

RED HAT INC
Form S-3/A
August 16, 2004
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As filed with the Securities and Exchange Commission on August 16, 2004

Registration Statement No. 333-113312

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

Amendment No. 3

to

FORM S-3

REGISTRATION STATEMENT UNDER THE SECURITIES ACT OF 1933

RED HAT, INC.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of incorporation or organization)

06-1364380

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

1801 Varsity Drive

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Raleigh, North Carolina 27606

(919) 754-3700

(Address, including zip code, and telephone number, including area code, of registrant's principal executive offices)

Michael R. Cunningham

General Counsel

Red Hat, Inc.

1801 Varsity Drive

Raleigh, North Carolina 27606

(919) 754-3700

(Name, address, including zip code, and telephone number, including area code, of agent for service)

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Approximate date of commencement of proposed sale to public: As soon as practicable after this Registration Statement becomes effective.

If the only securities being registered on this Form are being offered pursuant to dividend or interest reinvestment plans, please check the following box. "

If any of the securities being registered on this Form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933, other than securities offered only in connection with dividend or interest reinvestment plans, check the following box. x

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, please check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. " _____.

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If this Form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. " _____.

If delivery of the prospectus is expected to be made pursuant to Rule 434, please check the following box. "

The Company hereby amends this Registration Statement on such date or dates as may be necessary to delay its effective date until the Company shall file a further amendment which specifically states that this Registration Statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933 or until the Registration Statement shall become effective on such date as the Commission, acting pursuant to said Section 8(a), shall determine.

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Subject to completion, dated August 16, 2004

PROSPECTUS

RED HAT, INC.

3,284,041 SHARES OF COMMON STOCK

This prospectus relates to resales of shares of common stock previously issued, or to be issued, by Red Hat, Inc. to the former stockholders of Sistina Software, Inc. in connection with our acquisition of that company.

We will not receive any proceeds from the sale of the shares.

The selling stockholders identified in this prospectus, or their pledgees, donees, transferees or other successors-in-interest, may offer the shares from time to time through public or private transactions at prevailing market prices, at prices related to prevailing market prices or at privately negotiated prices.

Our common stock is traded on the Nasdaq National Market under the symbol RHAT. On August 13, 2004, the closing sale price of the common stock on Nasdaq was \$14.04 per share. You are urged to obtain current market quotations for the common stock.

Investing in our common stock involves a high degree of risk. See Risk Factors beginning on page 4.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

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The date of this prospectus is _____, 2004.

The information in this prospectus is not complete and may be changed. The selling stockholders named in this prospectus may not sell these securities until the registration statement filed with the Securities and Exchange Commission is effective. This prospectus is not an offer to sell these securities and the selling stockholders named in this prospectus are not soliciting offers to buy these securities in any jurisdiction where the offer or sale is not permitted.

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PROSPECTUS SUMMARY

This summary highlights important features of this offering and the information included or incorporated by reference in this prospectus. This summary does not contain all of the information that you should consider before investing in our common stock. You should read the entire prospectus carefully, especially the risks of investing in our common stock discussed under Risk Factors.

Unless the context otherwise requires references in this prospectus to Red Hat, we, us, and our refer to Red Hat, Inc. and its subsidiaries. Red Hat® is our registered trademark.

We have not authorized anyone to provide you with information different from that contained or incorporated by reference in this prospectus. The selling stockholders are offering to sell, and seeking offers to buy, shares of our common stock only in jurisdictions where offers and sales are permitted. The information contained in this prospectus is accurate only as of the date of this prospectus, regardless of the time of delivery of this prospectus or of any sale of common stock.

RED HAT, INC.

We are the global leader in providing an enterprise operating system and related systems management services based on open source technology for the information technology infrastructure requirements of large enterprises. We developed an enterprise operating system, Red Hat Enterprise Linux AS, which we introduced in May 2002. Since the original release, we have added two additional versions of Red Hat Enterprise Linux: Red Hat Enterprise Linux ES and Red Hat Enterprise Linux WS. With these offerings we provide a Red Hat Enterprise Linux operating system that, we believe, is suitable from a price and functionality perspective for a wide range of application areas of the information technology infrastructure of the large enterprise, including the technical/developer workstation, the middle tier of the information technology infrastructure, which includes applications such as database ERP and large file systems, and the data center. Red Hat Network provides an integrated management service that allows Red Hat Enterprise Linux technologies to be updated, configured, provisioned and the performance of these technologies to be monitored in an automated fashion. These technology solutions, and the enterprise technology and systems management offerings that will follow them, reflect our commitment to provide an enterprise-wide infrastructure platform based on open source technology.

