

Red Hat Reports Third Quarter Results

DEC 19, 2013

Total revenue of \$397 million, up 15% year-over-year

Subscription revenue of \$343 million, up 17% year-over-year

GAAP operating income of \$61 million, up 22% year-over-year; non-GAAP operating income of \$98 million, up 19% year-over-year

RALEIGH, N.C.--(BUSINESS WIRE)-- Red Hat, Inc. (NYSE: RHT), the world's leading provider of open source solutions, today announced financial results for its fiscal year 2014 third quarter ended November 30, 2013.

Total revenue for the quarter was \$397 million, an increase of 15% in U.S. dollars from the year ago quarter, or 17% measured in constant currency. Constant currency references in this release are as detailed in the tables below. Subscription revenue for the quarter was \$343 million, up 17% in U.S. dollars year-over-year, or 18% measured in constant currency.

"Strong demand in Q3 for our core Red Hat Enterprise Linux and JBoss Middleware technologies led to results that exceeded guidance across several key financial metrics," stated Jim Whitehurst, President and Chief Executive Officer of Red Hat. "Red Hat's technologies address the high growth opportunities in the data center to modernize and move away from legacy proprietary software in order to deploy open hybrid cloud technologies that drive IT velocity, efficiency and scalability."

GAAP operating income for the third quarter was \$61 million, up 22% year-over-year. After adjusting for stock compensation expense and amortization of intangible assets, as detailed in the tables below, non-GAAP operating income for the third quarter was \$98 million, up 19% year-over-year. For the third quarter, GAAP operating margin was 15.3% and non-GAAP operating margin was 24.8%.

Net income for the quarter was \$52 million, or \$0.27 per diluted share, compared with \$35 million, or \$0.18 per diluted share, in the year ago quarter. After adjusting for stock compensation expense and amortization of intangible assets, as detailed in the tables below, non-GAAP net income for the quarter was \$81 million, or \$0.42 per diluted share, as compared to \$57 million, or \$0.29 per diluted share, in the year ago quarter. As a result of a discrete tax benefit and cumulative adjustments that lowered the estimated annual effective tax rate, GAAP EPS and non-GAAP EPS results benefited by approximately \$0.04 per share and \$0.06 per share, respectively.

Operating cash flow was \$95 million for the third quarter, as compared to \$100 million in the year ago quarter. At quarter end, the company's total deferred revenue balance was \$1.12 billion, an increase of 14% on a year-over-year basis. Total cash, cash equivalents and investments as of November 30, 2013 was \$1.33 billion after repurchasing approximately \$40 million of common stock, or approximately 920 thousand shares, in the third quarter. Red Hat has repurchased approximately \$239 million of common stock, or approximately 5.0 million shares, during the first nine months of fiscal 2014.

"We experienced an acceleration in our billings proxy growth in Q3, both year-over-year and sequentially, due in part to the strengthening of our European and U.S. federal government businesses," stated Charlie Peters, Executive Vice President and Chief Financial Officer of Red Hat. "The billings proxy, which we define as total revenue plus the change in deferred revenue found on the Statement of Cash Flows, was \$453 million, up 19% in U.S. dollars and 21% in constant currency compared to last year. Red Hat associates executed well."

Additional information on Red Hat's reported results, including a reconciliation of the non-GAAP adjusted results, are included in the financial tables below. A live webcast of Red Hat's results will begin at 5:00 pm ET today and can be accessed by the general public at Red Hat's investor relations website at <http://investors.redhat.com>. A replay of the webcast will be available shortly after the live event has ended.

About Red Hat, Inc.

Red Hat is the world's leading provider of open source software solutions, using a community-powered approach to reliable and high-performing cloud, Linux, middleware, storage and virtualization technologies. Red Hat also offers award-winning support, training, and consulting services. As the connective hub in a global network of enterprises, partners, and open source communities, Red Hat helps create relevant, innovative technologies that liberate resources for growth and prepare customers for the future of IT. Learn more at <http://www.redhat.com>.

