

RED HAT INC  
Form 10-K  
April 29, 2010  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-K**

**Annual Report Pursuant to Sections 13 or 15(d) of the Securities Exchange Act of 1934**

(Mark One)

**Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**  
For the fiscal year ended February 28, 2010

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.)

**1801 Varsity Drive, Raleigh, North Carolina 27606**

(Address of principal executive offices, including zip code)

**(919) 754-3700**

(Registrant's telephone number, including area code)

**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 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, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer   
Non-accelerated filer

Accelerated filer   
Smaller reporting company

(Do not check if a smaller reporting company)

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

The aggregate market value of the common equity held by non-affiliates of the registrant as of August 31, 2009 was approximately \$3.2 billion based on the closing price of \$22.96 of our common stock as reported by the New York Stock Exchange on August 31, 2009. For purposes of the immediately preceding sentence, the term affiliate consists of each director, executive officer and greater than 10% stockholder of the

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registrant. There were 188,643,958 shares of common stock outstanding as of April 23, 2010.

### **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 12, 2010 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 documents shall not be deemed filed as part of this Annual Report on Form 10-K.

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**ITEM 1. BUSINESS**

**OVERVIEW**

We are a global leader in providing open source software solutions to the enterprise, including our core enterprise operating system platform, Red Hat Enterprise Linux, our enterprise middleware platform, JBoss Enterprise Middleware, our virtualization solutions and other Red Hat enterprise technologies. We employ an open source software development and licensing model that uses the collaborative input of an international community of contributors to develop and enhance software. We actively participate in this community-oriented development process, often in a leadership role, and leverage it to create our Red Hat- and JBoss-branded enterprise technologies.

We believe the open source development and licensing models offer advantages over the proprietary software development and licensing models both for Red Hat and our customers. Through the open source development model, we leverage the community of developers and users, whose collective resources and knowledge supplement the developers we employ. As a result, we believe we are able to offer functionality enhancements and upgrades more quickly and with less development cost than is typical of many proprietary software vendors. In turn, our customers are able to take advantage of the quality and value of open source software, which we help develop, aggregate, integrate, test, certify, deliver, maintain and support for their enterprise use.

The collectively developed software is distributed under open source licenses, such as the GNU General Public License and GNU Lesser General Public License, permitting access to the human-readable software source code. These licenses also provide relatively broad rights for licensees to use, copy, modify and distribute open source software. These broad rights afford significant latitude for our customers to inspect, suggest changes, customize or enhance the software if they so choose.

Red Hat's participation in the community-driven development process is illustrated by Red Hat's sponsorship role in the Fedora Project and the JBoss.org communities. This participation enables us to leverage the efforts of these international communities, which we believe allows us to reduce both development cost and time and to enhance community acceptance and support of our products and technologies. Thus, we are able to use the Fedora Project and the JBoss.org communities as proving grounds and virtual laboratories for new technology that we can draw upon for inclusion in our enterprise technologies. Additionally, the open and transparent nature of these projects provides our customers and potential customers with access and insights into the future direction of Red Hat products and technologies.

We offer a choice of operating systems and virtualization options for servers, work stations, mainframes and desktops that support multiple application areas, including the data center, cloud deployments, software as a service, edge-of-the-network applications, information technology infrastructure (applications such as database, ERP and large web servers), mainframe computing, corporate desktop and technical/developer workstations.

JBoss Enterprise Middleware delivers a range of middleware products for developing, integrating, deploying and managing distributed composite and web-based applications. JBoss Enterprise Middleware is based on the Java programming language that enables the deployment of service-oriented architectures. JBoss Enterprise Middleware provides an application infrastructure for building and deploying distributed applications that are accessible via the Internet, corporate intranets, extranets, clouds and virtual private networks. Examples of applications deployed on JBoss Enterprise Middleware include hotel and airline reservations, online banking, credit card processing, securities trading, healthcare systems, customer and partner portals, retail and point-of-sale systems and telecommunications network infrastructure.

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Our hosted content distribution services, Red Hat Network ( RHN ) and JBoss Customer Support Portal ( JBoss CSP ), permit these Red Hat enterprise technologies to be updated and configured. Our management offerings, Red Hat Network Satellite ( RHN Satellite ) and JBoss Operations Network ( JBoss ON ), permit our customers to provision, update, monitor and manage these and other technologies in an automated fashion. Our suite of training and other professional service offerings also enable enterprise customers to leverage the performance and scalability benefits of our enterprise technologies in their environments.

We also provide other infrastructure enterprise technologies, including software development tools, higher availability clustering of systems and services, and directory services. We intend to continue to expand capabilities available under our open source architecture to help meet the performance, security, reliability and scalability requirements critical to the enterprise. In addition, we also offer a range of consulting, training and support services that are designed to help our customers derive additional value from Red Hat enterprise technologies.

In addition to our development and licensing models, we believe that our business model differentiates Red Hat from many software companies. We provide Red Hat enterprise technologies under annual or multi-year subscriptions. Through the life of a subscription, a customer is entitled to specified levels of support as well as security updates, bug fixes, functionality enhancements and upgrades to the technology, when and if available, via our hosted content distribution services (i.e., RHN and JBoss CSP). This business model allows the customer to access consistent improvements to and innovations in our technologies and the services it needs for the duration of the subscription.

We sell subscriptions to Red Hat enterprise technologies directly to customers and indirectly through various channels of distribution. We sell directly to customers through our sales force and our web store. Our indirect sales channels include distributors, systems integrators, resellers, telecom/network technology companies, cloud computing providers, hosting providers and independent software vendors ( ISVs ). In addition, leading global server and workstation hardware vendors support and pre-load Red Hat enterprise technologies on various servers and workstations and also sell their hardware together with Red Hat Enterprise Linux as part of pre-configured solutions. Red Hat Enterprise Linux and JBoss Enterprise Middleware technologies also have gained widespread support from many of the leading ISVs and independent hardware vendors ( IHVs ). With the support and tools we make available, many of these companies have engineered and certified that their offerings run on or with Red Hat Enterprise Linux, JBoss Enterprise Middleware technologies and Red Hat Enterprise Virtualization or, in the case of some IHVs and ISVs, have built their products using Red Hat Enterprise Linux, JBoss Enterprise Middleware and Red Hat Enterprise Virtualization. We believe widespread support from these companies helps to increase the level of market acceptance and adoption of our enterprise technologies. See NOTE 2 to the Consolidated Financial Statements.

The benefits of the open source development model are becoming better recognized and the acceptance of open source software is continuing to grow. We see this growth in the number of Linux server operating systems in use today, the increasing number of JBoss Enterprise Middleware deployments and an increased level of interest in open source virtualization technologies.

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 refers to Red Hat, Inc. and its subsidiaries.

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**INDUSTRY BACKGROUND**

**Origins of open source software**

The open source software development model originated in academic and research environments. The model is based on the collaborative development of the software's source code, the human-readable code that is used to develop software based on open protocols and standards. Whether individually or in groups, and regardless of location, participating developers, many of whose projects are commercially funded, make their code available over the Internet, give and receive comments on open source code and modify it accordingly. This development model gives open source software an inherent level of transparency and choice that contrasts with the proprietary software development model.

Under the proprietary model of software development, a software vendor generally develops the code 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, with no or limited rights to copy, modify or redistribute that code, and does not make the source code available to the user or other developers. Moreover, peer review and collaborative enhancements are not readily possible because of the lack of access to the source code. In contrast, under the open source development model, the software vendor provides users and other developers with access both to the binary code and the source code and permits the user to copy, modify and redistribute the code to others.

The growth of the Internet has greatly increased the scale and efficiency of open source software development through the availability of collaborative technologies such as email lists, news groups and websites. These technologies have enabled large communities of independent developers, located around the world, to collaborate on more complex open source projects.

We believe that open source software is a viable and arguably superior alternative to traditional proprietary software. As compared to the proprietary model, the open source model:

- allows a company's in-house development team to collaborate and innovate with a global community of independent developers and testers;
- provides the user access to both binary and source code, and the right to inspect, copy, modify and alter the software;
- offers greater flexibility through open rather than proprietary protocols and formats; and
- permits the user ongoing access to improvements made to the software that are distributed by others.

Moreover, we believe open source software offers many potential benefits for software customers and vendors. Not only are customers able to take advantage of the quality and value of open source software, but they can inspect and help diagnose problems easily, and they also may choose to customize the software to suit their particular needs. Vendors are able to leverage the community of open source developers, reducing development costs, decreasing time-to-market and mitigating the risks associated with developing new software solutions.

**Challenges to the widespread adoption of open source by the enterprise**

Despite a strong initial market acceptance of Red Hat Enterprise Linux, JBoss Enterprise Middleware and other Red Hat enterprise technologies by large enterprises, a number of obstacles exist to the continued growth and adoption of these technologies within the enterprise, including:

- competition from well-established proprietary software industry participants such as Hewlett-Packard Company ( HP ), International Business Machines Corporation ( IBM ), Microsoft Corporation ( Microsoft ), Novell, Inc. ( Novell ), Oracle Corporation ( Oracle ), Sun Microsystems, Inc., which was acquired by Oracle in early 2010 ( Sun ), and VMware, Inc. ( VMware );





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- a limited number of established, profitable and viable open source industry participants;
- uncertainty as to the long term success of a development and business model not based on limiting access to proprietary technology; and
- potential concern over threats of intellectual property infringement claims.