Many of the leading independent software vendors to the large enterprise, or ISV s, have caused their applications to run on the Red Hat Enterprise Linux operating system. We believe that this widespread support from companies such as Oracle (Oracle 9i Database, Oracle 9i Application Server, Oracle E-Business Suite), IBM (WebSphere, DB2, Lotus, Tivoli, Rational), BMC, Computer Associates, EMC/Legato, VERITAS, BEA, SAP, PeopleSoft and Network Appliance among others has increased the market acceptance of the Red Hat Enterprise Linux operating system. In addition, we have signed global strategic agreements with leading global Intel-based server and workstation hardware vendors to the large enterprise, or IHV s, including Dell, HP, Fujitsu, NEC, Hitachi, Fujitsu Siemens and IBM, all of which have agreed to support Red Hat Enterprise Linux offerings on certain of their Intel-based servers and workstations. In addition, each of these hardware providers has agreed to pre-load Red Hat Enterprise Linux on certain of their Intel-based servers and workstations and sell the hardware and Red Hat Enterprise Linux to their customers as a pre-configured solution. We believe that the distribution of Red Hat Enterprise Linux and our layered infrastructure technologies by these companies will be one of our most critical channels of distribution.

We have developed a complete suite of consulting and training offerings that enable large enterprise customers to capture the significant cost, performance and scalability benefits of our enterprise solutions. We persist in our core belief that the collaborative open source development model is the most effective method to

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create and deliver high quality software to enterprise customers. We believe that the adoption of Red Hat Enterprise Linux, which is based on open source technology, as a mission critical operating system by the large enterprise, is a significant shift in the computing industry, which has by all accounts continued to gain significant momentum during calendar 2003.

We view Red Hat Enterprise Linux as the foundation upon which we will build an open source architecture for the enterprise. It is our strategy to provide an open source alternative to many of the proprietary infrastructure software applications currently used by large enterprises. However, we believe it is essential to our success that we provide our customers choices at all times, which means that we will aim to ensure that competing proprietary software performs as well on our Red Hat Enterprise Linux operating system as any alternative open source software that we distribute.

We were incorporated in Connecticut in 1993 under the name ACC Corp, Inc., and subsequently changed our name to Red Hat Software, Inc. in 1995. We reincorporated in Delaware in 1998 and subsequently changed our name to Red Hat, Inc. in 1999. Our principal executive offices are located at 1801 Varsity Drive, Raleigh, North Carolina 27606 and our telephone number at that address is (919) 754-3700. Our website is located at www.redhat.com. The information on our website is not part of this prospectus.

Sistina Acquisition

On December 17, 2003, we entered into an Agreement and Plan of Merger (the Merger Agreement), by and among us, Wild Acquisition Corp., a Delaware corporation and a wholly-owned subsidiary of us (the Merger Sub) and Sistina Software, Inc., a Delaware corporation (Sistina), providing for the merger of the Merger Sub with and into Sistina with Sistina as the surviving entity. The transaction closed on December 23, 2003. At the effective time of the transaction,

each share of Sistina issued and outstanding immediately prior to transaction was canceled and converted into the right to receive shares of Red Hat common stock pursuant to an exchange ratio provided by the Merger Agreement;

each outstanding option to purchase shares of Sistina capital stock was assumed by Red Hat and converted into an option to purchase shares of Red Hat common stock; and

each outstanding warrant to purchase shares of Sistina capital stock was assumed by Red Hat and converted into a warrant to purchase shares of Red Hat common stock.

Pursuant to the Merger Agreement, we acquired Sistina for consideration at closing valued at \$31.0 million and comprised of 1,979,874 shares of our common stock, the assumption of Sistina's outstanding options and warrants and a nominal amount of cash to avoid the issuance of fractional shares. In addition, the transaction included up to \$12.0 million of contingent consideration based on an earn-out carved into three tranches. No shares were issued at the conclusion of the first and second earn-out periods. The earn-out is based on the achievement of certain bookings targets for the technologies and services previously sold by Sistina over the period beginning on December 23, 2003 and ending March 31, 2005. Shares issued under the earn-out will be determined based on the average closing price of our common stock during the 10 trading days prior to issuance of each tranche of such earn-out shares.

This prospectus relates to the resales of shares of our common stock previously issued, or to be issued, by us to the former stockholders of Sistina in connection with the Merger Agreement.