Forward-Looking Statements

Certain statements contained in this press release may 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 does not directly relate to any historical or current fact. Actual results may differ materially from those indicated by such forward-looking statements as a result of various important factors, including: risks related to delays or reductions in information technology spending; the effects of industry consolidation; the ability of the Company to compete effectively; the integration of acquisitions and the ability to market successfully acquired technologies and products; uncertainty and adverse results in litigation and related settlements; the inability to adequately protect Company intellectual property and the potential for infringement or breach of license claims of or relating to third party intellectual property; the ability to deliver and stimulate demand for new products and technological innovations on a timely basis; risks related to data and information security vulnerabilities; ineffective management of, and control over, the Company's growth and international operations; fluctuations in exchange rates; and changes in and a dependence on key personnel, as well as other factors contained in our most recent Quarterly Report on Form 10-Q (copies of which may be accessed through the Securities and Exchange Commission's website at <http://www.sec.gov>), including those found therein under the captions "Risk Factors" and "Management's Discussion and Analysis of Financial Condition and Results of Operations". In addition to

these factors, actual future performance, outcomes, and results may differ materially because of more general factors including (without limitation) general industry and market conditions and growth rates, economic and political conditions, governmental and public policy changes and the impact of natural disasters such as earthquakes and floods. The forward-looking statements included in this press release represent the Company's views as of the date of this press release and these views could change. However, while the Company may elect to update these forward-looking statements at some point in the future, the Company specifically disclaims any obligation to do so. These forward-looking statements should not be relied upon as representing the Company's views as of any date subsequent to the date of this press release.

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RED HAT, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)
(In thousands - except per share amounts)

| | Three Months Ended | | Nine Months Ended | |
|---------------------------------------------------------------|----------------------|----------------------|----------------------|----------------------|
| | November 30, 2013 | November 30, 2012 | November 30, 2013 | November 30, 2012 |
| Revenue: | | | | |
| Subscriptions | \$342,770 | \$294,186 | \$985,279 | \$845,557 |
| Training and services | 53,766 | 49,420 | 148,939 | 135,375 |
| Total subscription, training and services revenue | 396,536 | 343,606 | 1,134,218 | 980,932 |
| Cost of revenue: | | | | |
| Subscriptions | 24,544 | 21,153 | 71,437 | 57,939 |
| Training and services | 35,883 | 31,965 | 100,627 | 89,056 |
| Total cost of subscription, training and services revenue | 60,427 | 53,118 | 172,064 | 146,995 |
| Total gross profit | 336,109 | 290,488 | 962,154 | 833,937 |
| Operating expense: | | | | |
| Sales and marketing | 153,528 | 133,792 | 440,568 | 378,240 |
| Research and development | 82,519 | 68,655 | 234,619 | 191,901 |
| General and administrative | 39,270 | 38,122 | 111,807 | 109,847 |
| Facility exit costs | - | - | 2,171 | 3,142 |
| Total operating expense | 275,317 | 240,569 | 789,165 | 683,130 |
| Income from operations | 60,792 | 49,919 | 172,989 | 150,807 |
| Interest income | 1,579 | 1,936 | 4,608 | 6,384 |
| Other income (expense), net | (440) | (730) | 332 | 502 |
| Income before provision for income taxes | 61,931 | 51,125 | 177,929 | 157,693 |
| Provision for income taxes | 9,906 | 16,360 | 44,705 | 50,462 |
| Net income | <u>\$52,025</u> | <u>\$34,765</u> | <u>\$133,224</u> | <u>\$107,231</u> |
| Net income per share: | | | | |
| Basic | \$0.27 | \$0.18 | \$0.70 | \$0.56 |
| Diluted | \$0.27 | \$0.18 | \$0.69 | \$0.55 |

Weighted average shares outstanding:

| | | | | |
|---------|---------|---------|---------|---------|
| Basic | 189,514 | 193,374 | 190,024 | 193,127 |
| Diluted | 191,365 | 195,666 | 192,049 | 195,898 |

RED HAT, INC.
CONSOLIDATED BALANCE SHEETS
(In thousands)

| ASSETS | November 30, 2013 (Unaudited) | February 28, 2013 (1) |
|---------------------------------------------------|-------------------------------------|--------------------------|
| | | |
| Current assets: | | |
| Cash and cash equivalents | \$642,111 | \$487,084 |
| Investments in debt and equity securities | 324,424 | 392,381 |
| Accounts receivable, net | 309,753 | 302,942 |
| Deferred tax assets, net | 93,711 | 88,765 |
| Prepaid expenses | 96,142 | 94,421 |
| Other current assets | 2,459 | 3,156 |
| Total current assets | 1,468,600 | 1,368,749 |
| Property and equipment, net | 168,604 | 141,586 |
| Goodwill | 687,490 | 690,911 |
| Identifiable intangibles, net | 136,073 | 142,243 |
| Investments in debt securities | 360,114 | 438,908 |
| Other assets, net | 30,487 | 31,263 |
| Total assets | \$2,851,368 | \$2,813,660 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Accounts payable and accrued expenses | \$190,868 | \$154,202 |
| Deferred revenue | 833,671 | 830,486 |
| Other current obligations | 1,007 | 1,024 |
| Total current liabilities | 1,025,546 | 985,712 |
| Long term deferred revenue | 289,622 | 259,466 |
| Other long term obligations | 64,997 | 48,321 |
| Stockholders' equity: | | |
| Common stock | 23 | 23 |
| Additional paid-in capital | 1,857,738 | 1,802,899 |
| Retained earnings | 675,104 | 541,880 |
| Treasury stock, at cost | (1,056,419) | (816,674) |
| Accumulated other comprehensive loss | (5,243) | (7,967) |
| Total stockholders' equity | 1,471,203 | 1,520,161 |
| Total liabilities and stockholders' equity | \$2,851,368 | \$2,813,660 |

