
**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**
Washington, D.C. 20549

FORM 10-K

(Mark One)

☒ **Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the fiscal year ended February 29, 2004

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: 0-26281

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(g) of the Act: Common Stock, \$.0001 par value

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 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 the 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 checkmark whether the registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2). Yes ☒ No ☐

Aggregate market value of the voting stock held by non-affiliates of the registrant as of August 31, 2003 was approximately \$1,162,905,351, based on the closing price of \$7.25 for our common stock as reported by The Nasdaq National Market on August 29, 2003. There were 183,087,460 shares of common stock outstanding as of April 30, 2004.

DOCUMENTS INCORPORATED BY REFERENCE

None

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PART I

ITEM 1 BUSINESS

GENERAL

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

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

We have developed a complete suite of consulting and training offerings that enable large enterprise customers to capture the significant cost, performance and scalability benefits of our enterprise solutions. We persist in our core belief that the collaborative open source development model is the most effective method to create and deliver high quality software to enterprise customers. We believe that the adoption of Red Hat Enterprise Linux, which is based on open source technology, as a mission critical operating system by the large enterprise, is a significant shift in the computing industry, which has by all accounts continued to gain significant momentum during calendar 2003.

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

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" means Red Hat, Inc. and its subsidiaries.

INDUSTRY BACKGROUND

Growth of open source software

The Internet has accelerated the development of open source software. Open source software has its origins in the academic and research environments and is based on an open, collaborative approach to the development and distribution of software, whereby multiple groups of developers collaborate on specific projects from remote locations around the globe. Developers can write code alone or in groups, make their code available over the Internet, give and receive comments on other developers' code and modify it accordingly. The growth of the Internet has greatly increased the scale and efficiency of open source development through the availability of collaborative technologies such as e-mail lists, news groups and web sites. These technologies have enabled increasingly large communities of independent developers to collaborate on more complex open source projects.

We believe that open source software has emerged as a viable alternative to traditional proprietary software. Under the proprietary model of software development, a software developer generally licenses to the user only the object, or binary code. Binary code consists of the 1's and 0's that only computers understand. By contrast, under the open source development model, the software developer provides the user with access to both the binary code and the source code. Source code is the language used by the developers. As compared to the proprietary model, the open source model:

- allows a company's in-house development team to collaborate with a global community of independent developers;
- provides the user access to both binary and source code, and the rights to copy, modify, alter and redistribute the software; and
- permits the user ongoing access to improvements made to the software by others.

We believe open source software offers many potential benefits for software customers, users and vendors. Customers and users are able to customize the software to suit their particular needs. Vendors are able to leverage the community of open source developers, allowing them to reduce development costs and decrease their time to market.

One of the better known open source technologies is the Linux kernel, the engine of our Linux-based enterprise operating system. An operating system is the software that allows a computer and its various hardware and software components to interact. Thousands of developers worldwide continually collaborate on improving the Linux operating system and we believe we are able to take the best of those improvements and integrate these improvements into our Red Hat Enterprise Linux operating system and provide a stable, rapidly innovating and high performing operating system which has the support of all of the major independent software and hardware vendors in the world.

Since 1991, the use of Linux-based operating systems has grown rapidly. According to International Data Corporation ("IDC"), only two operating systems have shown growth in net new shipments over the last three years: Linux and Microsoft NT/Windows 2000.

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

Despite a strong initial market acceptance of our Red Hat Enterprise Linux operating system and other open source products by the large enterprise, there exist a number of obstacles to widespread adoption within the enterprise, including:

- the need for additional third-party enterprise applications to run on our Red Hat Enterprise Linux operating system;
- limited number of well-financed, viable open source industry participants;
- competition from well-established industry participants; and
- success of a technology business model not based on the protection of proprietary technology.

