CCSPs has no associated deferred revenue.

The increase in deferred revenue reported on our Consolidated Balance Sheets of \$347.4 million differs from the increase of \$348.5 million we reported on our Consolidated Statements of Cash Flows for fiscal 2017 as the amount reported on our Consolidated Statements of Cash Flows for fiscal 2017 excludes (i) the impact of changes in foreign currency exchange rates used to translate deferred revenue balances from our foreign subsidiaries functional currency into U.S. dollars and (ii) deferred revenue of approximately \$0.4 million acquired as part of business combinations during the same period.

Current deferred revenue increased by 18.8%, or \$239.9 million, to \$1.51 billion at February 28, 2017 from \$1.27 billion at February 29, 2016 and long-term deferred revenue increased by 23.9%, or \$107.6 million, to \$557.2 million at February 28, 2017 from \$449.6 million at February 29, 2016. Excluding the impact of foreign currency exchange rate fluctuations, current deferred revenue increased by 18.8%, or \$239.8 million, and long-

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term deferred revenue increased by 24.3%, or \$109.1 million, from February 29, 2016 to February 28, 2017. Below is a summary of our deferred revenue for February 28, 2017 and February 29, 2016 (in thousands):

	February 28, 2017	February 29, 2016	Year-Over- Year Growth Rate
Current deferred revenue, as reported	\$ 1,512,762	\$ 1,272,908	18.8%
Adjustment for foreign currency exchange rates	(83)		
Current deferred revenue, excluding foreign currency impact	\$ 1,512,679	\$ 1,272,908	18.8%
Long-term deferred revenue, as reported	\$ 557,194	\$ 449,636	23.9%
Adjustment for foreign currency exchange rates	1,563		
Long-term deferred revenue, excluding foreign currency impact	\$ 558,757	\$ 449,636	24.3%
Total deferred revenue, as reported	\$ 2,069,956	\$ 1,722,544	20.2%
Adjustment for foreign currency exchange rates	1,480		
Total deferred revenue, excluding foreign currency impact	\$ 2,071,436	\$ 1,722,544	20.3%

Billings proxy

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

Our annual billings proxy increased by 19.4%, or \$447.6 million, to \$2.76 billion for fiscal 2017 from \$2.31 billion for fiscal 2016. Using the average foreign currency exchange rates from fiscal 2016, our billings proxy for fiscal 2017 would have increased by approximately 19.0%, or \$440.0 million. Below is a summary of our billings proxy for fiscal 2017 and fiscal 2016 (in thousands):

	Fiscal Year Ended		
	February 28, 2017	February 29, 2016	Year-Over- Year Growth Rate
Revenue, as reported	\$ 2,411,803	\$ 2,052,230	17.5%
Change in deferred revenue, as reported on Statements of Cash Flows	348,534	260,495	
Billings proxy	2,760,337	2,312,725	19.4%
Adjustment to revenue for foreign currency exchange rates	(7,643)		
Billings proxy, excluding foreign currency impact	\$ 2,752,694	\$ 2,312,725	19.0%

Seasonality

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

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each quarter. The year-over-year compounding effect of this seasonality in billing patterns and overall new business and renewal activity causes the value of invoices making up our billings that we generate in the last half of our fiscal year to continually increase in proportion to the value of our invoices making up our billings in the first half of our fiscal year.

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Below is a summary of our billings (approximated as described above by adding revenue for the period with the change in deferred revenue as reported on our Consolidated Statements of Cash Flows for the same period) by quarter for fiscal 2017, fiscal 2016, fiscal 2015, fiscal 2014 and fiscal 2013 (in thousands):