### **OUR BUSINESS**

We generally offer and provide our enterprise technologies with related services to our customers in the form of annual or multi-year subscriptions. Our subscription model is designed to provide customers with an all-inclusive software solution, incorporating product delivery, problem resolution, ongoing corrections, enhancements and new versions and compatibility with a portfolio of certified hardware and software applications. In addition, Red Hat customers are eligible to participate in our Open Source Assurance program, which provides certain assurances to customers in the event there is an intellectual property infringement issue with our enterprise products. We believe that the chief information officers of large enterprises select Red Hat enterprise technologies and choose to pay on a subscription basis because of the business value, flexibility and rapid innovation that we provide.

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

We believe the success of our business model is influenced by:

- the extent to which we can expand the breadth and depth of our technology and service offerings;
- our ability to enhance the value of subscriptions for Red Hat enterprise technologies through frequent and continuing innovations to these technologies;
- the acceptance and widespread deployment of open source solutions by small, medium and large enterprises and government agencies;
- our ability to generate subscription revenue for Red Hat enterprise technologies; and
- our ability to provide customers with consulting and training services that generate additional revenue.

### **Use of the open source development model**

We have embraced the open source model in the development of our technology solutions and services. By developing under a collaborative model, we provide a mechanism for independent and commercial developers and our customers to influence our enterprise technologies and to receive the benefits of the collective contributions.

### **Our open source software operating system**

One of the most widely known open source technologies is the Linux kernel, the operating system engine of Red Hat Enterprise Linux. An operating system is the software that allows a computer and its various hardware and software components to interact. A worldwide community of developers collaborates to improve the Linux kernel, and we believe we are able to integrate the best of those improvements into our stable, yet innovative and high-performance Red Hat Enterprise Linux platform. Moreover, as discussed below, Red Hat Enterprise Linux enjoys the support of major original equipment manufacturers ( OEMs ) and ISVs, increasing the interest of developers in adding further enhancements to

the Linux kernel.

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We seek to engineer Red Hat Enterprise Linux to be a comprehensive, technically advanced, reliable and stable operating system. Red Hat Enterprise Linux is an integrated, open source operating system that meets the performance, reliability and scalability demands of chief information officers of large and small enterprises, from the edge of the network to cloud deployments to the data center.

Our operating system is intended to be:

- flexible and scalable capable of running clusters of thousands of systems in a large enterprise on a single device;
- functional able to handle discrete or multiple applications accessed by multiple users;
- adaptable allowing the user to modify the software to meet particular needs and requirements;
- stable and reliable constantly reviewed and fine-tuned by developers worldwide;
- secure offering some of the highest levels of security in the commercial operating system market; and
- high performing yielding an array of quality performance results using industry benchmarks.

### **Our virtualization and other operating system options**

Virtualization allows a single computer system to function as multiple virtual systems by abstracting operating systems and application software from the underlying hardware infrastructure, thereby allowing customers to use a common hardware infrastructure to run multiple operating systems and applications. A major component of our virtualization technology is the Kernel Virtual Machine ( KVM ) platform, which is integrated within the Linux kernel. Our current version of Red Hat Enterprise Linux includes integrated virtualization.

Red Hat s virtualization offerings and other operating system options are intended to maximize resource allocation and operational flexibility both within corporate networks and in cloud computing environments. Red Hat Enterprise Virtualization for Servers is compatible with Red Hat Enterprise Linux and its ecosystem of certified hardware systems and software applications. Our virtualization solutions are designed to allow enterprises to centrally manage virtual environments.

### **Our middleware tools and platforms**

Middleware generally refers to the software that enables the development, operation and integration of software programs and applications. JBoss Enterprise Middleware combines, integrates and refines features from the JBoss.org communities into stable, enterprise-class platform distributions for application and service hosting, content aggregation, data integration and application integration for both the development and deployment of applications.

Our middleware tools and platforms are intended to:

- decrease development complexity;
- improve end-user experience;

- reduce business process friction;
- enable flexibility; and
- lower the total cost of ownership.

**Our systems management solutions**

RHN, RHN Satellite, JBoss CSP and JBoss ON provide management and software delivery services for Red Hat Enterprise Linux and JBoss Enterprise Middleware technologies. With a focus on open standards and

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scalability, our management solutions help organizations increase productivity, lower costs and enhance security by provisioning, managing, monitoring and updating systems.

These management solutions provide organizations with flexibility, security and scalability. Red Hat's customers can manage their deployments by connecting to Red Hat's hosted servers as part of a base subscription, or by implementing the enhanced on-site functionality of RHN Satellite and JBoss ON.

### **Our services**

Our services offerings consist of training, consulting and support designed to meet the needs of the enterprise. With these services, our goal is to help promote customer success by sharing knowledge, experience and advice at all stages of the information technology (IT) life cycle.

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

### **Support by leading independent software and hardware vendors and systems integrators**

To facilitate the widespread deployment of Red Hat Enterprise Linux, JBoss Enterprise Middleware and Red Hat Enterprise Virtualization, we have focused on gaining broad support for our technologies from the providers of hardware, software and systems integrator services critical to the large enterprise. For example, leading software vendors with applications that run on, or with, our enterprise technologies include BMC Software, Inc. (BMC), CA, Inc. (CA), HP, IBM, Microsoft, Oracle, SAP AG (SAP), Sybase, Inc. (Sybase), Symantec Corporation (Symantec) and VMware. In addition, we have certification and pre-load arrangements with leading hardware providers including HP, IBM and Dell Inc. (Dell), as well as Cisco Systems, Inc. (Cisco), Fujitsu Limited (Fujitsu), Fujitsu Siemens Computers (Holding) BV (Fujitsu Siemens), Hitachi, Ltd (Hitachi), and NEC Corporation (NEC), and certification agreements with leading networking and storage companies including Cisco, EMC Corporation (EMC), HP, NetApp, Inc., (Net App), Nokia Corporation (Nokia) and Nokia Siemens Networks. We also have strategic alliance relationships with the leading semiconductor providers Advanced Micro Devices, Inc. (AMD) and Intel Corporation (Intel).

### **An online destination for the open source community**

We are dedicated to helping serve the interests and needs of open source software users and developers online. Our websites, which include redhat.com, jboss.org, fedoraproject.org and opensource.com, serve as a substantial resource for information related to open source initiatives. These websites contain news we believe to be of interest to open source users and developers, features for the open source community, a commerce site and a point-of-access for software downloads and upgrades. Visitors to our websites can organize and participate in user groups, make available incremental code improvements and bug fixes and share knowledge regarding the use and development of open source software. By acting as a publisher of open source information and by facilitating the interaction of developers, particularly through the Fedora and JBoss.org projects, we believe our websites have become community centers for open source. Additionally, redhat.com serves as a primary customer interface, web store and order mechanism for many of our products and services.

### **Segment reporting**

Red Hat is organized primarily on the basis of three geographic business units: the Americas, EMEA (Europe, Middle East and Africa) and Asia Pacific. These business units are aggregated into one reportable

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segment due to the similarity in the nature of products provided (e.g., Red Hat Enterprise Linux, JBoss Enterprise Middleware and Red Hat Enterprise Virtualization products), financial performance economics (e.g., revenue growth and gross margin), methods of distribution (direct and indirect) and customer classification and base (e.g., distributors, resellers and enterprise).

### **Geographic Areas**

As of February 28, 2010, Red Hat had more than 65 locations around the world, including offices in North America, South America, Europe, Asia and Australia. As stated above, we manage our international business on the basis of three geographic business units: the Americas, EMEA and Asia Pacific. See NOTE 2 to our Consolidated Financial Statements for further discussion of our geographic areas of operation. See Item 1A, Risk Factors, for a discussion of some of the risks attendant to our operations.

### **Backlog**

The total value of all non-cancellable subscription and service agreements at February 28, 2010, included deferred revenue classified as a current liability of \$480.6 million, long-term deferred revenue of \$165.3 million and backlog (the value of customer contracts to be billed in the future) not reflected in our financial statements in excess of \$190.0 million. The total value of all non-cancellable subscription and service agreements at February 28, 2009, included deferred revenue classified as a current liability of \$382.1 million, long-term deferred revenue of \$161.0 million and backlog not reflected in our financial statements in excess of \$190.0 million. The amount of backlog at February 28, 2010 that we expect to be billed during the fiscal year ending February 28, 2011 is in excess of \$90.0 million.

## **BUSINESS STRATEGY**

Our business strategy is designed to (i) gain widespread adoption of Red Hat enterprise technologies by enterprise users globally, (ii) generate increasing revenue from our existing customer base by renewing existing subscriptions and providing additional value to our customers, and by growing the number of enterprise technologies that comprise our open source architecture, (iii) generate increasing revenue by providing additional systems management, support and other targeted services and (iv) generate increasing revenue from additional market penetration through a broader and deeper set of channel partner and other strategic relationships, including OEMs, other hardware partners, ISVs, cloud computing providers, value-added resellers ( VARs ) and systems integrators and our own international expansion, among other means.

