

RED HAT INC
Form 10-Q
January 09, 2014
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended November 30, 2013

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)

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Delaware
(State or other jurisdiction of

06-1364380
(I.R.S. Employer

incorporation or organization)

Identification No.)

100 East Davie Street, Raleigh, North Carolina 27601

(Address of principal executive offices, including zip code)

(919) 754-3700

(Registrant's telephone number, including area code)

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

Large accelerated filer Accelerated filer
Non-accelerated filer Smaller reporting company

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date:

As of December 31, 2013, there were 189,538,365 shares of common stock outstanding.

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CAUTIONARY NOTE ON FORWARD-LOOKING STATEMENTS

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

Table of Contents**RED HAT, INC.****CONSOLIDATED BALANCE SHEETS****(In thousands except share and per share amounts)**

	November 30, 2013 (Unaudited)	February 28, 2013 (1)
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 642,111	\$ 487,084
Investments in debt and equity securities, short-term	324,424	392,381
Accounts receivable, net of allowances for doubtful accounts of \$1,495 and \$1,339, respectively	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 of accumulated depreciation and amortization of \$218,565 and \$189,985, respectively	168,604	141,586
Goodwill	687,490	690,911
Identifiable intangibles, net	136,073	142,243
Investments in debt securities, long-term	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
Commitments and contingencies (NOTES 12 and 13)		
Stockholders' equity:		
Preferred stock, 5,000,000 shares authorized, none outstanding		
Common stock, \$0.0001 per share par value, 300,000,000 shares authorized, 230,728,912 and 229,210,961 shares issued, and 189,525,534 and 193,021,226 shares outstanding at November 30, 2013 and February 28, 2013, respectively	23	23
Additional paid-in capital	1,857,738	1,802,899
Retained earnings	675,104	541,880
Treasury stock at cost, 41,203,378 and 36,189,735 shares at November 30, 2013 and February 28, 2013, respectively	(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

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(1) Derived from audited financial statements.

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

Table of Contents**RED HAT, INC.****CONSOLIDATED STATEMENTS OF OPERATIONS****(In thousands except per share amounts)****(Unaudited)**

	Three Months Ended		Nine Months Ended	
	November 30,	November 30,	November 30,	November 30,
	2013	2012	2013	2012
Revenue:				
Subscriptions	\$ 342,770	\$ 294,186	\$ 985,279	\$ 845,557
Training and services	53,766	49,420	148,939	135,375
Total subscription and training and services revenue	396,536	343,606	1,134,218	980,932
Cost of subscription and training and services revenue:				
Cost of subscriptions	24,544	21,153	71,437	57,939
Cost of training and services	35,883	31,965	100,627	89,056
Total cost of subscription and training and services revenue	60,427	53,118	172,064	146,995
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 (NOTE 12)			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	\$ 52,025	\$ 34,765	\$ 133,224	\$ 107,231
Basic net income per common share	\$ 0.27	\$ 0.18	\$ 0.70	\$ 0.56
Diluted net income per common share	\$ 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

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

Table of Contents**RED HAT, INC.****CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME****(In thousands)****(Unaudited)**

	Three Months Ended		Nine Months Ended	
	November 30,	November 30,	November 30,	November 30,
	2013	2012	2013	2012
Net income	\$ 52,025	\$ 34,765	\$ 133,224	\$ 107,231
Other comprehensive income (loss):				
Change in foreign currency translation adjustment	5,248	5,485	3,199	(2,593)
Available-for-sale securities:				
Unrealized gain (loss) on available-for-sale securities during the period	2,213	849	(503)	2,578
Reclassification for gain realized on available-for-sale securities, reported in Other income (expense), net	(23)	(399)	(340)	(778)
Tax (expense) benefit	(759)	(144)	368	(576)
Net change in available-for-sale securities (net of tax)	1,431	306	(475)	1,224
Total other comprehensive income (loss)	6,679	5,791	2,724	(1,369)
Comprehensive income	\$ 58,704	\$ 40,556	\$ 135,948	\$ 105,862

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

Table of Contents**RED HAT, INC.****CONSOLIDATED STATEMENTS OF CASH FLOWS****(In thousands)****(Unaudited)**

	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 debt securities available for sale	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 investment in debt securities available for sale	(101,636)	(123,318)	(448,712)	(631,087)
Proceeds from sales and maturities of investment in debt securities available for sale	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
Payments related to net settlement of share-based compensation awards	(18,307)	(22,924)	(33,122)	(45,612)
Purchase of treasury stock	(40,018)	(52,018)	(239,363)	(84,900)
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

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Cash and cash equivalents at end of the period	\$ 642,111	\$ 605,911	\$ 642,111	\$ 605,911
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The accompanying notes are an integral part of these consolidated financial statements.

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RED HAT, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

NOTE 1 Company

Red Hat, Inc., incorporated in Delaware, together with its subsidiaries (Red Hat or the Company) is a leading global provider of open source software solutions, using a community-powered approach to develop and offer reliable and high-performing operating system, middleware, virtualization, storage and cloud technologies.