Fiscal Years Ended	First quarter		Second quarter		Third quarter		Fourth quarter	
	Billings proxy	% of fiscal year total	Billings proxy	% of fiscal year total	Billings proxy	% of fiscal year total	Billings proxy	% of fiscal year total
February 28, 2017	\$ 521,806	18.9%	\$ 572,851	20.8%	\$ 679,441	24.6%	\$ 986,239	35.7%
February 29, 2016	\$ 449,439	19.4%	\$ 479,131	20.7%	\$ 620,244	26.8%	\$ 763,911	33.0%
February 28, 2015	\$ 404,005	19.5%	\$ 439,690	21.2%	\$ 539,807	26.1%	\$ 688,680	33.2%
February 28, 2014	\$ 346,359	19.9%	\$ 376,303	21.6%	\$ 452,555	26.0%	\$ 564,755	32.5%
February 28, 2013	\$ 309,609	20.8%	\$ 349,025	23.4%	\$ 378,813	25.4%	\$ 453,944	30.4%

Backlog

Our total backlog as of February 28, 2017 was approximately \$2.75 billion and includes amounts billed to customers and recognized as current and long-term deferred revenue on our Consolidated Balance Sheet of \$1.51 billion and \$557.2 million, respectively, plus the value of non-cancellable subscription and services agreements to be billed in the future and not reflected in our financial statements, which was in excess of \$650.0 million. Our total backlog as of February 29, 2016 was approximately \$2.13 billion. The value of non-cancellable subscription and service agreements to be billed in the future and not reflected in our financial statements as of February 29, 2016 was in excess of \$410.0 million. The increase in total backlog from approximately \$2.13 billion as of February 29, 2016 to approximately \$2.75 billion as of February 28, 2017 demonstrates increased customer commitment to our open source technologies.

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

Revenue by geography

In fiscal 2017, approximately 41.9%, or \$1.01 billion, of our revenue was generated outside the U.S. compared to approximately 40.9%, or \$838.7 million, for fiscal 2016. Excluding the impact of foreign currency exchange rate fluctuations, our revenue generated outside the U.S. would have been 41.8%, or \$1.00 billion, of our total revenue in fiscal 2017. Our international operations are expected to grow as our international sales force and channels become more mature and as we enter new locations outside the U.S. or expand our presence in existing international locations. As of February 28, 2017, we had offices in more than 90 locations throughout the world.

We operate our business in three geographic regions: the Americas (U.S., Latin America and Canada); EMEA (Europe, Middle East and Africa); and Asia Pacific (principally Australia, China, India, Japan, Singapore and South Korea). Revenue and related year-over-year (YoY) revenue growth rates generated by the Americas, EMEA and Asia Pacific were as follows (in thousands):

Fiscal Year Ended	Americas		EMEA		Asia Pacific		Consolidated	
	Revenue	YoY Growth %	Revenue	YoY Growth %	Revenue	YoY Growth %	Revenue	YoY Growth %
February 28, 2017, as reported	\$ 1,555,290	14.8%	\$ 515,642	18.2%	\$ 340,871	30.3%	\$ 2,411,803	17.5%
Adjustment for foreign currency exchange rates	6,062		876		(14,581)		(7,643)	
February 28, 2017, excluding foreign currency impact	\$ 1,561,352	15.3%	\$ 516,518	18.4%	\$ 326,290	24.7%	\$ 2,404,160	17.1%

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Fiscal Years Ended	Americas		EMEA		Asia Pacific		Consolidated	
	Revenue	YoY Growth %	Revenue	YoY Growth %	Revenue	YoY Growth %	Revenue	YoY Growth %
February 29, 2016, as reported	\$ 1,354,345	18.4%	\$ 436,304	6.3%	\$ 261,581	11.3%	\$ 2,052,230	14.7%
Adjustments for foreign currency exchange	16,743		75,887		28,160		120,790	
February 29, 2016, excluding foreign currency impact	\$ 1,371,088	19.8%	\$ 512,191	24.8%	\$ 289,741	23.3%	\$ 2,173,020	21.4%
February 28, 2015, as reported	\$ 1,144,237	17.4%	\$ 410,299	16.3%	\$ 234,953	13.5%	\$ 1,789,489	16.6%
Adjustment for foreign currency exchange rates	9,092		14,632		12,175		35,899	
February 28, 2015, excluding foreign currency impact	\$ 1,153,329	18.3%	\$ 424,931	20.4%	\$ 247,128	19.4%	\$ 1,825,388	18.9%

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

Gross profit margin

Gross profit margin increased to 85.3% for fiscal 2017 from 84.9% for fiscal 2016. An increase in the cost to deliver our subscription revenue was more than offset by a higher mix of subscription revenue relative to training and services revenue and a lower relative cost to deliver our training revenue for fiscal 2017 as compared to fiscal 2016.