THE RED HAT BUSINESS MODEL

We have created a business model based on a suite of enterprise software products and technology-based systems management services (Red Hat Enterprise Linux and Red Hat Network), which are developed as open source technologies. We sell these technologies and services to our customers in the form of annual subscriptions on a per-server basis. Most of the contracts we have with our customers are for subscriptions to Red Hat Enterprise Linux. The base subscription entitles the end user to one year of maintenance, which includes configuration support and updates to the technology, when and if available, during the term of the subscription. We believe we have developed a compelling list of reasons for the CIO's of large enterprises to pay on a per-server basis for the software solutions and technology base-based systems management services that we provide. These reasons are based on the business value that we provide to our customers rather than the traditional lock-in of proprietary technology. Our business model is predicated on the acceptance and widespread deployment of Red Hat Enterprise Linux as a significant operating system by the large enterprise, our success at receiving annual subscription revenues on a per-server basis for Red Hat Enterprise Linux and related enterprise technologies and our ability to receive increasing annual average per server subscription revenues by providing additional value to our customers in the form of layers of technology and additional systems management services that our customers will purchase as needed.

Widespread support by the leading independent software and hardware vendors to the large enterprise

We engineer what we believe to be the most comprehensive, technically advanced, reliable and stable operating system based on open source technology, the Red Hat Enterprise Linux platform and related technologies. Red Hat Enterprise Linux AS, ES and WS provide an integrated operating system that we believe meets the performance, reliability and scalability demands of the chief information officer of the large enterprise from the edge of the network to the data center. In order to facilitate the widespread deployment of Red Hat Enterprise Linux, we have focused on gaining widespread support for the Red Hat Enterprise Linux operating system from the providers of hardware and software technology critical to the large enterprise. We believe that we are currently the only Linux company to have (i) the leading software vendors to large enterprises, such as: BMC, Computer Associates, IBM (Websphere, DB2, Lotus, Tivoli, Rational), EMC, Oracle (Oracle 9i Database, Oracle 9i Application Server, Oracle 10g, Oracle E-Business Suite), BEA, SAP, PeopleSoft, Network Appliance and VERITAS, cause their applications to run on our Red Hat Enterprise Linux operating system and (ii) support from the top Intel hardware providers, like: Dell, Fujitsu, Fujitsu/Siemens, HP, IBM, NEC, and Hitachi.

Red Hat Enterprise Linux is:

- flexible and scalable—capable of running the entire network of a large enterprise or 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 monitored and fine-tuned by thousands of developers worldwide; and
- economically compelling—providing a hard dollar, rapid return on investment (in most cases the return on investment occurs within six months or less).

Technology-based systems management services that significantly reduce the cost of managing the information technology infrastructure

Red Hat Network, the first of our systems management offerings, improves the system reliability and security of the Red Hat Enterprise Linux operating system while increasing system administrator productivity to reduce the overall cost of managing the Red Hat Enterprise Linux infrastructure. Red Hat Network brings together the tools, services, and information customers need to maximize the reliability and security of enterprise systems. With Red Hat Network, a single administrator can set up and maintain hundreds or thousands of Red

Red Hat Enterprise Linux systems more easily than maintaining a single system without Red Hat Network. The basic level of Red Hat Network services are received as part of an annual subscription to Red Hat Enterprise Linux. Options such as Proxy Server and Satellite Server can be purchased as additional annual subscriptions and can provide systems management services from inside the corporate firewall by changing the delivery point of the service from Red Hat, via the internet, to a server located inside the corporate firewall. In addition, we have recently expanded the functionality of Red Hat Network to provide, as an additional annual subscription, performance monitoring of the operating system, the network and certain infrastructure applications and provisioning of the operating system and certain applications. This performance monitoring service can be provided in a hosted model over the Internet or through a satellite model which moves the delivery point of the service inside the corporate firewall.

Extensive professional services

We offer a broad range of professional services relating to the development, deployment, and use of Red Hat Enterprise Linux and related technology-based systems management services. These professional services include information technology architecture consulting, Red Hat Enterprise technology deployment services, training and education and hardware certification. We believe that providing these services and establishing ourselves as our customers' technology development, deployment and systems management provider will allow us to facilitate the widespread adoption of Red Hat Enterprise Linux and other open source technologies by the large enterprise.