(1) Derived from audited financial statements

RED HAT, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)
(In thousands)

Three Months Ended

Nine Months Ended

| | November 30, 2013 | November 30, 2012 | November 30, 2013 | November 30, 2012 |
|-----------------------------------------------------------------------------------|-------------------------|-------------------------|----------------------|----------------------|
| Cash flows from operating activities: | | | | |
| Net income | \$52,025 | \$34,765 | \$133,224 | \$107,231 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | | |
| Depreciation and amortization | 18,955 | 16,126 | 55,326 | 44,773 |
| Share-based compensation expense | 30,190 | 26,678 | 83,196 | 72,743 |
| Deferred income taxes | 2,016 | 6,686 | 18,679 | 29,749 |
| Excess tax benefits from share-based payment arrangements | (3,428) | (8,100) | (9,071) | (27,900) |
| Net amortization of bond premium on available-for-sale debt securities | 2,301 | 1,675 | 6,637 | 5,094 |
| Other | 438 | (552) | 485 | (2,393) |
| Changes in operating assets and liabilities net of effects of acquisitions: | | | | |
| Accounts receivable | (75,330) | (35,291) | (9,249) | 534 |
| Prepaid expenses | (1,109) | 2,652 | (3,503) | (4,314) |
| Accounts payable and accrued expenses | 12,272 | 19,879 | 38,565 | 42,809 |
| Deferred revenue | 56,019 | 35,207 | 40,999 | 56,515 |
| Other | 805 | 431 | 610 | 3,572 |
| Net cash provided by operating activities | 95,154 | 100,156 | 355,898 | 328,413 |
| Cash flows from investing activities: | | | | |
| Purchase of available-for-sale debt securities | (101,636) | (123,318) | (448,712) | (631,087) |
| Proceeds from sales and maturities of available-for-sale debt securities | 118,084 | 169,743 | 597,851 | 587,522 |
| Acquisition of business, net of cash acquired | - | (21,188) | - | (31,239) |
| Purchase of other intangible assets | (682) | (5,577) | (13,203) | (32,440) |
| Purchase of property and equipment | (13,327) | (28,309) | (61,833) | (64,552) |
| Other | (150) | (66) | (2,084) | 264 |
| Net cash provided by (used in) investing activities | 2,289 | (8,715) | 72,019 | (171,532) |
| Cash flows from financing activities: | | | | |
| Excess tax benefits from share-based payment arrangements | 3,428 | 8,100 | 9,071 | 27,900 |
| Proceeds from exercise of common stock options | 223 | 4,294 | 1,311 | 10,810 |
| Purchase of treasury stock | (40,018) | (52,018) | (239,363) | (84,900) |
| Payments related to net settlement of employee share-based compensation awards | (18,307) | (22,924) | (33,122) | (45,612) |
| Payments on other borrowings | (362) | (205) | (979) | (682) |
| Net cash used in financing activities | (55,036) | (62,753) | (263,082) | (92,484) |
| Effect of foreign currency exchange rates on cash and cash equivalents | 2,910 | 5,647 | (9,808) | (7,703) |
| Net increase in cash and cash equivalents | 45,317 | 34,335 | 155,027 | 56,694 |
| Cash and cash equivalents at beginning of the period | 596,794 | 571,576 | 487,084 | 549,217 |
| Cash and cash equivalents at end of period | <u>\$642,111</u> | <u>\$605,911</u> | <u>\$642,111</u> | <u>\$605,911</u> |

RED HAT, INC.
RECONCILIATION OF CERTAIN GAAP RESULTS TO NON-GAAP ADJUSTED RESULTS
(Unaudited)
(In thousands - except per share amounts)