Gross profit margin by geography

Gross profit margins by our geographic regions were as follows:

Fiscal Years Ended	Americas	EMEA	Asia Pacific	Consolidated (1)
February 28, 2017	86.3%	86.7%	83.7%	85.3%
February 29, 2016	85.9%	86.5%	83.3%	84.9%
February 28, 2015	85.4%	87.0%	83.8%	84.7%

- (1) Consolidated gross profit as a percentage of revenue includes corporate (non-allocated) share-based compensation expense for fiscal 2017, fiscal 2016 and fiscal 2015 of \$16.6 million, \$15.9 million and \$14.0 million, respectively. For additional information, see NOTE 19 Segment Reporting to our Consolidated Financial Statements.

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

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

Table of Contents**Index to Financial Statements****Income from operations**

Operating income was 13.8%, 14.0% and 14.0% of total revenue for fiscal 2017, fiscal 2016 and fiscal 2015, respectively. Operating expenses as a percent of revenue increased slightly to 71.5% for fiscal 2017 from 70.9% for fiscal 2016 and 70.8% for fiscal 2015 due to continued investment in new and emerging cloud management technologies, including our recent business combinations. These investments are described further in our analysis of results of operations below.

Income from operations by geography

Operating income as a percentage of revenue generated by our geographic regions was as follows:

Fiscal Years Ended	Americas	EMEA	Asia Pacific	Consolidated (1)
February 28, 2017	20.5%	20.7%	29.3%	13.8%
February 29, 2016	22.0%	21.4%	24.3%	14.0%
February 28, 2015	21.2%	21.8%	22.9%	14.0%

- (1) Consolidated operating income as a percentage of revenue includes corporate (non-allocated) share-based compensation expense for fiscal 2017, fiscal 2016 and fiscal 2015 of \$192.5 million, \$166.2 million and \$135.2 million, respectively. For additional information, see NOTE 19 Segment Reporting to our Consolidated Financial Statements.

Cash, cash equivalents, investments in debt securities and cash flow from operations

Cash, cash equivalents and short-term and long-term available-for-sale investments in debt securities balances at February 28, 2017 totaled \$2.13 billion. Cash generated from operating activities for fiscal 2017 totaled \$783.7 million, which represents a 6.4% increase in operating cash flow as compared to fiscal 2016. This increase is due to an increase in subscription and services revenues, billings and collections during the same period.

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

Foreign currency exchange rates impact on results of operations

Approximately 41.9% of our revenue for fiscal 2017 came from sales outside the U.S. We are exposed to significant risks of foreign currency fluctuation primarily from receivables denominated in foreign currency and are subject to transaction gains and losses, which are recorded as a component of net income. The income statements of our non-U.S. operations are translated into U.S. dollars at the average exchange rates for each applicable month in a period. To the extent the U.S. dollar weakens against foreign currencies, the translation of these foreign-currency-denominated transactions results in increased revenue and operating expenses from operations for our non-U.S. operations. Similarly, our revenue and operating expenses will decrease for our non-U.S. operations if the U.S. dollar strengthens against foreign currencies.

Using the average foreign currency exchange rates from fiscal 2016, our revenue from non-U.S. operations for fiscal 2017 would have been lower than we reported by approximately \$7.6 million and operating expenses from non-U.S. operations for fiscal 2017 would have been higher than we reported by approximately \$7.5 million, which would have resulted in income from operations being lower by \$15.1 million.