An online destination for the open source community

We are dedicated to serving the interests and needs of open source software users and developers online. *redhat.com* serves as our primary customer interface and delivery mechanism for many of our products. *redhat.com* also serves as a comprehensive resource for the latest information related to open source initiatives. It contains news of interest to open source users and developers, features for the open source community, a commerce site and priority access for software downloads and upgrades. Visitors to our website can organize and participate in user groups, make available bug fixes and incremental code improvements and share knowledge regarding the use and development of open source software.

By acting as a clearinghouse of open source and Linux-related information and by facilitating the interaction of developers, businesses and technology enthusiasts, we believe our website has become a community center for the open source movement.

Commitment to the open source development model

We have fully embraced the open source model in the development of its technology solutions and services. Whereas some of our competitors have incorporated certain aspects of this model into their businesses while retaining various features of the proprietary model, our product offerings are true open source offerings. We share our improvements to the Linux kernel and other open source products with the development community. In this way, we help independent developers by making our products more useful for them in their own development projects. We believe that the collaborative open source development model is the best way to develop and deliver high quality software.

Strategic relationships

During fiscal 2003 and fiscal 2004, we entered into global strategic agreements that encompass technology development, marketing and distribution of Red Hat Enterprise Linux with leading technology companies, including Dell, Hewlett-Packard, IBM, IBM Global Services, Intel, Oracle, BEA, Fujitsu, Fujitsu Siemens, AMD, NEC, Hitachi, EMC and Network Appliance. We believe that this widespread support has increased the market acceptance of our Red Hat Enterprise Linux operating system and Red Hat Network Services. By

establishing and maintaining these strategic relationships, we believe we will be able to increase market awareness of our Red Hat Enterprise technologies, gather industry support for our enterprise technologies and services, penetrate new geographic, vertical and product markets and, most importantly, rapidly increase the deployment of Red Hat Enterprise Linux by large enterprises.

Segment Reporting

We identify our operating segments primarily based on differences in the nature of our products and services and on geographic location. Our operating segments are enterprise and embedded. These segments reflect our primary focus, sales of Red Hat Enterprise Linux and Red Hat Network subscriptions to large enterprises, and the fact that we have decided to maintain a small but strategic presence in the embedded systems market. Retail subscription revenue is included in the enterprise segment. Performance of these segments is evaluated based on their respective gross profit margins as disclosed in our Consolidated Statements of Operations.

We evaluate our assets on a consolidated basis only. Accordingly, no information has been provided and no allocations have been made related to segment assets.

We have international sales offices in the United Kingdom, France, Italy, Ireland, Germany, Hong Kong, Korea, Australia, India and Japan. We manage our international business on a Europe-wide and Asia Pacific-wide basis. See further discussion of our segment and geographic areas of operation in NOTE 2 of the Notes to our Consolidated Financial Statements.

BUSINESS STRATEGY

Our business strategy is to rapidly gain widespread acceptance and deployment of Red Hat Enterprise Linux as a mission critical operating system by the large enterprise, to generate annual subscription revenues on a per server basis for Red Hat Enterprise Linux, to generate increasing annual subscription revenues on a per server basis by providing additional value to our customers in the form of additional layers of open source technology that will be provided on top of our Red Hat Enterprise Linux operating system and to generate increasing revenue from providing additional systems management services. In addition, we are focused on selling our products and services to the Global 2000. The key elements of our strategy are:

Increase the adoption of Red Hat Enterprise Linux by the large enterprise

The past twenty-four months have seen market acceptance of the Red Hat Enterprise Linux operating platform by the large enterprise and the acceptance of Linux in general as a viable operating system for mission critical areas of the information technology infrastructure of large enterprises, and we intend to promote further acceptance of Red Hat Enterprise Linux and Red Hat Network through a variety of means. This includes developing additional layers of technology for our Red Hat Enterprise Linux operating system, bringing new systems management services to market, focusing on the success of our strategic relationships with companies such as Dell, Oracle, HP, IBM, Fujitsu, NEC, Hitachi, and Network Appliance and continuing to add strategic relationships with other major information technology companies and focusing on new geographic areas. The strength of our strategic relationships with these companies is crucial to the continued expansion of the use of our enterprise technologies globally, the technical advancement and widespread distribution of our enterprise solutions, the migration of existing third-party enterprise applications to Red Hat Enterprise Linux and the development of new third-party enterprise applications suitable for Linux-based operating systems.