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As we announced on July 13, 2004, our previously issued consolidated balance sheets as of February 29, 2004 and February 28, 2003 and the consolidated statements of operations, of stockholders' equity and of cash flows for the three fiscal years in the period ended February 29, 2004 have been restated to correct our method of accounting for subscription agreements. Historically, we have recognized revenue for subscription agreements ratably on a monthly basis, meaning that for a one-year subscription, one-twelfth of the subscription revenue was recognized in the calendar month of commencement of the subscription and the remaining revenue was recognized ratably over the next 11 calendar months. In the first quarter of fiscal 2005, we began to recognize revenue ratably over the period of each particular subscription agreement, beginning on the commencement date of the subscription agreement. The effect of the change in method of recognizing subscription revenues on our previously reported financial statements is to defer a portion of the revenue that had been previously recognized in the month of commencement of a subscription to the final month of the subscription term. In addition to the adjustment to revenue, we recorded related adjustments to match the direct cost of enterprise technologies and retail subscriptions and direct sales commissions with the associated adjustment to revenue. The restatement also reflects certain non-recurring adjustments to our unaudited quarterly results for the first, second and third quarters of fiscal 2004 that consist of adjustments to subscription revenues related to lack of adequate vendor specific objective evidence, or VSOE, for five contracts entered into during fiscal 2004, deferral of services revenues related to the sale of training units and other miscellaneous operating expense adjustments. These non-recurring adjustments had been reflected previously in our results for the fourth quarter of fiscal 2004, and we believe they are not material. These non-recurring adjustments also had no effect on our annual results for fiscal 2004.

In connection with the restatement, we determined that our systems, processes and controls were not originally set up to process and report revenues in this manner. We have concluded that this circumstance constitutes a material weakness in our internal control over financial reporting as defined by the Public Company Accounting Oversight Board. We have reflected this correction in our reported results for the quarter ended May 31, 2004 and will make the necessary system, process and control modifications to record, process, summarize and report transactions in accordance with our revenue recognition policy related to subscription agreements to address the identified material weakness in our internal control over financial reporting. We expect these modifications to be completed by September 1, 2004, and expect the costs will be approximately \$500,000 and comprised primarily of additional computer hardware to provide faster processing capability and greater data storage capacity.

THE OFFERING

Common Stock offered by selling stockholders	3,284,041 shares
Use of proceeds	Red Hat, Inc. will not receive any proceeds from the sale of shares in this offering
Nasdaq National Market symbol	RHAT

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RISK FACTORS

Investing in our common stock involves a high degree of risk. You should carefully consider the risks and uncertainties described below before purchasing our common stock. If any of the following risks actually occur, our business, financial condition or results of operations would likely suffer. In that case, the trading price of our common stock could fall, and you may lose all or part of the money you paid to buy our common stock.

RISKS RELATED TO OUR BUSINESS

We may not be able to timely release major product releases and upgrades to our products because we depend on the support of Linux developers not employed by us for improvements and advancement of our Red Hat Enterprise Linux technologies.

We may not be able to release major product releases and upgrades of Red Hat Enterprise Linux on a timely basis because the heart of Red Hat Enterprise Linux, the Linux kernel, is maintained by third parties. Linus Torvalds, the original developer of the Linux kernel, and a small group of engineers, many of whom are not employed by us, are primarily responsible for the development and evolution of the Linux kernel. If this group of developers fails to further develop the Linux kernel or if Mr. Torvalds or prominent Linux developers who are members of this group and are currently employed by us were: to join any of our competitors, no longer be employed by us or no longer work on the Linux kernel, we would have to either rely on another party to further develop the kernel or develop it ourselves. We cannot predict whether enhancements to the kernel would be available from reliable alternative sources. We could be forced to rely to a greater extent on our own development efforts, which would increase our development expenses and may delay our product release and upgrade schedules. In addition, any failure on the part of the kernel developers to further develop and enhance the kernel could stifle the development of additional Linux-based applications.

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

Our success depends in part on our ability to continue to establish and maintain strategic distribution and other collaborative relationships with industry-leading hardware manufacturers (such as Hewlett-Packard, Dell, IBM, Fujitsu and others), distributors, software vendors (such as Oracle) and enterprise solutions providers. These relationships allow us to offer our products and services to a much larger customer base than we would otherwise be able to through our direct sales and marketing efforts. We may not be able to maintain these relationships or replace them on attractive terms. In addition, our existing strategic relationships do not, and any future strategic relationships may not, afford us any exclusive marketing or distribution rights. As a result, many of the companies with which we have strategic alliances pursue alternative technologies and develop alternative products and services in addition to or in lieu of our products and services, 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 products effectively or continue to devote the resources necessary to provide us with effective sales, marketing, and technical support.