The key elements of our strategy aim to:

### **Increase the adoption of Red Hat enterprise technologies by enterprise users globally**

A growing number of enterprise users view Red Hat Enterprise Linux as a viable operating system and JBoss Enterprise Middleware as a viable middleware platform for mission-critical areas of their information technology infrastructure. An increasing number of these users deploy JBoss Enterprise Middleware as a comprehensive middleware reference architecture and product portfolio for development, deployment and integration of distributed applications, business processes and web services used in a service-oriented architecture. In addition, we see increasing interest among enterprise users for our virtualization and virtualization management offerings. We seek to promote further adoption of our enterprise technologies by expanding the breadth and depth of our technology and service offerings (such as messaging, high performance computing, realtime and virtualization), bringing new management services to market, improving our technology infrastructure to ease the purchasing and renewal process, offering expanded services, focusing on new geographic markets, and capitalizing on the success of our existing strategic relationships. We believe the relationships with our strategic partners will continue to stimulate the technical advancement and widespread

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distribution of our enterprise technologies and the growth of existing third-party enterprise applications using Red Hat enterprise technologies. We believe that the low-cost, high-value offerings from Red Hat are a catalyst for change in the IT industry, enabling new deployments and migrations, which encourage a larger ecosystem of compatible hardware and software solutions.

### **Continue to expand virtualization and other platform offerings**

We intend to expand our enterprise virtualization suite of server, client and management product offerings to enable customers to increase their deployments of virtualization in enterprise and mission-critical environments. We also expect to continue to invest resources to further develop and market our cloud computing, messaging, realtime and grid product offerings.

### **Continue to expand routes to market**

We intend to continue to grow our traditional distribution, reseller, OEM, ISV and channel partner networks on a global basis. In addition, we are enhancing our relationships with the systems integrators in order to expand our reach into customers who traditionally rely on system integrators for advice and recommendations regarding their technology purchases.

### **Continue to pursue strategic acquisitions and alliances**

We expect to continue to pursue a selective acquisition strategy as opportunities arise to complement and expand our offerings and service capabilities. We also intend to create and extend our strategic alliances where it is beneficial to our business.

### **Continue to grow our presence in international markets**

We have operations in a number of countries in the Americas, EMEA and Asia Pacific, with over 65 offices worldwide. We expect to continue to expand our operations geographically.

We offer our technologies and documentation in various languages. See NOTE 2 to the Consolidated Financial Statements for a discussion of our revenue by geographic area.

### **Continue to invest in the development of open source technology**

We intend to continue to invest significant resources in the development of new open source technology in areas that include messaging, virtualization, cloud computing, real-time computing, middleware, management, security and identity, capitalizing on our substantial experience working with the open source model and community. 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 services.

## **PRODUCTS AND SERVICES**

Red Hat's software solutions, consisting of Red Hat enterprise technologies such as Red Hat Enterprise Linux, JBoss Enterprise Middleware and Red Hat Enterprise Virtualization, are at the center of our subscription strategy and our open source architecture. Our services offerings, principally directed toward our medium and large enterprise customers and the leading hardware providers with whom we have strategic relationships, include technical support and maintenance, training, professional consulting services, engineering services and hardware certification.

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Generally, we provide our enterprise technologies with related services in the form of annual or multi-year subscriptions. Our subscriptions include a bundle of services encompassing product delivery, problem resolution, ongoing corrections, enhancements and new versions, certified capability with a portfolio of hardware and software applications and Red Hat's Open Assurance program. The subscriptions offer varying levels of support services as well as access to basic software updates and configuration management functionality via our integrated management technologies RHN, RHN Satellite, JBoss CSP and JBoss ON.

### **Red Hat Enterprise Linux technologies**

Red Hat Enterprise Linux is an operating system built from various open source software packages including the Linux kernel, and is designed expressly for enterprise computing. Red Hat Enterprise Linux delivers the features required for commercial deployments, including:

- Support for a wide range of ISV applications from vendors such as BMC, CA, HP, IBM, Microsoft, Oracle, SAP, Sybase and Symantec;
- Certification on multiple architectures and leading OEM platforms, including Cisco, Dell, Fujitsu, Fujitsu Siemens, HP, Hitachi, IBM, NEC and Sun;
- Comprehensive technical support, with up to 24x7, one-hour response, available both from Red Hat and selected ISV/OEM partners;
- Performance and scalability in accordance with leading industry benchmarks;
- Stability based upon periodic upgrade cycles on a when and if available basis and multiyear support lifecycle; and
- Virtualization capability incorporated into the core operating system.

Red Hat Enterprise Linux is generally offered in three configurations:

- *Red Hat Enterprise Linux* a base product server offering with virtualization support and a virtual guest offering for use with Red Hat or third-party hypervisors.
- *Red Hat Enterprise Linux Advanced Platform* a comprehensive solution bundle that includes Red Hat Enterprise Linux, Red Hat Global File System and Red Hat Cluster Suite. Red Hat Enterprise Linux Advanced Platform targets customers who require a complete, integrated virtualization solution.
- *Red Hat Enterprise Linux Desktop* an open source desktop offering.

We believe that these configurations simplify the product selection and purchase process and drive deeper product adoption, while providing the flexibility that our customers desire. Each of these offerings includes virtualization capabilities that provide customers with tools to help in optimizing both existing and new hardware while providing more deployment options regarding variable workloads, virtual appliances, legacy applications and testing configurations.

### **JBoss Enterprise Middleware**



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JBoss Enterprise Middleware provides a suite of products for developing, deploying, integrating and managing distributed, composite and web-based applications and services. JBoss products are based on the Java programming language, are deployed on a variety of leading operating systems and support a distributed, modular, reusable and open standards-based Service Oriented Architecture or SOA deployment for applications and data. JBoss Enterprise Middleware offerings consist of a number of deployment platforms, tools and development frameworks, including:

- *JBoss Enterprise Application Platform* provides an environment for building, hosting and deploying Java-based applications and services. It includes JBoss Application Server, Seam, Hibernate, JBoss Cache, JBoss Transactions, JBoss Messaging and JBoss Web services.

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- *JBoss Enterprise Web Platform* leverages the Java Enterprise Edition Web Profile concept to provide a standards-based environment for building light Java applications.
- *JBoss Enterprise Web Server* a single enterprise open source solution for large scale websites and lightweight applications that utilize Apache Tomcat and Apache Web Server.
- *JBoss Enterprise SOA Platform* provides the environment for deploying and integrating SOAs and business processes.
- *JBoss Enterprise Portal Platform* provides a Java-based platform for deploying standards-based portals.
- *JBoss Enterprise BRMS* a business rules management system that enables business policy and rules development, access and change management.
- *JBoss Developer Studio* provides an Eclipse-based application development environment for developing Java applications and development tools for building rich web-based applications and SOA services.
- *JBoss Enterprise Data Services Platform* provides an environment integrating distributed data sources and provides for data federation, data abstraction, data transformation and metadata management.
- *JBoss Hibernate Framework* an object/relational mapping and persistence framework.
- *JBoss Seam Framework* an application framework for building Web 2.0 applications.
- *JBoss Web Framework Kit* an integrated bundle of open source frameworks that are used for building light Java applications.

## **Red Hat Enterprise Virtualization**

Red Hat Enterprise Virtualization for Servers is designed to enhance the capital and operational efficiencies of our customers by increasing server utilization and deployment flexibility. Our virtualization solution for servers consists of two offerings:

- *Red Hat Enterprise Virtualization Hypervisor* a hypervisor based on KVM technology that essentially converts the Red Hat Enterprise Linux kernel into a virtualization platform; and
- *Red Hat Enterprise Virtualization Manager for Servers* a server virtualization management system that provides advanced capabilities for both host and guest operating systems, including high availability, live migration, power manager, storage manager and system scheduler.

Red Hat Enterprise Virtualization for Servers is compatible with Red Hat Enterprise Linux and its wide ecosystem of certified hardware systems and software applications. Our virtualization solution allows enterprises to centrally manage virtual environments.

## **Additional Red Hat enterprise technologies**

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Red Hat enterprise technologies also include other technology infrastructure, including software for software development, high availability clusters of Linux systems and storage, directory server services and authentication of users. These applications broaden customer choice and are components of our open source architecture vision for the enterprise. These technologies include:

- *Red Hat MRG* integrates open and scalable messaging, a real-time kernel with predictable performance and grid management tools for high-performance distributed computing solutions, including virtualization, cloud computing and bare-metal mission-critical applications.
- *Red Hat Developer Offering* provides integrated development environments and support for application developers.

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- *Red Hat Cluster Suite* features clustering and uses application fail-over technology, which is designed to enable high-availability application environments.
- *Red Hat Global File System* is an enterprise-strength clustered file system for Linux, designed for commercial and technical computing applications requiring access to shared data.
- *Red Hat Certificate System* is a scalable authentication system for appropriately limiting access to mission-critical resources and data.
- *Red Hat Directory Server* centralizes application settings, user profiles, group data, policies and access control information into an operating system-independent, network-based registry.