Continue to pursue strategic acquisitions and alliances

We intend to continue to pursue a selective acquisition strategy as opportunities arise to complement and expand our systems management offerings, add additional layers of infrastructure products to our Red Hat

Enterprise Linux operating system and extend our service capabilities. During fiscal 2004, we acquired Sistina Software, Inc., or Sistina. Sistina provides us with a global file system software product that provides our initial entry into the storage management marketplace. We also intend to create additional strategic alliances where it is beneficial to our business model.

Continue to grow our market share in international markets

We have operations in many countries in Europe and Asia. We are continuing to expand our operations geographically. We offer Red Hat Enterprise Linux in English, French, German, Italian, Spanish, Japanese, traditional Chinese, simplified Chinese, and Korean, and plan to introduce it in additional languages in the future. We expect that our international operations will remain an integral part of our business and that we will expand into new countries such as Korea, China and continents such as South America. Please see NOTE 2 to the Notes to the Consolidated Financial Statements for a discussion of our revenues 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, capitalizing on our extensive experience working with the open source model. We expect this continued investment to take the form of increased expenditures on internal development efforts, as well as continued funding of third-party open source projects. We also plan to continue our financial support of the development efforts of many of the top-tier engineers in the open source community.

PRODUCTS AND SERVICES

The Red Hat Enterprise suite of products, consisting of Red Hat Enterprise Linux, Red Hat Network, and Red Hat Applications, are at the center of our subscription strategy and our open source architecture. Our professional services offerings, principally directed toward our large enterprise customers and the leading hardware providers with whom we have strategic agreements, include technical support and maintenance, custom development, consulting, training and education, and hardware certification.

Many of our software products come with a limited services subscription. Users are entitled to access Red Hat Network in addition to various levels of Internet-based or telephone-based support.

Red Hat Enterprise Linux

Red Hat Enterprise Linux is a version of the Linux operating system designed expressly for enterprise computing. Red Hat Enterprise Linux is built around a common core that delivers the features required for commercial deployments, including:

- Support for a wide range of ISV applications, including Oracle, VERITAS, IBM, and BEA;
- Certification on multiple architectures and leading Intel-based hardware original equipment manufacturer, or OEM, platforms, including Dell, HP, Fujitsu, Fujitsu Siemens, IBM, NEC, Hitachi, and Sun Microsystems;
- Comprehensive service offerings, up to 24 x 7 with 1 hour response, available both from Red Hat and selected ISV/OEM partners;
- Performance, scalability, and availability, with leading audited industry benchmarks;
- Stability with 12-18 month version upgrade cycles and five years product support; and
- A fully homogeneous suite of products that enables interoperation of systems from the technical/developer workstation to the data center.

Red Hat Enterprise Linux is available in three versions:

Red Hat Enterprise Linux AS Red Hat Enterprise Linux AS is our top-of-the-line Enterprise Linux product designed for use in mission critical areas of the information technology infrastructure. Supporting the largest commodity-architecture servers and available with the highest levels of support, Red Hat Enterprise Linux AS is designed for large departmental, middle tier of the information technology infrastructure and data center server deployments.

Red Hat Enterprise Linux ES Red Hat Enterprise Linux ES is our version designed for systems ranging from the edge-of-network to medium scale departmental deployments.

Red Hat Enterprise Linux WS Red Hat Enterprise Linux WS is designed for technical/developer workstations and high performance computing/clustering applications. It is designed for client-server deployments, development environments, and client applications environments (such as electronic design automation and oil/gas applications).

Our Red Hat Enterprise Linux products are primarily delivered on an annual subscription basis with one year of subscription services and access to the basic software update and configuration management functionality of Red Hat Enterprise Network.

Red Hat Network

Red Hat Network provides simple systems management services for Linux-based infrastructures. With a focus on open standards and scalability, Red Hat Network helps organizations increase productivity, lower costs, and enhance security. The modular design allows customers to purchase desired services for provisioning, managing, and updating systems. Red Hat Network services are also available through different architectures—Hosted, Proxy, and Satellite—that are designed to provide organizations with the right level of support and functionality based on their size or needs.