Business combinations*3scale*

On June 24, 2016, we completed our acquisition of all of the shares of 3scale, Inc. (3scale) for approximately \$29.1 million. 3scale is a provider of application programming interface (API) management

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technology. By adding 3scale to our existing portfolio, including Red Hat JBoss Middleware, Red Hat OpenShift and Red Hat Mobile Application Platform, we strengthened our enablement of the API economy with simplified cloud integration and microservices-based architectures. We incurred approximately \$1.8 million in transaction costs, including legal and accounting fees, relating to the acquisition. These transaction costs have been expensed as incurred and included in general and administrative expense on our Consolidated Statements of Operations for fiscal 2017.

Ansible

On October 16, 2015, we completed our acquisition of all of the shares of Ansible, Inc. (*Ansible*) for approximately \$126.0 million. Ansible is a provider of IT automation solutions that allows its users to manage applications across hybrid cloud environments. The acquisition augments our management portfolio and help customers to deploy and manage applications across private and public clouds, speed service delivery through development and operations initiatives, streamline OpenStack installations and upgrades and accelerate container adoption by simplifying orchestration and configuration. We incurred approximately \$3.9 million in transaction costs, including legal and accounting fees, relating to the acquisition. These transaction costs have been expensed as incurred and included in general and administrative expense on our Consolidated Statements of Operations for fiscal 2016.

FeedHenry

On October 8, 2014, we completed our acquisition of all of the shares of FeedHenry Ltd. (*Feed Henry*) for approximately \$80.2 million. FeedHenry is a provider of cloud-based enterprise mobile application platforms. The acquisition expands our portfolio of application development, integration and platform as a service solutions, enabling us to support mobile application development in public and private environments. We incurred approximately \$1.1 million in transaction costs, including legal and accounting fees, relating to the acquisition. These transaction costs have been expensed as incurred and included in general and administrative expense on our Consolidated Statements of Operations for fiscal 2015.

eNovance

On June 24, 2014, we completed our acquisition of all of the shares of eNovance, SAS (*eNovance*) a provider of open source cloud computing services, for \$67.6 million. The acquisition assists in advancing our market position in OpenStack, and the addition of eNovance's systems integration capabilities and engineering talent is expected to help meet growing demand for enterprise OpenStack consulting, design and deployment. We incurred approximately \$0.9 million in transaction costs, including legal and accounting fees, relating to the acquisition. These transaction costs have been expensed as incurred and included in general and administrative expense on our Consolidated Statements of Operations for fiscal 2015.

Inktank

On April 30, 2014, we completed our acquisition of all of the shares of Inktank Storage, Inc. (*Inktank*), a provider of scale-out, open source storage systems, whose technology, Inktank Ceph Enterprise, delivers object and block storage software to enterprises deploying public or private clouds, for consideration of \$152.5 million. The acquisition complements our existing GlusterFS-based storage and Red Hat Enterprise Linux OpenStack Platform offerings. We incurred approximately \$2.0 million in transaction costs, including legal and accounting fees, relating to the acquisition. These transaction costs have been expensed as incurred and are included in general and administrative expense on our Consolidated Statements of Operations for fiscal 2015.

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CRITICAL ACCOUNTING ESTIMATES

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

Revenue recognition;

Goodwill and other long-lived assets;

Share-based compensation;

Income taxes; and

Loss contingencies.

Revenue recognition

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

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

We also derive a portion of our revenue from CCSPs that provide public clouds with computing resources that allow users to consume such resources as a service. We earn revenue based on subscription units consumed by the CCSP or its end users. These cloud-usage services began expanding in fiscal 2013 and have continued to grow.

For periods prior to March 1, 2015, we recognized cloud-usage revenue upon receipt of usage reports from the CCSPs, which typically report fees owed to us one month or more after the fees have been earned. Effective March 1, 2015, we believed that we had sufficient historical data and experience to estimate this cloud-usage revenue and have begun estimating the amount of and recognizing such revenue in the period earned. The estimates are based on the historical cloud-usage data available.