### **Red Hat systems management solutions**

RHN, RHN Satellite, JBoss CSP and JBoss ON provide management and software delivery services for Red Hat Enterprise Linux and JBoss Enterprise Middleware technologies. With a focus on open standards and scalability, our management solutions help organizations increase productivity, lower costs and enhance security by provisioning, managing, monitoring and updating systems.

Services for Red Hat Enterprise Linux and JBoss Enterprise Middleware are available to provide organizations with the appropriate level of flexibility, security and scalability based on their size and needs. Red Hat's customers can manage their deployments by connecting to Red Hat's hosted servers or by implementing the enhanced functionality of RHN Satellite and JBoss ON.

*Red Hat Network* Through RHN, Red Hat provides an on-line method for its customers to obtain certified software and upgrades and to manage, provision and monitor deployments of Red Hat Enterprise Linux.

*RHN Update Module* The RHN Update Module is an entry-level offering included with each subscription for Red Hat Enterprise Linux, providing functionality enhancements and upgrades to individual systems. The RHN Update Module includes functionality such as a graphical user interface, priority notification, errata information, and Red Hat Package Manager (RPM) dependency checking and auto update. RHN Update Module also gives customers access to electronic delivery of software related to their Red Hat subscriptions. This is the default method for accessing subscription services for Red Hat Enterprise Linux.

Customers may purchase entitlements to the following additional RHN modules on an annual subscription basis:

*RHN Satellite* RHN Satellite provides RHN functionality, such as managing system profiles and reporting data, locally on a customer's system behind its IT firewall. A customer's RHN Satellite server connects with RHN over the Internet to download updates and upgrades. RHN Satellite offers customers greater control and flexibility over the management of their Red Hat Enterprise Linux systems and may also be used to distribute custom or third party content to their Red Hat Enterprise Linux systems, and monitor the health of their systems. Additional RHN Proxy Servers can be added to an RHN Satellite deployment to improve performance and package downloads for remote locations.

*RHN Management Module* The RHN Management Module allows customers to manage systems running Red Hat enterprise technology. Designed to enable scalable enterprise administration, the RHN Management Module features systems grouping, role-based administration and scheduled actions.

*RHN Provisioning Module* The RHN Provisioning Module includes features such as operating system provisioning (for new, unformatted systems or previously deployed systems), configuration management, multistate rollback, scheduled remote actions, auto discovery, configuration tools and RPM-based application provisioning.

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*RHN Monitoring Module* The RHN Monitoring Module, only available for RHN Satellite deployments, adds performance-tracking capabilities. Users can configure monitoring checks based on numerous pre-built probes, or they can create their own. Email or pager warnings send alerts when defined performance thresholds are crossed.

*JBoss Customer Support Portal* Through JBoss CSP, Red Hat provides an on-line method for JBoss Enterprise Middleware customers to obtain certified software, access to the JBoss information knowledge base and software update alerts and advisories, as well as interact with our JBoss technical support engineers.

*JBoss ON* JBoss ON is deployed in a manner similar to RHN Satellite and allows the customer to manage its JBoss Enterprise Middleware environments. Similar to RHN Satellite, JBoss ON functionality includes inventory, software update, administration, configuration management and resource deployment. JBoss ON also provides an extended module for monitoring and alert notifications on the status of JBoss Enterprise Middleware deployments.

### **Red Hat training, consulting and support services**

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

*Training* Our training services consist of an array of performance-based courses designed to meet the diverse needs of our customers. We deliver more than 30 Red Hat Enterprise Linux and JBoss Enterprise Middleware courses offered worldwide in classroom, corporate on-site and online settings. These courses span topics such as system administration and advanced enterprise development, deployment security, middleware and role-based offerings. Certification paths include Red Hat Certified Technician, Red Hat Certified Engineer, Red Hat Certified Data Specialist, Red Hat Certified Security Specialist, Red Hat Certified Virtualization Administrator, Red Hat Certified Architect and JBoss Certified Application Administrator.

*Consulting* We offer the services of experienced consultants to assist with the technology infrastructure needs of our customers. Our offerings include assessments, installations, 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 installing, configuring and using Red Hat enterprise technologies. Additionally, we offer a technical account manager ( TAM ) service for customers that require a more personalized support relationship. The TAM service is designed to offer a highly skilled, proactive support engineer that 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.

## **COMPETITION**

In the operating systems market, 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. These competitors include Microsoft, Novell, Sun and Oracle, all of which offer hardware-independent, multi-user operating systems, and various virtualization software for Intel platforms that compete with Red Hat s offerings. Moreover, HP, IBM, Sun and Unisys Corporation each offer 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. Moreover, Sun also provides its Solaris UNIX software under an open source license. In addition, with virtualization emerging as an important element of the operating environment, virtualization software companies like VMware, Microsoft, Citrix Systems, Inc. ( Citrix ) and Novell are also competitors to Red Hat. No assurance can be given that our efforts to compete effectively will be sufficient.

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Within the specific category of Linux operating systems, our chief competitor has historically been Novell, with its SUSE brand of Linux. In 2006, Oracle, a large and well-capitalized company, also began to sell support for its version of the Linux operating system. See Item 1A, Risk Factors . Other, less well-capitalized, Linux brands include Ubuntu, Debian Mandriva, and other regionally-specific distributions. The financial and legal barriers to creating a new Linux distribution are relatively low because the open source license governing Linux distributions permits copying, modification and redistribution.

In the middleware market, 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. These competitors include, but are not limited to, IBM, Microsoft, Oracle and Sun, all of which offer broad portfolios of enterprise Java and non-Java middleware products. All of these vendors offer the majority of their middleware products under a typical proprietary software license model. IBM and Sun often bundle hardware and software for their customers, making it more difficult to penetrate these customer bases.

In the virtualization market, 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. These competitors include, but are not limited to, VMware, Microsoft, Citrix, Novell and Oracle, and in the case of VMware and Microsoft, have virtualization technologies that are certified and supported with Red Hat Enterprise Linux operating system offerings.

With our services offerings, we face competition in the market for services related to the deployment of our enterprise technologies and the development and integration of applications. Our competitors in the market include HP, IBM, Oracle and Sun, as well as other technology consulting companies.

For our management offerings, we compete with a number of large companies that have significantly greater financial resources, larger development staffs and more extensive marketing and distribution capabilities. These competitors include, but are not limited to, BMC, CA, HP, IBM, Microsoft, Novell and Oracle, all of which offer support for heterogeneous operating system environments, such as Linux, Solaris, AIX, HP-UX and Windows. Many of these competitors have legacy client/server offerings that require relatively long implementation cycles and are difficult to displace in enterprise customers due to, among other reasons, switching costs. There are numerous other companies that focus exclusively on management offerings that are likely to support Linux-based systems as well as non-Linux-based systems.

The recent acquisition of Sun by Oracle could place additional competitive pressure on Red Hat across the virtualization, operating systems and middleware markets. Oracle's acquisition of Sun creates a large, integrated supplier of enterprise software that may also provide hardware optimized for these software products. In addition, Oracle's ownership of the Solaris technologies could make it more difficult for Red Hat to penetrate Sun's installed base of customers.

The open source software market is not characterized by the traditional barriers to entry that are found in the proprietary software model due to the nature of open source technology. For example, anyone can copy, modify and redistribute Red Hat Enterprise Linux, JBoss Enterprise Middleware and our other open source products. However, they are not permitted to refer to these products as Red Hat or JBoss products unless they have a formal business relationship with us that allows such references. Moreover, as it relates to our enterprise technologies and management offerings, our customers agree that during their support relationship with Red Hat, they will purchase a support subscription for each computer system, CPU or other unit on which they deploy Red Hat's software. In addition, the primary means by which customers can receive a certified version of Red Hat enterprise software and receive certified functionality enhancements and upgrades to a copy of Red Hat enterprise software is to purchase and maintain a current subscription directly from us or our partners with whom we have agreements.

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

- the name and reputation of the vendor;
- the ability to adapt development, sales, marketing and support to the open source model;
- the product price, performance, reliability and functionality;
- the alliances of the vendor with major industry hardware and/or software providers;
- the quality of our support and consulting services;
- the financial and value relationship of subscription services;
- the number of Global 2000 reference accounts;
- the number of cloud computing partners and reference accounts;
- the availability of third-party enterprise infrastructure applications that are compatible with the technology;
- the breadth of hardware and software ecosystem compatibility;
- the management framework for administering the software technologies;
- the distribution strength and number of distribution partners of the vendor; and
- the strength of the vendor's relationships and reputation in the open source community.

Although we believe that overall we generally compete on par or favorably with many of our competitors in a number of respects, including product performance, price and breadth of hardware and software compatibility, we believe that a number of our key competitors currently have superior distribution capabilities. In addition, there are significantly more enterprise infrastructure applications available for competing operating systems technologies, such as Windows and UNIX, 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 relationships and entering into new ones to expand our distribution capabilities and by attracting more attention to the open source movement. Also, increasing the volume of installed subscriptions of Red Hat enterprise technologies should create additional opportunities and incentives for software developers to write more applications that are compatible with Red Hat enterprise technologies.