If third-party enterprise software application providers do not continue to make their new applications compatible with our Linux-based operating systems, our software will cease to be competitive.

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Our products will not be competitive unless new enterprise software applications continue to be compatible with our Linux-based operating systems. We intend to encourage the development of additional applications that operate on Linux-based operating systems by attracting third-party developers to the Linux platform, providing open source tools to create these applications and maintaining our existing developer relationships through marketing and technical support for third-party developers. If we are not successful in achieving these goals, however, our products will not be competitive and our sales growth will be adversely affected.

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

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 adopt new technology and incorporate it into our products and competing technology becomes more widely used or accepted, the market appeal of our products may be reduced and that could harm our reputation, diminish the Red Hat brand and result in decreased revenue.

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

One of the characteristics of open source software is that anyone can modify the existing software or develop new software that competes with existing open source software. Such competition can develop without the degree of overhead and lead time required by traditional proprietary software companies. It is possible for a new competitor with greater resources than ours to develop its own open source operating system solution, potentially reducing the demand for our solutions.

We have entered into and may continue to enter into or seek to enter into business combinations and acquisitions, which may be difficult to integrate, disrupt our business, dilute stockholder value or divert management attention.

We have acquired several businesses, including, most recently, Sistina Software, Inc. on December 23, 2003. As part of our business strategy, we may enter into additional business combinations and acquisitions in the future. We have limited experience in making acquisitions. In addition, acquisitions are typically accompanied by a number of risks, including:

the difficulty of integrating the operations and personnel of the acquired companies;

the maintenance of acceptable standards, controls, procedures and policies;

the potential disruption of our ongoing business and distraction of management;

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

the inability to maintain a relationship with customers of the acquired business;

the difficulty of incorporating acquired technology and rights into our products and services;

the potential failure to achieve the expected benefits of the combination or acquisition;

expenses related to the acquisition;

potential unknown liabilities associated with acquired businesses; and

unanticipated expenses related to acquired technology and its integration into existing technology.

If we are not successful in completing acquisitions that we may pursue in the future, we would be required to reevaluate our growth strategy and we may have incurred substantial expenses and devoted significant management time and resources in seeking to complete the acquisitions. In addition, with future acquisitions, we could use substantial portions of our available cash as all or a portion of the purchase price. We could also issue additional securities as consideration for these acquisitions, which could cause our stockholders to suffer significant dilution, or incur substantial debt. Any future acquisitions may not generate additional revenue or profit for us.

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If we fail to effectively manage our growth, our operations and financial results could be adversely affected.

We have expanded our operations rapidly in recent years. For example, our aggregate revenues increased from approximately \$90.3 million for the year ended February 28, 2003 to approximately \$124.7 million for the year ended February 29, 2004. Moreover, the total number of employees of Red Hat has been steadily increasing over at least the last three quarters. In addition, we continue to explore ways to extend our product and service offerings, and geographic reach. Our growth has placed and may continue to place a strain on our management systems, information systems, resources and internal controls. Our ability to successfully offer products and services and implement our business plan requires adequate information systems and resources and oversight from our senior management. We have, with our audit committee, undertaken to review and improve our financial and managerial controls, reporting systems and procedures. We will need to continue to modify and improve these controls, systems and procedures and other internal controls and compliance procedures as we continue to grow and expand our business. As we grow, we must also continue to hire, train, supervise and manage new employees. We may not be able to hire, train, supervise and manage sufficient personnel or develop management and operating systems to manage our expansion effectively. If we are unable to manage our growth and improve our controls, systems and procedures, our operations and financial results could be adversely affected.

RISKS RELATED TO LEGAL UNCERTAINTY

We could be prevented from selling or developing our software if the GNU General Public License and similar licenses under which our products are developed and licensed are not enforceable.

The Linux kernel and the Red Hat Linux operating system 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. The GNU General Public license is a subject of litigation in the case of The SCO Group, Inc. v. International Business Machines Corporation, pending in the United States District Court for the District of Utah. It is possible that a court would hold these licenses to be unenforceable in that litigation or that someone could assert a claim for proprietary rights in a program developed and distributed under them. Any ruling by a court that these licenses are not enforceable, or that Linux-based operating systems, or significant portions of them, may not be liberally copied, modified or distributed, would have the effect of preventing us from selling or developing all or a portion of our products.