Goodwill and other long-lived assets

We make judgments about the recoverability of goodwill, identifiable intangible assets and other long-lived assets, including capitalized software purchased or developed for internal use. The assumptions and estimates

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

Share-based compensation

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

Share-based awards expected to vest

With respect to performance-based awards that we grant to certain executive officers and senior management, we estimate the number of shares expected to vest based primarily on our most current reported financial results relative to a defined peer group's most recent reported financial results. Because past or current financial trends may not be predictive of future financial performance, our estimate of the number of shares expected to vest may differ materially from the number of shares that actually vest. The maximum number of potential performance-based shares available to vest as of February 28, 2017 totaled 1.9 million, of which approximately 1.3 million shares are expected to vest with associated compensation expense of \$31.1 million. If all of the potential performance-based shares were to vest, we would be required to recognize additional expense of approximately \$8.6 million. See NOTE 13 Share-based Awards to our Consolidated Financial Statements for further discussion related to awards outstanding and expected to vest.

Income tax benefits related to share-based awards

We recognize share-based compensation expense based on an award's grant date fair value over the performance period and/or requisite service period. Because we do not know the actual amount of tax benefits an award will generate until such award is exercised (or vested), we assume that the amount ultimately recognized for tax purposes will be the same amount we recognized in our operating results, that is for book purposes. Consequently, our deferred tax asset related to share-based compensation expense, which totaled \$51.0 million as of February 28, 2017, is based on each qualifying award's grant date fair value rather than the award's to-be-determined exercise date intrinsic value (or vesting date fair value).

Historically, the difference between the grant date fair value and the exercise date intrinsic value has been significant. As a result of such differences, for fiscal 2017, fiscal 2016 and fiscal 2015, we realized excess tax benefits related to share-based awards totaling \$16.0 million, \$20.2 million and \$5.6 million, respectively.

If the share price for our common stock were to depreciate for a sustained period of time we could be required to recognize a tax benefit shortfall. Such shortfalls could have a material adverse effect on our cash flows and financial results. For further discussion, see NOTE 2 Summary of Significant Accounting Policies, NOTE 11 Income Taxes and NOTE 13 Share-based Awards to our Consolidated Financial Statements.

Income taxes

As described in NOTE 2 Summary of Significant Accounting Policies to our Consolidated Financial Statements, we account for income taxes using the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled.

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We continue to assess the realizability of our deferred tax assets, which primarily consist of share-based compensation expense deductions (described above), tax credit carryforwards and deferred revenue. In assessing the realizability of these deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will be realized. As of February 28, 2017, deferred tax assets totaled \$199.0 million, of which \$5.6 million was offset by a valuation allowance. For further discussion regarding deferred income taxes see NOTE 2 Summary of Significant Accounting Policies and NOTE 11 Income Taxes to our Consolidated Financial Statements.

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

Loss contingencies

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

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

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The following table is a summary of our results of operations (in thousands):

	Fiscal Years Ended			
	February 28, 2017	February 29, 2016	\$ Change	% Change
Revenue:				
Subscriptions	\$ 2,135,780	\$ 1,803,449	\$ 332,331	18.4%
Training and services	276,023	248,781	27,242	11.0
Total subscription and training and services revenue	2,411,803	2,052,230	359,573	17.5%
Cost of subscription and training and services revenue:				
Cost of subscriptions	158,977	126,663	32,314	25.5
As a % of subscription revenue	7.4%	7.0%		
Cost of training and services	195,401	182,966	12,435	6.8
As a % of training and services revenue	70.8%	73.5%		
Total cost of subscription and training and services revenue	354,378	309,629	44,749	14.5%
As a % of total revenue	14.7%	15.1%		
Total gross profit	2,057,425	1,742,601	314,824	18.1%
Operating expense:				
Sales and marketing	1,036,021	848,950	187,071	22.0
Research and development	480,668	413,322	67,346	16.3
General and administrative	208,491	192,281	16,210	8.4
Total operating expense	1,725,180	1,454,553	270,627	18.6%
Income from operations	332,245	288,048	44,197	15.3
Interest income	13,921	11,673	2,248	19.3
Interest expense	23,822	23,121	701	3.0
Other income (expense), net	(2,164)	(1,735)	(429)	24.7
Income before provision for income taxes	320,180	274,865	45,315	16.5%
Provision for income taxes	66,477	75,500	(9,023)	(12.0)
Net income	\$ 253,703	\$ 199,365	\$ 54,338	27.3%
Gross profit margin subscriptions	92.6%	93.0%		
Gross profit margin training and services	29.2%	26.5%		
Gross profit margin	85.3%	84.9%		
As a % of total revenue:				
Subscription revenue	88.6%	87.9%		
Training and services revenue	11.4%	12.1%		
Sales and marketing expense	43.0%	41.4%		
Research and development expense	19.9%	20.1%		