Non cash share-based compensation expense included in Consolidated Statements of Operations:

| Three Months Ended | | Nine Months Ended | |
|----------------------|----------------------|----------------------|----------------------|
| November 30, 2013 | November 30, 2012 | November 30, 2013 | November 30, 2012 |

| | | | | |
|----------------------------------------|-----------------|-----------------|-----------------|-----------------|
| Cost of revenue | \$2,922 | \$2,444 | \$8,861 | \$6,777 |
| Sales and marketing | 10,268 | 8,875 | 30,009 | 23,962 |
| Research and development | 9,161 | 7,935 | 25,100 | 22,040 |
| General and administration | 7,839 | 7,424 | 19,226 | 19,964 |
| Total share-based compensation expense | <u>\$30,190</u> | <u>\$26,678</u> | <u>\$83,196</u> | <u>\$72,743</u> |

Amortization of intangible assets expense included in Consolidated Statements of Operations:

| | Three Months Ended | | Nine Months Ended | |
|-------------------------------------------------|----------------------|----------------------|----------------------|----------------------|
| | November 30, 2013 | November 30, 2012 | November 30, 2013 | November 30, 2012 |
| Cost of revenue | \$2,504 | \$1,433 | \$7,672 | \$3,252 |
| Sales and marketing | 2,479 | 2,076 | 6,395 | 6,272 |
| Research and development | 959 | 959 | 2,877 | 2,877 |
| General and administration | 1,288 | 1,476 | 4,028 | 3,800 |
| Total amortization of intangible assets expense | <u>\$7,230</u> | <u>\$5,944</u> | <u>\$20,972</u> | <u>\$16,201</u> |

Facility exit costs included in Consolidated Statements of Operations:

| | Three Months Ended | | Nine Months Ended | |
|---------------------|----------------------|----------------------|----------------------|----------------------|
| | November 30, 2013 | November 30, 2012 | November 30, 2013 | November 30, 2012 |
| Facility exit costs | <u>-</u> | <u>-</u> | <u>\$2,171</u> | <u>\$3,142</u> |

| | Three Months Ended | | Nine Months Ended | |
|------------------------------------------------------------|----------------------|----------------------|----------------------|----------------------|
| | November 30, 2013 | November 30, 2012 | November 30, 2013 | November 30, 2012 |
| GAAP net income | \$52,025 | \$34,765 | \$133,224 | \$107,231 |
| Provision for income taxes | 9,906 | 16,360 | 44,705 | 50,462 |
| GAAP income before provision for income taxes | \$61,931 | \$51,125 | \$177,929 | \$157,693 |
| Add: Non-cash share-based compensation expense | 30,190 | 26,678 | 83,196 | 72,743 |
| Add: Amortization of intangible assets | 7,230 | 5,944 | 20,972 | 16,201 |
| Add: Facility exit costs | - | - | 2,171 | 3,142 |
| Non-GAAP adjusted income before provision for income taxes | \$99,351 | \$83,747 | \$284,268 | \$249,779 |
| Provision for income taxes (1) | 18,474 | 26,799 | 73,949 | 79,929 |
| Non-GAAP adjusted net income (basic and diluted) | <u>\$80,877</u> | <u>\$56,948</u> | <u>\$210,319</u> | <u>\$169,850</u> |
| Non-GAAP adjusted net income per share: | | | | |
| Basic | \$0.43 | \$0.29 | \$1.11 | \$0.88 |
| Diluted | \$0.42 | \$0.29 | \$1.10 | \$0.87 |

(1) Provision for income taxes:

| | | | | |
|-----------------------------------------------------------------|-----------------|-----------------|-----------------|-----------------|
| Non-GAAP adjusted net income before income tax provision | \$99,351 | \$83,747 | \$284,268 | \$249,779 |
| Estimated effective tax rates, excluding discrete tax items | 22.8% | 32.0% | 27.5% | 32.0% |
| Non-GAAP provision for income taxes before discrete tax benefit | \$22,699 | \$26,799 | \$78,174 | \$79,929 |
| Discrete tax benefit | 4,225 | - | 4,225 | - |
| Provision for income taxes on Non-GAAP adjusted net income | <u>\$18,474</u> | <u>\$26,799</u> | <u>\$73,949</u> | <u>\$79,929</u> |

RED HAT, INC.
RECONCILIATION OF CERTAIN GAAP RESULTS TO NON-GAAP ADJUSTED RESULTS
(Unaudited)
(In thousands - except per share amounts)