Red Hat Network consists of three modules: Update, Management, and Provisioning. Customers purchase entitlements to these services on an annual per-system subscription basis.

Update Module Complimentary with a RHEL subscription. The Update Module is the entry-level offering for Red Hat Network. It allows our customers to maintain single systems and includes functionality such as a graphical user interface, priority notification, errata information, Red Hat Package Manager (“RPM”) dependency checking, and auto update.

Management Module Includes all of the functionality of the Update Module. The Management Module allows our customers to manage their entire Linux infrastructure. Designed for enterprise scalability, the Management Module features systems grouping, role-based administration for policies and permissions, scheduled actions, and higher-end functionality (with Satellite server – see the discussion of our architecture below), such as third-party channels, custom channels, local package caching, and off-network capability.

Provisioning Module Includes all of the functionality of the Management Module plus the Provisioning Module includes features such as operating system provisioning (from bare metal boxes or previously deployed boxes), configuration management, multi-state rollback, scheduled remote actions, Kickstart configuration tools, and RPM-based application provisioning.

Red Hat Network has three architectures designed around our customers’ requirements: Hosted, Proxy, and Satellite.

Hosted In the Hosted architecture, individual systems of the customer connects to the Red Hat Network via the Internet and exchanges packages and information with the central Red Hat Network servers. This is the default architecture for purchasing a subscription to Red Hat Network.

Proxy In the Proxy architecture, individual systems of the customer connect to a Red Hat Network proxy hosted on the customer's network. The proxy aggregates all necessary data and performs selected tasks locally. It also communicates via the Internet with the central Red Hat Network servers. All information stored in the Red Hat Network database is kept on the Red Hat Network servers. The Proxy architecture is available for all of the service modules listed above.

Satellite In the Satellite architecture, all Red Hat Network functionality (system profiles, reporting data, application server, etc.) is stored locally on a customer's network. The satellite server connects with Red Hat Network over the Internet to download updates. This architecture allows our customers to take their Red Hat Network technology off the Internet if desired to improve security. The Satellite architecture is available for all of the service modules listed above.

Red Hat Applications

Red Hat Applications include software for managing Web content, software development, and high availability clusters of Linux systems. These applications are a key component of our vision of open source architecture for the enterprise. In the application infrastructure layer, we offer a range of standards-based open source technologies to enable Java™-based Web application development and deployment. In addition, the Red Hat Developer Suite provides an Integrated Development Environment for application developers. The Red Hat Cluster Suite features high availability clustering using application failover technology, which is designed to make applications available at all times. Network load balancing technology provides performance and availability improvements for network-intensive applications. Red Hat GFS is an enterprise-strength clustered file system for Linux, designed for commercial and technical computing applications requiring access to fully shared data.

This growing suite of products and services that comprises our open source architecture provides new opportunities for our customers to deploy open source technologies that integrate with their Red Hat Enterprise Linux operating system and make it even more productive.

Professional services

Our professional services are designed to help individuals and enterprises derive the full value of our products and open source technology.

Global Professional Services Our strategy is to provide comprehensive solutions to assist our customers at every phase of the infrastructure lifecycle, from analysis and design of use of our open source products to development and deployment. We also offer services in areas such as migration to Linux from UNIX and integration of disparate operating environments, high-performance computing, and high-availability clustering.

Global Learning Services Red Hat Global Learning Services ("GLS") provides comprehensive Linux training for system administrators. The central element of our training program is RHCE (Red Hat Certified Engineer) certification, which has been consistently ranked as one of the top three technical training certification programs by groups, such as Certification Magazine. The GLS curriculum includes courses on security, developer skills, and much more. We offer open enrollment in more than 85 cities worldwide, and the majority of the curriculum also can be delivered via e-learning or a customized on-site course.

COMPETITION

In the market for operating systems, we compete with a limited 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, IBM, and Sun Microsystems, all of which offer hardware-independent, multi-user operating systems for Intel platforms, and HP and Unisys, each of which, together with IBM and Sun Microsystems, offers its own version of the UNIX operating system with their own hardware offerings. Many of these competitors bundle competitive operating systems with their own hardware offerings, thereby making it more difficult for us to penetrate their customer bases.