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General and administrative expense	8.6%	9.4%
Total operating expenses	71.5%	70.9%
Income from operations	13.8%	14.0%
Income before provision for income taxes	13.3%	13.4%
Net income	10.5%	9.7%
Effective income tax rate (1)	20.8%	27.5%

(1) See NOTE 11 Income Taxes to our Consolidated Financial Statements for further discussion.

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Revenue

Subscription revenue

Subscription revenue, which is primarily comprised of direct and indirect sales of Red Hat offerings, increased by 18.4%, or \$332.3 million, to \$2.14 billion for fiscal 2017 from \$1.80 billion for fiscal 2016.

Revenue derived from the sale of subscriptions supporting our Infrastructure-related offerings, increased by 14.6%, or \$216.0 million, to \$1.70 billion for fiscal 2017 from \$1.48 billion for fiscal 2016. The increase in subscription revenue is primarily due to increases in volumes sold, including additional subscriptions attributable to geographic expansion and the continued migration of customers to our open source Linux platform from proprietary operating systems.

Revenue derived from the sale of subscriptions supporting our Application Development-related and other emerging technology offerings increased by 36.0%, or \$116.4 million, to \$439.3 million for fiscal 2017 from \$323.0 million for fiscal 2016. The increase is primarily due to additional subscriptions for Red Hat JBoss Middleware offerings. We expect the growth rate of revenue derived from our Application Development-related and other emerging technology offerings to exceed the growth rate of revenue derived from our Infrastructure-related offerings as our Application Development-related and other emerging technology offerings continue to gain broader market acceptance in the enterprise IT environment.

Training and services revenue

Training revenue includes fees paid by our customers for delivery of educational materials and instruction. Services revenue includes fees received from customers for consulting services regarding our offerings, deployment of Red Hat technologies and for delivery of added functionality to Red Hat technologies for our major customers and OEM partners. Total training and services revenue increased by 11.0%, or \$27.2 million, to \$276.0 million for fiscal 2017 from \$248.8 million for fiscal 2016. Training revenue increased by 17.5%, or \$10.2 million, primarily as a result of increased revenue generated from our Red Hat Learning Subscription (RHLS) offerings. Our services revenue increased by 9.0%, or \$17.1 million, as a result of an increase in consulting engagements driven by increased demand for our open source solutions. We expect services revenue to continue growing, though at a slower pace than subscription revenue, as we continue to expand our reach by enabling our channel partners to provide consulting services on our behalf. Combined training and services revenue as a percentage of total revenue was 11.4% and 12.1% for fiscal 2017 and fiscal 2016, respectively.

Cost of revenue

Cost of subscription revenue

The cost of subscription revenue primarily consists of expenses we incur to support, distribute, and package Red Hat offerings. These costs include labor-related costs to provide technical support, security updates and fixes, as well as costs for fulfillment. Cost of subscription revenue increased by 25.5%, or \$32.3 million, to \$159.0 million for fiscal 2017 from \$126.7 million for fiscal 2016. Employee-related expenses increased \$21.7 million for fiscal 2017 as compared to fiscal 2016, due to the expansion of our technical staff in order to meet the demands of our growing subscriber base for support, security updates and fixes, especially with respect to the surge in demand for our emerging technology offerings. The remaining expense increase is related to \$6.9 million higher expense associated with facility and technology infrastructure enhancements and \$3.2 million higher professional services expense. As the number of open source technology subscriptions continues to increase, we expect associated support costs will continue to increase, although we anticipate this will occur at an overall slower rate than that of subscription revenue growth due to economies of scale. Gross profit margin on subscriptions was 92.6% and 93.0% for fiscal 2017 and fiscal 2016, respectively.