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

The Company derives its revenue and generates cash from customers primarily from two sources: (i) subscription revenue and (ii) training and services revenue. These arrangements typically involve subscriptions to Red Hat enterprise technologies. The arrangements with the Company's customers that produce this revenue and cash are explained in further detail in NOTE 2 Summary of Significant Accounting Policies contained in the Company's Annual Report on Form 10-K for the fiscal year ended February 28, 2013.

NOTE 2 Summary of Significant Accounting Policies

Basis of presentation

The unaudited interim consolidated financial statements as of and for the three months and nine months ended November 30, 2013 have been prepared by the Company pursuant to the rules and regulations of the Securities and Exchange Commission (the SEC) for interim financial reporting. These consolidated statements are unaudited and, in the opinion of management, include all adjustments (consisting of normal recurring adjustments and accruals) necessary to present fairly the consolidated balance sheets, consolidated operating results, consolidated other comprehensive income and consolidated cash flows for the periods presented in accordance with accounting principles generally accepted in the United States of America. Operating results for the three months and nine months ended November 30, 2013 are not necessarily indicative of the results that may be expected for the fiscal year ending February 28, 2014. Certain information and footnote disclosures normally included in annual financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been omitted in accordance with the SEC's rules and regulations for interim reporting. For further information, see the Company's Consolidated Financial Statements, including notes thereto, included in the Company's Annual Report on Form 10-K for the fiscal year ended February 28, 2013.

There have been no changes to the Company's significant accounting policies from those described in NOTE 2 Summary of Significant Accounting Policies to the Consolidated Financial Statements contained in the Company's Annual Report on Form 10-K for the fiscal year ended February 28, 2013. These unaudited financial statements should be read in conjunction with such Annual Report on Form 10-K.

Certain reclassifications have been made to the prior year's financial statements to conform to the current year's presentation.

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RED HAT, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Consolidation Policy

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

Use of Estimates

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

Recent Accounting Pronouncements

In July 2013, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update No. 2013-11, *Income Taxes (Topic 740) Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists* (ASU 2013-11), to eliminate diversity in practice of presenting unrecognized tax benefits as a liability or presenting unrecognized tax benefits as a reduction of a deferred tax asset for a net operating loss or tax credit carryforward in certain circumstances by requiring that an unrecognized tax benefit be presented in the financial statements as a reduction to deferred tax assets excluding certain exceptions. ASU 2013-11 is effective prospectively for the Company in the first quarter of its fiscal year ending February 28, 2015. The Company does not believe that this updated standard will have a material impact on its consolidated financial statements.

In March 2013, the FASB issued Accounting Standards Update No. 2013-05, *Foreign Currency Matters (Topic 830) Parent's Accounting for the Cumulative Translation Adjustment upon Derecognition of Certain Subsidiaries or Groups of Assets within a Foreign Entity or of an Investment in a Foreign Entity* (ASU 2013-05), which requires a parent entity to release a related foreign entity's cumulative translation adjustment into net income only if its sale or transfer results in the complete or substantially complete liquidation of the foreign entity in which the subsidiary or group of assets had resided. ASU 2013-05 is effective prospectively for the Company in the first quarter of its fiscal year ending February 28, 2015. The Company does not believe that this updated standard will have a material impact on its consolidated financial statements.

Table of Contents**RED HAT, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)****NOTE 3 Changes in Equity**

The following table summarizes the changes in the Company's stockholders' equity during the three months ended November 30, 2013 (in thousands):

	Common Stock	Additional Paid-In Capital	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income (Loss)	Total Stockholders Equity
Balance at August 31, 2013	\$ 23	\$ 1,846,825	\$ 623,079	\$ (1,016,401)	\$ (11,922)	\$ 1,441,604
Net income			52,025			52,025
Other comprehensive income (loss), net of tax					6,679	6,679
Exercise of common stock options		223				223
Common stock repurchase (see NOTE 10)				(40,018)		(40,018)
Share-based compensation expense		30,190				30,190
Tax benefits related to share-based awards		(1,193)				(1,193)
Minimum tax withholdings paid by the Company on behalf of employees related to net settlement of employee share-based awards		(18,307)				(18,307)
Balance at November 30, 2013	\$ 23	\$ 1,857,738	\$ 675,104	\$ (1,056,419)	\$ (5,243)	\$ 1,471,203

The following table summarizes the changes in the Company's stockholders' equity during the three months ended November 30, 2012 (in thousands):

	Common Stock	Additional Paid-In Capital	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income (Loss)	Total Stockholders Equity
Balance at August 31, 2012	\$ 23	\$ 1,761,524	\$ 464,142	\$ (728,894)	\$ (13,112)	\$ 1,483,683
Net income			34,765			34,765
Other comprehensive income (loss), net of tax					5,791	5,791
Exercise of common stock options		4,294				4,294
Common stock repurchase				(52,018)		(52,018)
Share-based compensation expense		26,678				26,678
Tax benefits related to share-based awards		953				953
Minimum tax withholdings paid by the Company on behalf of employees related to net settlement of employee share-based awards		(22,924)				(22,924)
Balance at November 30, 2012	\$ 23	\$ 1,770,525	\$ 498,907	\$ (780,912)	\$ (7,321)	\$ 1,481,222

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)