In addition, in January 2004, Novell, Inc. acquired Suse, Inc., a Linux company. Novell is significantly more capitalized than Suse had been and has historical relationships with many of the Intel hardware providers.

With the development of our enterprise consulting and training and education offerings, we now face competition in the market for providing consulting services related to the deployment of our enterprise technologies, including Red Hat Enterprise Linux and Red Hat Network. Our competitors in the market include IBM Global Services, with which we have a global strategic agreement, as well as other technology infrastructure consulting companies.

In the market for systems management services, we compete with a limited number of large companies that have significantly greater financial resources, larger development staffs and more extensive marketing and distribution capabilities. These competitors include IBM, HP, Computer Associates and BMC, all of which offer heterogeneous operating system support including Linux, Solaris, AIX, HPUX and Windows. Many of these competitors have legacy client/server offerings that require long implementation cycles and are more difficult to replace in enterprise customers due to switching costs.

The open source software market is not characterized by the traditional barriers to entry that are found in most other markets due to the nature of open source technology. For example, anyone can copy, modify and redistribute Red Hat Enterprise Linux and most of our other open source products themselves. However, they are not permitted to refer to these products as “Red Hat” products unless they purchase such products from us and, as it relates to our Red Hat Enterprise Linux and Red Hat Network offerings, our customers agree not to utilize the benefits of the subscription services that they receive from us on any server/workstation for which they have not purchased a subscription. In addition, the only means by which customers can receive a certified version of Red Hat Enterprise Linux and receive certified updates and upgrades to a copy of Red Hat Enterprise Linux is to purchase and maintain a current subscription directly from us, our certified distributors/resellers or the hardware vendors with which we have global strategic agreements.

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

- the name and reputation of vendor;
- the product performance, reliability, functionality and price;
- the alliances of the vendor with major industry hardware providers such as Dell, HP, IBM, Fujitsu, Fujitsu Siemens, NEC, and Hitachi;
- the quality of subscription services;
- the number of Global 2000 reference accounts;
- the availability of third-party enterprise infrastructure applications that run on the operating system;
- the breadth of hardware compatibility;
- the distribution strength and number of distribution partners of the vendor; and
- the strength of the vendor’s relationships in the open source community.

Although we believe that we compete favorably with many of our non-linux competitors in a number of respects, including product performance, functionality and price, and breadth of hardware compatibility, we believe that many of our competitors currently have superior distribution capabilities. In addition, there are significantly more enterprise infrastructure applications available for competing operating systems, such as Windows NT, Windows 2003, and UNIX, than there are for Red Hat Enterprise Linux. An integral part of our strategy has been to address these shortcomings by, among other things, strengthening our existing strategic relationships and entering into new ones to expand our distribution capabilities, and attracting more attention to the open source movement, which in turn should create additional incentives for software developers to write more applications for Red Hat Enterprise Linux.

SOFTWARE ENGINEERING AND DEVELOPMENT

We have invested, and intend to continue to invest, significant resources in product and technology development. We have expensed \$36.5 million, \$32.4 million, and \$20.5 million, respectively, in the past three fiscal years 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 Red Hat Enterprise Linux and Red Hat Network that is needed by the Global 2000 and the leading third-party applications upon which the Global 2000 are dependent. Our software engineers collaborate with open source software development teams working across the Internet. This involvement enables us to remain abreast of, and lead, technical advances, plans for development of new features and timing of releases, as well as other information related to the development of the Linux kernel and other open source projects.

Our software engineers have contributed to the development and maintenance of some of the most important components of the Red Hat Enterprise Linux operating system, including the installation program and the package management program. The installation program provides users with a single method to install the hundreds of separate software programs that are included with Red Hat Enterprise Linux so that, from the user's perspective, the hundreds of programs appear as one. This simplified process sharply reduces the time and effort required to install as compared to the alternative of gathering the hundreds of programs one by one via the Internet. The installation program provides default settings for the user depending upon whether the user wishes to use Red Hat Enterprise Linux as a server operating system or as a workstation operating system. The installation also provides advanced users with the ability to customize the programs that are installed, allowing for significant flexibility and control over the operating system. The installation also automatically detects the type of hardware that comprises the user's computer, in order to ensure that all programs necessary for Red Hat Enterprise Linux to work on the hardware are properly installed.