Our subscription-based contract model may encounter customer resistance.

The subscription agreement for Red Hat Enterprise Linux requires customers to agree to a subscription for our systems management services for each machine on which they deploy Red Hat Enterprise Linux. At the same time, the subscription agreement places no restriction on the customer's right to redistribute Red Hat Enterprise Linux. While we believe this practice fully complies with the requirements of the GNU General Public License, and while we have reviewed this practice with the Free Software Foundation, the organization that maintains and provides interpretations of the GNU General Public license, we may still encounter customer resistance to this distribution model. To the extent we are unsuccessful in promoting or defending this distribution model, our business and operating results could be materially and adversely affected.

If our products are found to infringe third-party intellectual property rights, we could be required to redesign our products, replace components of our products or enter into license agreements with third parties.

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We have committed to all of our customers with valid, registered Red Hat Enterprise subscriptions that if any portion of our Red Hat Enterprise Linux product is found to infringe any third party intellectual property rights we will, at our expense and option: (i) obtain the right for the customer to continue to use the product consistent with their subscription agreement with us; (ii) modify the product so that it is non-infringing; or (iii)

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replace the infringing component with a non-infringing component. Although we cannot predict whether we will need to satisfy this commitment, and although our subscription agreements typically state that our liability thereunder shall not exceed the amount a customer paid to us during the previous 12 months, satisfying the commitment could be costly and time consuming and could materially and adversely affect our financial results. In addition, our insurance policies may not adequately cover our exposure to this type of claim.

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

We are vulnerable to claims that our products infringe third-party intellectual property rights including trade secrets because our products are comprised of distinct software components, many of which are developed by numerous independent parties. Claims for infringement of intellectual property rights may be filed and may seek damages and injunctive relief. The risk of infringement claims is exacerbated by the fact that much of the code in our products is developed by numerous independent parties over whom we exercise no supervision or control. It is further exacerbated by our lack of access to unpublished software patent applications. Claims of infringement could require us to seek to obtain licenses from third parties in order to continue offering our products, re-engineer our products, or discontinue the sale of our products in the event that obtaining licenses and re-engineering could not be accomplished on a timely and cost effective basis.

SCO Group, Inc., or SCO, has publicly alleged that certain Linux kernels contain unauthorized UNIX code or derivative works. On August 4, 2003, we filed a complaint against SCO in the United States District Court for the District of Delaware seeking, among other things, a declaratory judgment that we are not infringing any of SCO's intellectual property rights. SCO, to date, has not asserted a claim of infringement against us. Uncertainty concerning SCO's allegations, regardless of their merit, could adversely affect sales of our products. If SCO were to prevail in this or other actions related to their claims regarding Linux, our business could be materially and adversely affected. Defending patent infringement, copyright infringement and/or trade secret claims, even claims without significant merit, can be expensive. An adverse legal decision affecting our intellectual property could materially harm our business.

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

Despite certain testing by ourselves and our customers, errors have been and may continue to be found in our products after commencement of commercial shipments. This risk is exacerbated by the fact that much of the code in our products is developed by independent parties over whom we exercise no supervision or control. If errors are discovered, we may have to make significant expenditures of capital to eliminate them and may not be able to successfully correct them in a timely manner or at all. Errors and failures in our products could result in a loss of, or delay in, market acceptance of our products and could damage our reputation and our ability to convince commercial users of the benefits of Linux-based operating systems and other open source software products.

In addition, failures in our products could cause system or other failures for our customers who may assert warranty and other claims for substantial damages against us. Although our license agreements with our customers typically contain provisions designed to limit our exposure to potential product liability claims, it is possible that these provisions may not be effective or enforceable under the laws of some jurisdictions. In addition, our insurance policies may not adequately limit our exposure to this type of claim. These claims, even if unsuccessful, could be costly and time consuming to defend.

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

Our most valuable intellectual property is our collection of trademarks. The protective steps we have taken in the past have been, and may in the future continue to be, inadequate to deter misappropriation of our trademark rights. Although we do not believe that we have suffered any material harm from misappropriation to date, 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 the Americas, Europe, Asia and Australia and have other trademark applications pending in each of those regions. Effective trademark protection may not be available in every country in which we offer or intend to offer our products and services. Failure to adequately protect our trademark rights could damage or even destroy the Red Hat brand 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.