**SOFTWARE ENGINEERING AND DEVELOPMENT**

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We have invested, and intend to continue to invest, significant resources in product and technology development. We expended \$148.4 million, \$130.2 million and \$97.4 million, in our fiscal years ended February 28, 2010, February 28, 2009 and February 29, 2008, respectively, in research and development costs. We focus and modify our product development efforts based on the needs of users and changes in the marketplace. We are currently focusing our development efforts on improving or adding the functionality to our offerings that are needed by the Global 2000 or required for leading third-party applications upon which the Global 2000 are dependent. However, any upgrades and enhancements are offered on a when and if available basis.

Our software engineers collaborate with open source software development teams working across the Internet and through open source communities such as the Fedora Project and JBoss.org. 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 development of open source projects.



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Our software engineers make development contributions to many components comprising the Red Hat Enterprise Linux operating system, JBoss Enterprise Middleware and Red Hat Enterprise Virtualization and provide leadership within the various open source communities across many of the core components.

Our software development engineers perform extensive testing of Red Hat Enterprise Linux, JBoss Enterprise Middleware, Red Hat Enterprise Virtualization, RHN, RHN Satellite, JBoss CSP, JBoss ON, JBoss Developer Studio and other Red Hat enterprise technologies. We use various industry methods of quality assurance testing to help ensure that our enterprise technologies are solidly engineered and ready for use by our customers when delivered. We also work closely with leading hardware and software vendors to help ensure that their hardware and applications will operate effectively with Red Hat enterprise platforms.

In addition, we continue to invest substantial resources in the development and commercialization of open source technologies that provide added value in addition to the operating system.

## **INTELLECTUAL PROPERTY**

Red Hat Enterprise Linux, JBoss Enterprise Middleware and our other open source products have been developed and made available for licensing under the GNU General Public License, the GNU Lesser General Public License and other open source licenses. These licenses permit the licensee to copy, modify and distribute the software. Some licenses, such as the GNU General Public License and the GNU Lesser General Public License, require that any resulting or derivative work that is distributed to others be licensed under the same terms. Therefore, although we generally retain ownership of the copyright in the code that we develop, due to the nature of our open source software products and the licenses under which we develop and distribute them, our most valuable intellectual property is our collection of trademarks. 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.

We pursue registration of some of our trademarks in the United States and in other countries. We have registered the trademark Red Hat 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 name 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 United States. 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 of some of the innovative ideas of our software developers. Not all of these inventions are applicable to our current technologies. Some provide protection to new and other technologies. 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. This permits the development and distribution of open source applications by third parties that could otherwise infringe on our patents. Consequently, it is unlikely that our patents will, of themselves, provide us substantial revenue. Rather, they may provide a measure of deterrence against the potential patent infringement claims of third parties and may help ensure that new technologies and innovations covered by our patents remain open. We are also a founding member and active participant, along with other industry leaders (including IBM, NEC, Philips, Sony and Novell) in the Open Invention Network LLC, which acquires patents with the goal of promoting innovation in open source for the Linux platform.

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Third-parties have in the past asserted, and may in the future 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 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 enterprise products 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 product consistent with their subscription agreement with us; (ii) modify the product so that its use is non-infringing; or (iii) replace the infringing component with a non-infringing component, and indemnify them against specified infringement claims. Although we cannot predict whether we will need to satisfy these commitments and often have limitations on these commitments, satisfying these commitments could be costly and time-consuming and could materially and adversely affect our business, operating results and financial condition.

**EMPLOYEES**

As of February 28, 2010, Red Hat had more than 3,200 employees. From time to time, we also employ independent contractors. Our employees are not represented by any labor union and are not recognized under a collective bargaining agreement, and we have never experienced a work stoppage. We believe our relations with our employees are generally good.

**AVAILABLE INFORMATION**

We maintain a website at [www.redhat.com](http://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 Securities and Exchange Commission (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](http://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.*

*Moreover, 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 include any statement that is not strictly a historical 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 and its partners). Words such as anticipates, believes, expects, estimates, intends, plans, projects, and similar expressions, may also identify such forward-looking statements. Investors are cautioned that these forward-looking statements 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 below and elsewhere in this report as well as in Red Hat's other filings with the Securities and Exchange Commission (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. 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.*

**RISKS RELATED TO BUSINESS UNCERTAINTY**

**Ongoing uncertainty regarding the duration and extent of the recent economic downturn and in global economic and market conditions generally could adversely affect our business, financial condition and results of operations.**

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

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### **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, distributors, software vendors and enterprise solutions providers such as SAP AG ( SAP ), Dell Inc. ( Dell ), Hewlett-Packard Co. ( HP ), International Business Machines Corporation ( IBM ), Fujitsu Limited ( Fujitsu ), NEC Corporation ( NEC ) and others. These relationships allow us to offer our products and services to a much larger customer base than we would otherwise be able 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.

### **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 financial condition or results of operations and dilute stockholder value.**

As part of our business strategy, we have in the past entered into business combinations and acquisitions (for example, our acquisition of JBoss in June 2006 and our acquisition of Qumranet in September 2008), and we may continue to do so in the future. We have limited experience in making acquisitions, and acquisitions present significant challenges and risks, including:

- The difficulty of integrating the operations, systems and personnel of the acquired companies;
- The difficulty of gathering full information regarding the target business prior to the acquisition;
- 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 potential loss of key employees of the acquired business;
- Challenges in maintaining good and effective relations with existing business partners or of those of the acquired business, including as a result of the changes in the competitive landscape effected by the acquisition;
- The difficulty of incorporating acquired technology and rights into our products and services and of maintaining quality standards consistent with our brand;

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- The potential failure to achieve the expected benefits of the combination or acquisition;
- Expenses related to the acquisition;
- Potential unknown liabilities associated with the acquired businesses;
- Unanticipated expenses related to acquired technology and its integration into existing technology; and
- The dilutive impact on our current stockholders' percentage of ownership as a result of issuing shares of our common stock in connection with an acquisition or business combination.

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There can be no assurance that we will manage these challenges and risks successfully. Moreover, if we are not successful in completing acquisitions 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 such 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 we may incur substantial debt. Any acquisition may not generate additional revenue or profit for us, which may adversely affect our operating results.

**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 total revenue increased from \$652.6 million for the fiscal year ended February 28, 2009 to \$748.2 million for the fiscal year ended February 28, 2010. Moreover, the total number of our employees increased from over 2,800 as of February 28, 2009 to over 3,200 as of February 28, 2010 and is expected to generally increase in the foreseeable future. In addition, we continue to explore ways to extend our product and service 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 offer products and services and implement our business plan requires adequate information systems and resources and oversight from our senior management. As we grow, we must also continue to hire, train, supervise and manage new employees. As we grow and expand globally, controls and oversight functions will become more complex and distributed and may in part be outsourced. We may not be able to adequately screen and hire or adequately train, supervise and manage sufficient personnel or develop management, or effectively manage and develop our controls and oversight functions and information systems to adequately manage our expansion effectively. If we are unable to adequately manage our growth and expansion, our business, operating results and financial condition could be materially adversely affected.

**We rely, to a significant degree, on an indirect sales channel for distribution of our products and services, and disruption of any part of this channel could adversely affect the sales of our products.**

We use a variety of different distribution methods to sell our products and services, including indirect channel partners, such as third-party OEMs, resellers and distributors. A number of these partners in turn distribute via their own networks of channel partners (e.g., distributors and resellers), with whom we have no direct relationship. We rely, to a significant degree, on our channel partners to, among other activities, select, screen and maintain relationships with our indirect distribution network and for the distribution of our products and services in a manner that is consistent with Red Hat's quality standards. Our indirect distribution channel could be affected by disruptions in the relationships of and with our channel partners and their networks, including their customers or suppliers. As a result, we may be required to devote greater support and professional services resources to distribute our products and support our customers, which could drive up costs and may not be as effective. We cannot guarantee that our channel partners will market our products effectively. Disruptions in our distribution channel or poor marketing support by channel partners could lead to decreased sales or slower than expected growth or increased distribution and support costs.

**We rely on software licensed from other parties, the loss of which could increase our costs and delay software shipments.**

We utilize various types of software licensed from unaffiliated third parties. Aspects of our business could be disrupted if any of the software we license from others or functional equivalents of this software were either no longer available to us or no longer offered to us on commercially reasonable terms. In either case, we would be required to either redesign our products to function with software available from other parties, develop these components ourselves or eliminate the functionality, which would result in increased costs, delays in our product shipments and the release of new product offerings and limit the features available in our current or future products.

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

Our ability to retain key management personnel or hire capable new management personnel as we grow may be challenged to the extent the technology sector performs well and/or if companies with more generous compensation packages or greater perceived growth opportunities compete for the same personnel. In addition, historically we have used share-based compensation as a key component of our compensation packages. Changes in the accounting for share-based compensation could adversely affect our earnings or force us to use more cash compensation to attract and retain capable personnel. If the price of our common stock falls, the value of our share-based awards to the recipient is reduced. Such events, or if we are unable to secure shareholder approval for increases in the number of shares eligible for share-based compensation grants, could adversely affect our ability to successfully attract and retain key management personnel.