Our software development engineers perform extensive testing of Red Hat Enterprise Linux, Red Hat Network and other Red Hat enterprise technologies. We use industry standard methods of quality assurance testing to ensure that our enterprise technologies are solidly engineered and ready for use by our customers when shipped.

In addition, we are beginning to invest substantial resources on the development/commercialization of open source technologies which will provide added value on top of the operating system, such as the Global File System and Logical Volume Management and Security Enhanced Linux.

INTELLECTUAL PROPERTY

Red Hat Enterprise Linux, Red Hat Enterprise technologies and our other open source products have been developed and made available for licensing under the GNU General Public License and similar open source licenses. These licenses generally permit anyone to copy, modify and distribute the software, subject only to the

restriction that any resulting or derivative work that is made available to the public be licensed under the same terms. Therefore, although we retain the copyrights to the code that we develop ourselves, 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 rely primarily on a combination of trademarks and copyrights to protect our intellectual property. We also generally enter into confidentiality and nondisclosure agreements with our employees and consultants, and generally control access to and distribution of our 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, Africa and Australia. Other trademarks we have registered or for which registrations are pending in the United States include Red Hat Certified Engineer, RHCE, GNUPro, Bluecurve, Stronghold and Red Hat Press.

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 the continued misappropriation of our tradename and trademarks in these circumstances or that we will be able to prevent this type of unauthorized use in the future. The laws of some foreign countries do not protect our trademark rights to the same extent as do the laws of the United States. In addition, policing unauthorized use of our trademark rights is difficult, expensive and time consuming, however, we maintain a vigorous enforcement program. The loss of any material trademark or tradename could have a material adverse effect on our business, operating results and financial condition.

Red Hat has also undertaken 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 of potential new technologies. As part of Red Hat’s commitment to the open source community, we provide our patent promise to permit development and distribution of open source applications that read on our patents. Consequently, it is unlikely that our patents will, of themselves, provide us substantial revenue. Rather, they are intended to provide a shield from the potential patent infringement claims of third parties and to ensure that such new technologies and innovations remain open.

Although we do not believe that our products infringe the rights of third parties, 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 rights. 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.

EMPLOYEES

As of March 31, 2004, we had a total of 681 employees. From time to time we also employ independent contractors to support our professional services, product development, sales, marketing and business development organizations. Our employees are not represented by any labor union and are not organized under a collective bargaining agreement, and we have never experienced a work stoppage. We believe our relations with our employees are good.

COMPANY INFORMATION

Our website is located at www.redhat.com. This Annual Report on Form 10-K, our Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and all amendments to these reports, as well as proxy statements and other information we file with or furnish to the SEC are available free of charge on our website. We make these

documents available as soon as reasonably practicable after we file or furnish them to the SEC. Except as otherwise stated in these documents, the information contained on our website or available by hyperlink from our website is not incorporated by reference into this report or any other documents we file with or furnish to the SEC.

ITEM 2 PROPERTIES

Our headquarters are 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 \$1.4 million.

We also lease offices in Mountain View, California; Westford, Massachusetts; Tyson's Corner, Virginia; Huntsville, Alabama; Toronto, Canada; Tokyo, Japan; and several locations throughout Europe and Australia. We believe that our properties have been satisfactorily maintained, are in good condition and are suitable for our operations.

ITEM 3 LEGAL PROCEEDINGS

Red Hat Professional Consulting, Inc., formerly PTI, a wholly-owned subsidiary of ours that we acquired in February 2001, along with its former directors and some of its former principal shareholders is a defendant in a suit brought in the Superior Court of DeKalb County, State of Georgia, by a former employee. The plaintiff asserts, among other things, breach of various employment agreements and seeks monetary damages. PTI has filed an answer, affirmative defenses and counterclaims denying all liability and has filed a motion to dismiss which remains pending. All discovery in the matter is complete. We have been indemnified in this matter by the former PTI shareholders and further believe that the likelihood of a material loss is remote.