In connection with our restatement of historical financial statements, class action and derivative lawsuits have been filed against us and additional lawsuits may be filed.

Following the announcement of our intention to restate historical financial statements, as of August 12, 2004, at least 13 lawsuits claiming to be class actions and at least one lawsuit claiming to be a derivative action were commenced against us and certain of our current directors and officers, by or on behalf of persons claiming to be our shareholders and persons claiming to have purchased or otherwise acquired our securities at specified periods beginning as early as June 19, 2001 and continuing through July 13, 2004. Additional lawsuits that have been announced have not yet been served on us and additional lawsuits may be announced or filed against us. Regardless of the outcome of any of these actions, it is likely that we will incur substantial defense costs and that such actions will cause a diversion of our management's time and attention. If we do not prevail in these cases we could be required to pay substantial damages or settlement costs, which could have a material adverse effect on our financial condition or results of operations. We are unable at this time to assess the validity of the claims or estimate the possible range of damages that might be incurred as a result of the lawsuits. We have not yet established any financial reserves relating to any of these lawsuits.

We may suffer material adverse consequences if we are deemed to be an investment company and may incur significant costs to avoid investment company status.

We may be deemed to be an investment company under the Investment Company Act of 1940 (the "1940 Act"), if we own investment securities with a value exceeding 40% of our total assets, unless a particular exclusion or safe harbor provision applies. A large portion of our assets has been invested in investment grade interest-bearing securities, many of which constitute investment securities under the 1940 Act. As of May 31, 2004 our investment securities exceeded 40% of our total assets. We believe that we are excluded from the definition of investment company and the registration requirements of the 1940 Act, but absent further interpretation by the courts or the SEC of the relevant exclusions, this result cannot be assured. Investment companies are subject to registration under the 1940 Act and compliance with a variety of restrictions and requirements imposed under the 1940 Act. If we were to be deemed an investment company, we would become subject to these restrictions and requirements of the 1940 Act and the consequences of having been an investment company without registering thereunder, which could have a material adverse impact on our business.

In addition, we may incur significant costs to avoid investment company status if an exclusion from the 1940 Act were to be considered unavailable to us at a time when the value of our investments that constitute investment securities exceeds 40% of our total assets. If we were required to change the allocation of our assets to reduce our ownership of securities that constitute investment securities, and acquire non-investment security assets, this could result in transaction costs and a reduction in the rate of return on our liquid assets.

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RISKS RELATED TO OUR FINANCIAL RESULTS AND CONDITION

We have incurred substantial net losses on a GAAP basis in the past and may not be able to increase or maintain profitability.

We have incurred net losses in seven of our previous nine fiscal years. As of February 29, 2004, we had an accumulated deficit of \$276.8 million. While we have achieved profitability in fiscal 2004 on a restated basis of \$13.7 million, we cannot be certain that we will be able to sustain or increase profitability. Failure to increase or maintain profitability may adversely affect the market price of our common stock and our ability to raise capital and continue operations.

You should not rely on our quarterly results of operations as an indication of our future results.

Due to the unpredictability of the technology spending environment, our revenue and operating results have fluctuated and may continue to fluctuate from quarter to quarter. 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. We may not be able to adjust our spending quickly enough to protect our projected operating results for a quarter if our revenue in that quarter falls short of our expectations. If among other considerations our future operating results fall below expectations of securities analysts or investors, the market price of our common stock may decline.

We may not be able to effectively attract additional enterprise customers and preserve relationships with current enterprise customers, which could adversely affect revenue.

Historically, we focused our sales and marketing efforts on product sales to individuals. In late fiscal 2002, we began to focus the predominant portion of our sales and marketing efforts on expanding our enterprise customer base. To this end, we have invested extensively to attract enterprise customers. While we have been successful to date in acquiring large enterprise customers, if we are unsuccessful in gaining additional large enterprise customers in the future or in securing subscription renewals from existing enterprise customers, it will adversely affect our future financial performance. In addition, while our subscription agreements generally provide for renewals at prices that are the same as those in effect during the initial term or at then current list prices, there can be no assurance that customers will renew their subscription agreements at the end of the initial or any renewal term or that customers will not seek to condition any renewal on reduced prices. Any failure to obtain customer renewals, or reduction in prices upon renewal, could reduce future revenues.

We may not be able to continue to attract capable management personnel.

Over the past three years we have built our management team during a time of significant unemployment and downturn in the technology sector. This has given us the opportunity to attract capable management personnel. However, our ability to retain key management personnel or hire capable new management personnel as we grow may be challenged if the technology sector rebounds and/or if companies with more generous compensation packages or greater perceived growth opportunities compete for the same personnel.