### **We depend on our key personnel that we employ, the loss of which could adversely affect our business or stock price and diminish the Red Hat brand.**

Our future success depends on the continued services and effectiveness of a number of key officers and employees, including our CEO, who assumed his role on January 1, 2008. The loss of the technical knowledge and industry expertise of any of these individuals could seriously impede our success. Moreover, the loss of these individuals, particularly to a competitor, some of which may be in a position to offer greater compensation, and any resulting loss of customers could reduce our market share and diminish the Red Hat brand and adversely affect our business or stock price.

A number of our key employees have become, or will soon 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. If we do not succeed in retaining and motivating our CEO and key employees and attracting new key personnel, our business, its financial performance and our stock price may decline.

### **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 teamwork fostered by our culture, and our business may be harmed.**

We believe that a critical contributor to our success has been our corporate culture, which we believe fosters innovation, creativity and teamwork. As our organization grows, and we are required to implement more complex organizational management structures, we may find it increasingly difficult to maintain 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.

### **Our subscription-based contract model may encounter customer resistance or we may experience a decline in the demand for our products.**

The subscription agreement used for many of our products, including Red Hat Enterprise Linux, requires customers to agree to a subscription for our services for each installed system on which they deploy our subscription based products. At the same time, the subscription agreement places no restriction on the customer's right to redistribute the products. While we believe this practice complies with the requirements of the GNU General Public License, and while we have reviewed this practice with the Free Software Foundation, the organization that maintains and provides interpretations of the GNU General Public License, we may still encounter customer resistance to this distribution model or customers may fail to honor the terms of our subscription agreements. To the extent we are unsuccessful in promoting or defending this distribution model, our business and operating results could be materially and adversely affected. Additionally, as technologies and the markets for our enterprise offerings change, our subscription-based contract model may no longer meet the needs of our customers. If we are unable to adapt our contract model to changes in the marketplace, our business and operating results could be adversely impacted.

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### **If our current and future customers do not renew their subscription agreements with us, our operating results may be adversely impacted.**

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

### **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 products, adequately enhance our existing products 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 products. 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 products or we would need to develop and enhance our products 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 product 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 products could become less competitive. Delays in developing, completing or shipping new or enhanced products could result in delayed or reduced revenue for those products and could also adversely affect customer acceptance of those offerings.

### **If third-party enterprise hardware and software providers do not continue to make offerings compatible with our offerings, our software will cease to be competitive.**

Our products will not be competitive unless third-party enterprise hardware and software offerings are compatible with our 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 the Linux platform, 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 hardware platforms by maintaining and expanding our relationships, both business and technical, with relevant independent hardware vendors. If we are not successful in achieving these goals, however, our products will not be competitive and our sales growth will be adversely affected.

### **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 acquire or adopt new technology and incorporate it into our products but competing technology becomes more



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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 the 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 we have 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 new competitors with greater resources than ours to develop their own open source solutions, potentially reducing the demand for, and putting price pressure on, our solutions. For example, in October 2006 Oracle Corporation ( Oracle ) announced plans to sell support for its version of the Linux operating system. In addition, some competitors make their open source software available for free download and use on an ad hoc basis or may position their open source software as a loss leader. We cannot guarantee that we will be able to compete successfully against current and future competitors or that competitive pressure and/or the availability of open source software will not result in price reductions, reduced operating margins and loss of market share, any one of which could seriously harm our business.

**Industry consolidation may lead to increased competition and may harm our operating results.**

There has been a trend in industry consolidation in our markets for several years. We expect this trend to continue as companies attempt to strengthen or hold their market positions in an evolving industry and as companies are acquired or are unable to continue operations. For example, in early 2010, Oracle Corporation ( Oracle ) completed its acquisition of Sun Microsystems, Inc. ( Sun ). Oracle's acquisition of Sun creates a large, integrated supplier of enterprise software that may also provide hardware optimized for these software products. We believe that industry consolidation may result in stronger competitors that are better able to compete as sole-source vendors for customers. This could have a material adverse effect on our business, financial condition and results of operations.

**Our continued success depends on our ability to adapt to a rapidly changing industry as well as maintaining a strong brand. Investment in new business strategies and initiatives could disrupt our ongoing business and may present risks not originally contemplated.**

We must continue to invest significant resources in research and development in order to enhance our existing products and services and introduce new high-quality products and services and technology infrastructure. If we are unable to ensure that our users and customers have a high quality experience with our products and services, then they may become dissatisfied and move to competitors' products and services. In addition, if we are unable to predict user preferences or industry changes, or if we are unable to modify our products and services on a timely basis, we may lose customers.

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

Our future success will depend on our ability to adapt to rapidly changing technologies, to adapt our services to evolving industry standards and to improve the performance and reliability of our services. Our failure to adapt to such changes would harm our business. In addition, the widespread adoption of other technological changes could require substantial expenditures to modify or adapt our services or infrastructure.

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Moreover, we believe that our continued success depends on our investing in new business strategies or initiatives that complement our strategic direction and product 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 materially adversely affect our business, operating results or financial condition.

### **We must effectively develop, deliver and stimulate demand for new products and technologies in order to remain competitive.**

We operate in highly competitive markets that are characterized by rapid technological change and frequent new product and service announcements. To retain and grow our market share, we must continually introduce new and innovative offerings and technologies, enhance and adapt existing offerings and technologies and effectively stimulate customer demand for our new offerings. Delays in developing, completing or shipping 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 depend on several factors, including our ability to develop and complete new products in a timely manner, successfully promote the offerings, manage the risks associated with the offerings, make sufficient resources available to support them and address any quality or other defects in the early stages of introduction. Our failure to deliver new and enhanced offerings and technologies in a timely and cost-effective manner and to effectively stimulate demand for them may harm our reputation as a leader in open source technology, diminish the Red Hat brand and adversely affect our business, operating results and financial condition.

### **Our Red Hat Enterprise Virtualization offerings are based on an emerging technology area, and the potential market for these offerings remains uncertain.**

Our Red Hat Enterprise Virtualization products and related services are based on an emerging technology area, the success of which will depend on the perceived technological and operational benefits and cost savings associated with the adoption of this technology, virtualization solutions and the acceptance of cloud computing environments. The market for these products and services remains uncertain. To the extent that the adoption of virtualization solutions occurs more slowly or less pervasively than we expect, the revenue growth associated with these products and services may be slower than currently expected, which could adversely affect our business, operating results and financial condition.

### **If our growth rate slows, our stock price could be adversely impacted.**

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

### **Security and privacy breaches may expose us to liability and harm our reputation and business.**

Our security and testing measures may not prevent security breaches that could harm our business. Advances in computer capabilities, new discoveries in the field of cryptography, inadequate technology or facility security measures or other factors may result in a compromise or breach of our systems and the data we process. Any compromise of our systems or the data we process could harm our reputation or financial condition and, therefore, our business. In addition, a party who is able to circumvent our security measures or exploit inadequacies in our security measures, could, among other effects, misappropriate proprietary information, cause interruptions in our operations or expose customers to computer viruses or other disruptions or vulnerabilities.

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Actual or perceived vulnerabilities may lead to claims against us by customers, partners or other third-parties, which could be material. 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.

### **We are vulnerable to system failures, which could harm our reputation and business.**

We rely on our technology infrastructure, among other functions, to sell our products and services, support our partners, fulfill orders and bill, collect and make payments. Our systems are vulnerable to damage or interruption from natural disasters, power loss, telecommunication failures, terrorist attacks, computer intrusions and viruses, computer denial-of-service attacks and other events. A significant number of our systems are not redundant, and our disaster recovery planning is not sufficient for every eventuality. Our systems are also subject to break-ins, sabotage and intentional acts of vandalism by internal employees, contractors and third-parties. Despite any precautions we may take, such problems could result in, among other consequences, interruptions in our services, which could harm our reputation, business and financial condition. We do not carry business interruption insurance sufficient to protect us from all losses that may result from interruptions in our services as a result of system failures or to cover all contingencies. Any interruption in the availability of our websites and on-line interactions with customers and partners would create a large volume of user questions and complaints that would need to be addressed by our support personnel rather than by self-help. If our support personnel cannot meet this demand, customer and partner satisfaction levels may fall, which in turn could cause additional claims, reduced revenue or loss of customers.

### **If we fail to comply with our customer contracts or government contracting regulations, our business could suffer.**

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

## **RISKS RELATED TO LEGAL UNCERTAINTY**

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

We regularly commit to our subscription customers that if portions of our enterprise products are 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) replace the infringing component with a non-infringing component, and indemnify them against specified infringement claims. Although we cannot predict whether we will need to satisfy these commitments and often have limitations on these commitments, satisfying the commitments could

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be costly and time consuming and could materially and adversely affect our operating results and financial condition. In addition, our insurance policies would likely 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 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 patent, copyright and trade secrets because our products are comprised of software components, many of which are developed by numerous independent parties. Moreover, because the scope of software patent protection is often not well defined or readily determinable, patent applications in the United States are not publicly disclosed at the time of filing, and the number of software patents that are issued each year is significant and growing, we may be unable to assess the relevance of patents to our products, or take appropriate responsive action, in a timely or economic manner. We expect that our products could increasingly be subject to intellectual property infringement claims as the size of our business and market share grow, the number of products and competitors in our industry segment grows and the functionality of products in different industry segments overlaps. Defending patent infringement, copyright infringement and/or trade secret claims, even claims without significant merit, can be expensive.