Cost of training and services revenue

Cost of training and services revenue is mainly comprised of personnel and third-party consulting costs for the design, development and delivery of custom engineering, training courses and professional services provided

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to various types of customers. Cost of training and services revenue increased by 6.8%, or \$12.4 million, to \$195.4 million for fiscal 2017 from \$183.0 million for fiscal 2016. Costs to deliver our services revenue increased by 6.2%, or \$9.4 million, to \$160.5 million for fiscal 2017. The increase in costs to deliver services includes \$9.8 million increased employee compensation expenses, partially offset by lower outside contractor fees of \$1.8 million. The increase in employee compensation expense is due to the expansion of our professional consulting teams needed to meet a surge in demand for services related to our emerging technology offerings. Total costs to deliver training and services as a percentage of training and services revenue decreased to 70.8% for fiscal 2017 from 73.5% for fiscal 2016 primarily as a result of increased revenue generated from our RHLS offerings.

Gross profit

Gross profit margin increased to 85.3% for fiscal 2017 from 84.9% for fiscal 2016. An increase in the cost to deliver our subscription revenue was more than offset by a higher mix of subscription revenue relative to training and services revenue and a lower relative cost to deliver our training revenue for fiscal 2017 as compared to fiscal 2016.

Operating expenses*Sales and marketing*

Sales and marketing expense consists primarily of salaries and other related costs for sales and marketing personnel, sales commissions, travel, public relations and marketing materials and trade shows. Sales and marketing expense increased by 22.0%, or \$187.1 million, to \$1.04 billion for fiscal 2017 from \$849.0 million for fiscal 2016. Selling costs increased by 24.0%, or \$152.8 million, for fiscal 2017 as compared to fiscal 2016 and include \$130.6 million and \$8.7 million of additional employee- and travel-related expenses, respectively, the majority of which is attributable to the expansion of our sales force from the prior year. Marketing costs grew by 16.1%, or \$34.3 million, for fiscal 2017 as compared to fiscal 2016. The increase in marketing costs includes \$26.5 million of employee compensation expense related to increased headcount and incremental marketing program costs of \$4.0 million. The remaining increase in sales and marketing costs primarily relates to facility and technology infrastructure enhancements, which increased \$11.3 million for fiscal 2017 as compared to fiscal 2016. As a result of continued investments made to expand the breadth of our global sales coverage and depth of our product sales coverage, sales and marketing expense as a percentage of revenue increased to 43.0% for fiscal 2017 from 41.4% for fiscal 2016.

Research and development

Research and development expense consists primarily of personnel and related costs for development of software technologies. Research and development expense increased by 16.3%, or \$67.3 million, to \$480.7 million for fiscal 2017 from \$413.3 million for fiscal 2016. Employee compensation increased by \$60.3 million primarily from the expansion of our engineering group through both direct hires and business acquisitions as we continue investing in hybrid cloud management and our other emerging technologies. The remaining increase in research and development costs relates primarily to process and technology infrastructure enhancements, which increased \$6.2 million. Research and development expense was 19.9% and 20.1% of total revenue for fiscal 2017 and fiscal 2016, respectively.

General and administrative

General and administrative expense consists primarily of personnel and related costs for general corporate functions, including information systems, finance, accounting, legal, human resources and facilities expense. General and administrative expense increased by 8.4%, or \$16.2 million, to \$208.5 million for fiscal 2017 from \$192.3 million for fiscal 2016. The increase in general and administrative expenses results from increased