We depend on our key personnel.

Our future success depends on the continued services of a number of key officers. The loss of the technical knowledge and industry expertise of any of these individuals could seriously impede our success. Moreover, the loss of one or a group of our key employees, particularly to a competitor, and any resulting loss of customers could reduce our market share and diminish the Red Hat brand and adversely affect our business or stock price.

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We may lack the financial and operational resources needed to increase our market share and compete effectively with operating systems providers, Microsoft, other established operating systems developers, software development tools developers, and certain infrastructure service providers.

In the market for operating systems, we face significant competition from larger companies with greater financial resources and name recognition than we have. These competitors, which offer hardware-independent multi-user operating systems for Intel platforms and/or Linux and UNIX-based operating systems, include Microsoft, Novell, IBM, Sun Microsystems, Hewlett-Packard and Unisys, and we may lack the financial and operational resources needed to compete successfully with the current competitors as well as potential new competitors.

As we increase our services offerings, we may face additional competition from larger companies that currently provide service and training related to the Linux operating system as well as other operating systems, particularly UNIX-based operating systems, due to the fact that Linux- and UNIX-based operating systems share many common features. These companies, including IBM, Novell and Hewlett-Packard, may be able to leverage their existing service organizations and provide higher levels of consulting and training on a more cost-effective basis than we can. We may not be able to compete successfully with current or potential competitors.

We may not be able to meet the operational and financial challenges that we will encounter as our international operations, which represented approximately 31% of our total revenue for the year ended February 29, 2004, continue to expand.

Our international operations accounted for 31% of total revenue for the year ended February 29, 2004. As we expand our international operations, we will face a number of additional challenges associated with the conduct of business overseas. For example:

we may have difficulty managing and administering a globally-dispersed business;

fluctuations in exchange rates may negatively affect our operating results;

we have to comply with a wide variety of foreign laws;

we may not be able to adequately protect our intellectual property rights overseas due among other reasons to the uncertainty of laws and enforcement in certain countries relating to the protection of intellectual property rights;

export controls and times of crisis could prevent us from shipping our products into and out of certain markets;

changes in import/export duties and quotas could affect the competitive pricing of our products and services and reduce our market share in some countries; and

economic or political instability in some international markets could result in the forfeiture of some foreign assets and the loss of sums spent developing and marketing those assets.

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

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SPECIAL NOTE REGARDING FORWARD-LOOKING INFORMATION

This prospectus includes and incorporates forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. All statements, other than statements of historical facts, included or incorporated in this prospectus regarding our strategy, future operations, financial position, future revenues, projected costs, prospects, plans and objectives of management are forward-looking statements. The words anticipates, believes, estimates, expects, intends, may, plans, projects, will, and similar expressions are intended to identify forward-looking statements, although not all forward-looking statements contain these identifying words. We cannot guarantee that we actually will achieve the plans, intentions or expectations disclosed in our forward-looking statements and you should not place undue reliance on our forward-looking statements. Actual results or events could differ materially from the plans, intentions and expectations disclosed in the forward-looking statements we make. We have included important factors in the cautionary statements included or incorporated in this prospectus, particularly under the heading Risk Factors, that we believe could cause actual results or events to differ materially from the forward-looking statements that we make. Our forward-looking statements do not reflect the potential impact of any future acquisitions, mergers, dispositions, joint ventures or investments we may make. We do not assume any obligation to update any forward-looking statements.

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We will not receive any proceeds from the sale of shares by the selling stockholders.

The selling stockholders will pay any underwriting discounts and commissions and expenses incurred by the selling stockholders for brokerage, accounting, tax or legal services or any other expenses incurred by the selling stockholders in disposing of the shares. We will bear all other costs, fees and expenses incurred in effecting the registration of the shares covered by this prospectus, including, without limitation, all registration and filing fees, Nasdaq listing fees and fees and expenses of our counsel and our accountants.

SELLING STOCKHOLDERS

We issued, or will issue, the shares of common stock covered by this prospectus in a private placement in connection with our acquisition of Sistina Software, Inc. in December 2003 pursuant to Rule 506 under the Securities Act of 1933, as amended. The following table sets forth, to our knowledge, certain information about the selling stockholders as of June 30, 2004.