The SCO Group, Inc. ( SCO ) as well as others have publicly alleged that Linux may infringe certain third-party intellectual property rights. SCO filed suit against IBM, alleging, among other things, that certain Linux kernels wrongfully include SCO's intellectual property. Uncertainty concerning allegations of this type, regardless of their merit, could adversely affect our reputation and business. If those asserting such claims were to prevail in this or other actions related to their claims regarding Linux or other products, our operating results and financial condition could be materially and adversely affected.

An adverse legal decision regarding the intellectual property in and to our technology and other offerings could harm our business and may do so materially. See Legal Proceedings .

**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 or are modified so as to become incompatible with other open source licenses.**

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

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

Despite our testing procedures, errors have been and will 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

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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 and devote significant technical resources to analyze, correct, eliminate or work around them and may not be able to successfully do so 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, loss of existing or potential customers and delayed or lost revenue 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 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. 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 and could materially harm our business.

### **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 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 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.

### **Efforts to assert intellectual property ownership rights in our products could impact our standing in the open source community, which could limit our product 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, which 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 products and further our research and development efforts, and could adversely affect our business.

### **We are, and may become, involved in disputes and lawsuits that could have a material adverse affect on our performance or stock price.**

Lawsuits or legal proceedings may be commenced against us. These disputes and proceedings may involve significant expense and divert management's attention. If we do not prevail in these matters, we could be required to pay substantial damages or settlement costs, which could have a material adverse affect on our financial condition or results of operations. See [Legal Proceedings](#) for additional information on this and other certain matters that may affect our performance or stock price.

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

Our business is subject to federal, state and international laws regarding privacy and protection of user data. We post, on our website, our privacy policies and practices concerning the use and disclosure of user data. Any

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failure by us to comply with our posted privacy policies or other federal, state or international privacy-related or data protection laws and regulations could result in proceedings against us by governmental entities or others which could have a material adverse effect on our business, results of operations and financial condition.

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

### **RISKS RELATED TO FINANCIAL UNCERTAINTY**

#### **Our quarterly operating results may not be a reliable indicator of our future operating results.**

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

#### **Our stock price has been volatile historically and may continue to be volatile. Further, the sale of our common stock by significant stockholders may cause the price of our common stock to decrease.**

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 products 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 and news reports relating to trends in our markets or general economic conditions.

In addition, 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 lack the financial and operational resources needed to increase our market share and compete effectively.**

In the market for operating systems, we face significant competition from larger companies with greater financial, operational and technical resources and name recognition than we have. Competitors, which offer hardware-independent multi-user operating systems for Intel platforms and/or Linux and UNIX-based operating systems, include Microsoft Corporation ( Microsoft ), Oracle, Novell, Inc. ( Novell ), IBM, HP and Sun.

In the market for middleware offerings, we face significant competition from larger companies with greater financial, operational and technical resources and name recognition than we have. These competitors include, but

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are not limited to, IBM, Microsoft, Oracle and Sun, all of which offer broad portfolios of enterprise Java and non-Java middleware products. IBM and Oracle bundle hardware and software for their customers, making it more difficult to penetrate these customer bases.

In the market for virtualization offerings, we face significant competition from larger companies with greater financial, operational and technical resources and name recognition than we have. These competitors include, but are not limited to, VMware, Inc. ( VMware ), Microsoft, Citrix Systems, Inc. ( Citrix ), Novell and Oracle.

In the market for services offerings, we face significant competition from larger companies with greater financial, operational and technical resources and name recognition than we have, including those 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 larger companies, including IBM, Oracle, Novell and HP, 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 lack the resources needed to compete successfully with our current competitors as well as potential new competitors. Moreover, we compete in certain areas with our strategic partners and potential strategic partners, and this may adversely impact our relationship with an individual partner or a number of partners. Competitive pressures could affect prices or demand for our products and services, resulting in reduced profit margins and loss of market opportunity. We may have to lower the prices of our products and services to stay competitive, which could affect our margins and financial condition. In addition, if our pricing and other factors are not sufficiently competitive, we may lose market share. Industry consolidation may also effect competition by creating larger and potentially stronger competitors in the markets in which we compete, which may have an adverse effect on our business.

During fiscal 2007, several of our largest competitors made announcements relevant to markets in which we operate, including an announcement by Oracle to offer Linux support services and an announcement by Novell regarding an agreement with Microsoft to collaborate on technology, a cross covenant not to sue the other party's customers for patent infringement and an agreement by Microsoft to purchase and distribute coupons for SUSE Linux maintenance and support. Microsoft and Novell announced an extension of their partnership and the purchase and distribution of an additional \$100 million in coupons for SUSE Linux by Microsoft in August 2008.

**We may not be able to meet the financial and operational challenges that we will encounter as our international operations, which represented approximately 43.4% of our total revenue for the fiscal year ended February 28, 2010, continue to expand.**

Our international operations accounted for approximately 43.4% of total revenue for the fiscal year ended February 28, 2010. 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 software products for a significant number of international markets, which may negatively affect our operating results.

Additional challenges associated with the conduct of our business overseas that may negatively affect our operating results include:

- Fluctuations in exchange rates;
- Longer payment cycles and less financial stability of customers;
- Compliance with a wide variety of foreign laws;

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- Difficulty selecting and monitoring channel partners outside of the United States;
  
- Difficulty protecting our intellectual property rights overseas due to, among other reasons, the uncertainty of laws and enforcement in certain countries relating to the protection of intellectual property rights;
  
- Difficulty maintaining quality standards consistent with the Red Hat brand;
  
- Export control regulations could prevent us from shipping our products into and out of certain markets;
  
- Changes in import/export duties, quotas or other trade barriers could affect the competitive pricing of our products and services and reduce our market share in some countries; and
  
- Economic or political instability or terrorist acts in some international markets could 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.

Moreover, in many foreign countries, particularly in certain developing economies, it is not uncommon to engage in business practices that are prohibited by regulations applicable to us, such as the Foreign Corrupt Practices Act and similar laws. Although we have policies and procedures designed to promote compliance with these laws, our employees, contractors 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 such violation, even if prohibited by our policies and procedures or the law, could have a material adverse effect on our business. 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.

**We may be subject to greater tax liabilities.**

We are subject to income and other taxes in the U.S. and in numerous foreign jurisdictions. Our domestic and foreign tax liabilities are subject to the allocation of revenue and expenses in different jurisdictions. Additionally, the amount of taxes paid is subject to our interpretation of applicable tax laws in the jurisdictions in which we operate. We are regularly subject to audits by tax authorities. While we endeavor to comply with all applicable tax laws, there can be no assurance that a governing tax authority will not have a different interpretation of the law than we do or that we will comply in all respects with applicable tax laws, which could result in additional taxes. There can be no assurance that the outcomes from these audits will not have an adverse effect on our results of operations in the period for which the review is made.

**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 may not be fully reflected in our results of operations until future periods. Our subscription model also makes it difficult for us to rapidly increase our revenue through additional sales in any period, as revenue from new customers must be recognized over the applicable subscription term.

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

Under generally accepted accounting principles, we review our amortizable intangible assets for impairment when events or changes in circumstances indicate the carrying value may not be recoverable. Goodwill is



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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, future cash flows 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 resulting in an adverse impact on our results of operations.

### **We may be exposed to potential risks if we do not have an effective system of disclosure controls or internal controls or fail on an ongoing basis to properly address Section 404 of the Sarbanes-Oxley Act of 2002.**

We must comply, on an on-going basis, with the requirements of Section 404 of the Sarbanes-Oxley Act of 2002 ( SOX ), 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 the Section 404 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 products and services, 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 Section 404 of SOX, 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 position of our business could be harmed; current and potential future shareholders 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.

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

We maintain an investment portfolio of various holdings, types and maturities. Our portfolio as of February 28, 2010 consisted primarily of money market funds, U.S. government securities, certificates of deposit, agency securities, corporate securities and equity 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.

We may be required to record impairment charges for other-than-temporary declines in fair market value in our investments. Future fluctuations 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 operating results and financial condition. For information regarding the sensitivity of and risks associated with the market value of portfolio investments and interest rates, see Quantitative and Qualitative Disclosures About Market Risk .

Our investments in private companies are subject to risk of loss of investment capital. These investments 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.

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**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 will affect our net revenue, operating expenses and operating margins. We cannot predict the impact of future exchange rate fluctuations. We use financial instruments, primarily forward purchase contracts, to economically hedge U.S. dollar and other 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 Quantitative and Qualitative Disclosures About Market Risk .

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**ITEM 1B. UNRESOLVED STAFF COMMENTS**

None.

**ITEM 2. PROPERTIES**

Our headquarters is currently located in a leased facility in Raleigh, North Carolina, which consists of approximately 120,000 square feet. In January 2002, we assumed this lease from an unrelated third-party. The lease, which has an original term of 20 years, will expire on June 10, 2020. The annual rental expense under this lease is approximately \$1.7 million. In March 2006, we assumed a second lease in Raleigh, North Carolina as part of our headquarters facilities which consisted of approximately 25,000 square feet. In 2007, 2008 and 2009, we acquired under this second lease an additional 25,000, 10,000 and 8,000 square feet, respectively, further expanding our headquarters facilities. The term for this second lease, as amended, will expire on February 28, 2017. The term for 8,000 square feet on the second lease, as amended, will expire on January 31, 2014. The annual rental expense under this second lease is approximately \$1.7 million.