Reconciliation of GAAP results to non-GAAP adjusted results

| | Three Months Ended | | Nine Months Ended | |
|-------------------------------------------------------|--------------------|-------------------|-------------------|-------------------|
| | November 30, 2013 | November 30, 2012 | November 30, 2013 | November 30, 2012 |
| GAAP gross profit | \$336,109 | \$290,488 | \$962,154 | \$833,937 |
| Add: Non-cash share-based compensation expense | 2,922 | 2,444 | 8,861 | 6,777 |
| Add: Amortization of intangible assets | 2,504 | 1,433 | 7,672 | 3,252 |
| Non-GAAP gross profit | \$341,535 | \$294,365 | \$978,687 | \$843,966 |
| Non-GAAP gross margin | 86% | 86% | 86% | 86% |

| | Three Months Ended | | Nine Months Ended | |
|----------------------------------------------------------|--------------------|-------------------|-------------------|-------------------|
| | November 30, 2013 | November 30, 2012 | November 30, 2013 | November 30, 2012 |
| GAAP operating expenses | \$275,317 | \$240,569 | \$789,165 | \$683,130 |
| Deduct: Non-cash share-based compensation expense | (27,268) | (24,234) | (74,335) | (65,966) |
| Deduct: Amortization of intangible assets | (4,726) | (4,511) | (13,300) | (12,949) |
| Deduct: Facility exit costs | - | - | (2,171) | (3,142) |
| Non-GAAP adjusted operating expenses | \$243,323 | \$211,824 | \$699,359 | \$601,073 |

| | Three Months Ended | | Nine Months Ended | |
|-------------------------------------------------------|--------------------|-------------------|-------------------|-------------------|
| | November 30, 2013 | November 30, 2012 | November 30, 2013 | November 30, 2012 |
| GAAP operating income | \$60,792 | \$49,919 | \$172,989 | \$150,807 |
| Add: Non-cash share-based compensation expense | 30,190 | 26,678 | 83,196 | 72,743 |
| Add: Amortization of intangible assets | 7,230 | 5,944 | 20,972 | 16,201 |
| Add: Facility exit costs | - | - | 2,171 | 3,142 |
| Non-GAAP adjusted operating income | \$98,212 | \$82,541 | \$279,328 | \$242,893 |
| Non-GAAP adjusted operating margin | 24.8% | 24.0% | 24.6% | 24.8% |

Reconciliation of constant currency revenue growth rates

| | Three Months Ended | | |
|--|--------------------|-------------------|----------------------------|
| | November 30, 2013 | November 30, 2012 | Year-Over-Year Growth Rate |

| | | | |
|-----------------------------------------------------------------------------------------|-----------|-----------|-------|
| GAAP subscription revenue | \$342,770 | \$294,186 | 16.5% |
| Adjustment for currency impact | 4,481 | - | |
| Non-GAAP subscription revenue on a constant currency basis | \$347,251 | \$294,186 | 18.0% |
| GAAP training and services revenue | \$53,766 | \$49,420 | 8.8% |
| Adjustment for currency impact | 757 | - | |
| Non-GAAP training and services revenue on a constant currency basis | \$54,523 | \$49,420 | 10.3% |
| GAAP total subscription, training and services revenue | \$396,536 | \$343,606 | 15.4% |
| Adjustment for currency impact | 5,238 | - | |
| Non-GAAP total subscription, training and services revenue on a constant currency basis | \$401,774 | \$343,606 | 16.9% |

| | Nine Months Ended | | Year-Over-Year Growth Rate |
|-----------------------------------------------------------------------------------------|-------------------------|-------------------------|-------------------------------|
| | November 30, 2013 | November 30, 2012 | |
| GAAP subscription revenue | \$985,279 | \$845,557 | 16.5% |
| Adjustment for currency impact | 13,011 | - | |
| Non-GAAP subscription revenue on a constant currency basis | \$998,290 | \$845,557 | 18.1% |
| GAAP training and services revenue | \$148,939 | \$135,375 | 10.0% |
| Adjustment for currency impact | 1,750 | - | |
| Non-GAAP training and services revenue on a constant currency basis | \$150,689 | \$135,375 | 11.3% |
| GAAP total subscription, training and services revenue | \$1,134,218 | \$980,932 | 15.6% |
| Adjustment for currency impact | 14,761 | - | |
| Non-GAAP total subscription, training and services revenue on a constant currency basis | <u>\$1,148,979</u> | <u>\$980,932</u> | 17.1% |

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