Pursuant to the Merger Agreement, we acquired Sistina for consideration at closing valued at \$31.0 million and comprised of 1,979,874 shares of our common stock, the assumption of Sistina's outstanding options and warrants and a nominal amount of cash to avoid the issuance of fractional shares. In addition, the transaction included up to \$12.0 million of contingent consideration based on an earn-out carved into three tranches. No shares were issued at the conclusion of the first and second earn-out periods. The earn-out is based on the achievement of certain bookings targets for the technologies and services previously sold by Sistina over the period beginning on December 23, 2003 and ending March 31, 2005. Shares issued under the earn-out will be determined based on the average closing price of our common stock during the 10 trading days prior to issuance of each tranche of such earn-out shares.

Beneficial ownership is determined in accordance with the rules of the SEC, and includes voting or investment power with respect to shares. Shares of common stock issuable under stock options that are exercisable within 60 days after June 30, 2004 are deemed outstanding for computing the percentage ownership of the person holding the options but are not deemed outstanding for computing the percentage ownership of any other person. Unless otherwise indicated below, to our knowledge, all persons named in the table have sole voting and investment power with respect to their shares of common stock, except to the extent authority is shared by spouses under applicable law. The inclusion of any shares in this table does not constitute an admission of beneficial ownership for the person named below. Each of Joseph Osha, Robert Swiller, St. Paul Venture Capital V, LLC and St. Paul Venture Capital VI, LLC is an affiliate of a registered broker-dealer and each has represented to us that he, she or it acquired the securities to be resold in the ordinary course of business and that he, she or it did not have at the time of acquisition any agreements, understandings or arrangements with any other persons either directly or indirectly, to dispose of the securities.

<u>Name of Selling Stockholder</u>	<u>Shares of Common Stock Beneficially Owned Prior to Offering (1)</u>		<u>Number of Shares of Common Stock Being Offered</u>	<u>Shares of Common Stock to be Beneficially Owned After Offering (1)(2)</u>	
	<u>Number</u>	<u>Percentage</u>		<u>Number</u>	<u>Percentage</u>
Andcor Companies, Inc. (4)	54	*	54		

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Steven Beauclair	25	*	25
Lee Beauclair	4	*	4
Nicole Beauclair	4	*	4
Bruce Bergman (5)	12,816	*	12,816
Bergman Family Trust (6)	45,360	*	45,360
The Bergman Family Trust dated February 6, 1997 (6)	656	*	656

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<u>Name of Selling Stockholder</u>	<u>Shares of Common Stock Beneficially Owned Prior to Offering (1)</u>		<u>Number of Shares of Common Stock Being Offered</u>	<u>Shares of Common Stock to be Beneficially Owned After Offering (1)(2)</u>	
	<u>Number</u>	<u>Percentage</u>		<u>Number</u>	<u>Percentage</u>
Ian Bonner (3)	14,179	*	14,179		
Crescendo IV, L.P. (7)	901,792	*	901,792		
Crescendo IV AG & Co. Beteiligungs KG (7)	54,267	*	54,267		
Crescendo IV Entrepreneur Fund, L.P. (7)	25,228	*	25,228		
Crescendo IV Entrepreneur Fund A, L.P. (7)	11,280	*	11,280		
Frank W. Crusing (3)(8)	37,725	*	37,725		
Tina M. Declerck (3)(9)	1,515	*	1,515		
Enterprise Storage Group (10)	10	*	10		
Faegre & Benson LLP (11)	205	*	205		
Donald D. Frank (12)	10	*	10		
Norikazu Fukunishi	19	*	19		
Mark A. Funari (3)	398	*	398		
Lawrence Brian Greenberg	301	*	301		
Justin Kowalchuk	50	*	50		
Michael J. Lovas, Trustee of the Lovas Trust UTA dated 10/28/99	197	*	197		
Sean MacDonald	298	*	298		
Lisa J. Mephram, Trustee of the Lisa J. Mephram Living Revocable Trust	365	*	365		
Montgomery S. Mouw (3)	566	*	566		
David Mullarkey (13)	1,279	*	1,279		
William C. & Nancy S. Nicholson	1,523	*	1,523		
Daniel P. O Keefe	2,670	*	2,670		
Matthew T. O Keefe (3)(14)	48,499	*	7,316	41,183	*
Matthew T. and Jean S. O Keefe	1,133	*	1,133		
Norbert O Keefe	295	*	295		
Joseph A. Osha and Stephanie M. Oana, joint tenants with right of survivorship	79	*	79		
Joseph Osha and Stephanie Oana	72	*	72		
Michelle L. Peterson					