In addition to our headquarters, we have leased office facilities in 29 countries and more than 65 locations. Significant locations in North America include Atlanta, Georgia; Charlotte, North Carolina; Mountain View, California; Richmond, Virginia; Toronto, Canada; Tyson's Corner, Virginia and Westford, Massachusetts. Significant locations in Latin America include Buenos Aires, Argentina and Sao Paulo, Brazil. Significant locations in EMEA include Brno, Czech Republic; Cork, Ireland; Farnborough, United Kingdom; Munich, Germany; Puteaux, France; Ra'anana, Israel and Stuttgart, Germany. Significant locations in Asia Pacific include offices in Beijing, China; Brisbane, Australia; Mumbai, India; Pune, India; Singapore 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**

Commencing on or about March 2001, the Company and certain of its officers and directors were named as defendants in a series of purported class action suits arising out of the Company's initial public offering and secondary offering. Approximately 310 other IPO issuers were named as defendants in similar class action complaints (together, the "IPO Allocation Actions"). On August 8, 2001, Chief Judge Michael Mukasey of the U.S. District Court for the Southern District of New York issued an order that transferred all of the IPO Allocation Actions, including the complaints involving the Company, to one judge for coordinated pre-trial proceedings (Case No. 21 MC 92). The plaintiffs contend that the defendants violated federal securities laws by issuing registration statements and prospectuses that contained materially false and misleading information and failed to disclose material information. Plaintiffs also challenge certain IPO allocation practices by underwriters and the lack of disclosure thereof in initial public offering documents. On April 19, 2002, plaintiffs filed amended complaints in each of the 310 consolidated actions, including the Red Hat action. The relief sought consists of unspecified damages, attorneys' and expert fees and other unspecified costs. In October of 2002, the individual director and officer defendants of the Company were dismissed from the case without prejudice. In October of 2004, the District Court certified a class in six of the 310 actions (the "focus cases") and noted that the decision is intended to provide strong guidance to all parties regarding class certification in the remaining cases. The Company's action is not one of the focus cases. On December 5, 2006, the U.S. Court of Appeals for the Second Circuit vacated the District Court's class certification with respect to the focus cases and remanded the matter for further consideration. In September 2007, discovery moved forward in the focus cases and plaintiff filed and amended complaints against the focus case issuer and underwriter defendants. Defendants in the focus cases filed motions to dismiss the second amended complaints in November 2007 and filed their oppositions to plaintiffs' motion for class certification in December 2007. The motions to dismiss in the focus cases were granted in part and denied in part, and the issue of class certification is currently pending before the Court. On April 2, 2009, the plaintiffs filed a motion for preliminary approval of a settlement agreement to resolve the lawsuit, to which the Company has consented and for which payments called for by the settlement agreement are to be paid by the defendant insurers. The trial court heard arguments on September 10, 2009 on the fairness of

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the settlement. In an opinion and order filed October 5, 2009, the trial court granted plaintiffs' motion for approval of the settlement and directed the clerk of the court to close the action. Notices of appeal in the matter have been filed, and the appeal is pending before the Court of Appeals for the Second Circuit.

In the summer of 2004, 14 class action lawsuits were filed against the Company and several of its former officers on behalf of investors who purchased the Company's securities during various periods from June 19, 2001 through July 13, 2004. All 14 suits were filed in the U.S. District Court for the Eastern District of North Carolina. In each of the actions, plaintiffs sought to represent a class of purchasers of the Company's common stock during some or all of the period from June 19, 2001 through July 13, 2004. All of the claims arose in connection with the Company's announcement on July 13, 2004 that it would restate certain of its financial statements (the Restatement). One or more of the plaintiffs asserted that certain former officers (the Individual Defendants) and the Company violated Sections 10(b) and 20(a) of the Securities Exchange Act of 1934, as amended (the Securities Exchange Act), and Rule 10b-5 thereunder by issuing the financial statements that the Company subsequently restated. One or more of the plaintiffs sought unspecified damages, interest, costs, attorneys' and experts' fees, an accounting of certain profits obtained by the Individual Defendants from trading in the Company's common stock, disgorgement by the Company's former chief executive officer and former chief financial officer of certain compensation and profits from trading in the Company's common stock pursuant to Section 304 of the Sarbanes-Oxley Act of 2002 and other relief. As of September 8, 2004, all of these class action lawsuits were consolidated into a single action referenced as Civil Action No. 5:04-CV-473BR and titled In re Red Hat, Inc. Securities Litigation. On May 6, 2005, the plaintiffs filed an amended consolidated class action complaint. On July 29, 2005, the Company, on behalf of itself and the Individual Defendants, filed a motion to dismiss the action for failure to state a claim upon which relief may be granted. Also on that date, PricewaterhouseCoopers LLP (PwC), another defendant, filed a separate motion to dismiss. On May 12, 2006, the Court issued an order granting the motion to dismiss the Securities Exchange Act claims against several of the Individual Defendants, but denying the motion to dismiss the Securities Exchange Act claims against the Company, its former chief executive officer and former chief financial officer. The Court dismissed the claims under the Sarbanes-Oxley Act in their entirety, and also granted PwC's motion to dismiss. On November 6, 2006, the plaintiffs filed a motion for class certification. Subsequent to the filing of that motion, several plaintiffs withdrew as potential class representatives, and the Company opposed the certification of the remaining proposed class representatives. On May 11, 2007, the Court entered an order denying class certification and denying all other pending motions as moot. Thereafter, on July 13, 2007 Charles Gilbert filed a renewed motion for appointment as lead plaintiff and approval of selection of lead counsel. On November 13, 2007, the Court entered an Order allowing Gilbert's motion, appointing him lead plaintiff, adding him as a party plaintiff and appointing lead counsel. On January 14, 2008, Gilbert's counsel filed a motion to certify the action as a class action. On August 28, 2009, the Court entered an Order certifying the action as a class action, appointing Gilbert as the class representative, and defining the class as all purchasers of the common stock of Red Hat, Inc. between December 17, 2002, and July 12, 2004, inclusive and who were damaged thereby, excluding Company insiders. On December 15, 2009, the Company announced that it had reached an agreement in principle to settle this matter, subject, among other matters, to completion of a final written settlement agreement and court approval. The Company recorded, for its quarter ended November 30, 2009, an estimated liability in the amount of \$8.8 million for its portion of the proposed settlement. Should the efforts to settle this matter not be successful, the Company intends to vigorously defend itself in this matter. There can be no assurance, however, that the Company would be successful, and an adverse resolution of the lawsuit could have a material adverse effect on the Company's financial position and results of operations in the period in which the lawsuit is resolved.

On October 9, 2007, IP Innovation, LLC and Technology Licensing Corporation filed a complaint in the Eastern District of Texas (Civil Action No. 2-07CV-447) against Red Hat, Inc. and Novell, Inc., alleging direct and indirect infringement of U.S. Patent Nos. 5,072,412, 5,394,521 and 5,533,183 with regard to aspects of the Company's Linux-based products. The complaint seeks, among other relief, compensatory damages. The Company answered the complaint on February 1, 2008, including counterclaims against plaintiffs for declaratory judgment of invalidity, unenforceability and noninfringement of the patents-in-suit, and the plaintiffs filed a reply to those counterclaims on February 11, 2008. The court issued a memorandum opinion and order denying

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defendants' motion for partial summary judgment for invalidity due to indefiniteness and construing disputed claim terms on August 10, 2009. Discovery in the case is complete, and trial began on April 26, 2010. Based on information available to date, the Company believes it has meritorious defenses to this matter and does not anticipate that the lawsuit will have a material adverse effect on its business, financial position and results of operations. There can be no assurance, however, that the Company will be successful in its defense. The Company estimates that an adverse resolution of the lawsuit could result in damages ranging from approximately \$0.1 million to \$11.0 million.

On March 3, 2009, Software Tree LLC filed a complaint in the Eastern District of Texas (Civil Action No. 6:09-cv-00097-LED) against Red Hat, Inc., Hewlett-Packard Co., Genuitec, L.L.C., and Dell, Inc. alleging direct and indirect infringement of U.S. Patent No. 6,163,776 with regard to aspects of the Company's JBoss Hibernate product, among other products of the Defendants. The complaint seeks, among other relief, compensatory damages, enhanced damages and injunctive relief. The Company answered the complaint on April 7, 2009 and denied the allegations of direct and indirect infringement, asserted affirmative defenses and filed a counterclaim seeking a declaration that the patent was invalid, unenforceable and not infringed. Discovery in the case is proceeding, and trial has been scheduled for September 13, 2010. Based on the Company's efforts to date, it believes it has meritorious defenses to this matter, and intends to vigorously defend itself. There can be no assurance, however, that the Company will be successful in its defense, and an adverse resolution of the lawsuit could have a material adverse