Commencing on or about March 29, 2001, we and certain of our officers and directors were named as defendants in a series of purported class action suits arising out of our initial public offering and secondary offering. On August 8, 2001, Chief Judge Mukasey of the federal district court for the Southern District of New York issued an order that transferred all of the so-called IPO allocation actions, including the complaints involving us, to one judge for coordinated pre-trial proceedings. The court has consolidated the actions by issuer, and our actions have been consolidated into a single action. 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 our action. The relief sought consists of unspecified damages. No discovery has occurred to date. The individual director and officer defendants have been dismissed from the case without prejudice. We believe these complaints are without merit and will defend against them vigorously in this matter. No assurance can be given, however, that this matter will be resolved in our favor. We have, together with other issuers, the plaintiffs, and the insurers, agreed in concept to a proposed settlement whereby we would be released from this litigation. That proposed settlement has not been submitted to the court for its consideration, and there is no certainty that the court will approve the settlement.

Commencing May 23, 2002, we were named as defendant in a suit brought by The Monotype Corporation in federal district court for the Northern District of Illinois alleging copyright and trademark infringement. The plaintiff contended that we infringed certain of plaintiff's font software copyrights and related trademarks in our retail distributions, versions 5.2 through the initial release of version 7.3. On December 4, 2002, the plaintiff filed a second amended complaint adding allegations of violations of the Lanham Act, as well as the state unfair and deceptive trade practices acts under Illinois and North Carolina law. The relief sought consisted of unspecified damages. We counterclaimed alleging plaintiff's copyrights and trademarks are unenforceable and/or invalid. In

December 2003, the parties entered into a license agreement that provides us the right to distribute a number of Monotype's commercial fonts over a 5 year period. We recorded a charge of \$500,000 in the third quarter of fiscal 2004 related to this license agreement. In conjunction with the license, the parties entered into a mutual release and all claims asserted by each party were dismissed with prejudice.

Commencing August 4, 2003, we filed suit against The SCO Group, Inc., or SCO, in the U.S. District Court for the District of Delaware (Civil Action No. 03-722 SLR) (the "Action") seeking a declaratory judgment that we are not infringing any of SCO's intellectual property rights. In addition, we have asserted claims against SCO under Delaware and federal law, including deceptive trade practices, unfair competition, tortious interference with prospective business opportunities, trade libel and violations of the Lanham Act. We contend that SCO has made false and misleading public statements alleging that software code, in which SCO claims to own copyrights and trade secrets, was misappropriated and incorporated into our product and has threatened legal action. On September 15, 2003, SCO filed a Motion to Dismiss contending, among other things, that there exists no actual controversy that would warrant the declaratory judgment we seek. On April 6, 2004, the Court denied SCO's Motion to Dismiss but stayed further action in the case pending the resolution of litigation pending in the U.S. District Court for the District of Utah between SCO and IBM. On April 20, 2004, we filed a Motion for Reconsideration contending that a stay based on the Utah case would be inappropriate and SCO has filed an opposition to that motion. That motion is now pending before the Court. At this early stage of the proceedings, no assurance can be given as to the outcome.

In addition to the litigation described above, we experience other routine litigation in the normal course of our business. We believe that the outcome of this routine litigation will not have a material adverse impact on our consolidated financial position or results of operations.

ITEM 4 SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

No matter was submitted to a vote of our stockholders, through the solicitation of proxies or otherwise, during the fourth quarter of fiscal year 2004.

PART II

ITEM 5 MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

Market Information

Our common stock is traded on The Nasdaq National Market under the symbol "RHAT". The chart below sets forth the high and low sales information for each of the quarters of the fiscal years ended February 29, 2004 and February 28, 2003.

<u>Quarter</u>	<u>FY 2004</u>		<u>FY 2003</u>	
	<u>High</u>	<u>Low</u>	<u>High</u>	<u>Low</u>
First	\$ 7.45	\$ 5.43	\$7.32	\$4.37
Second	\$ 8.70	\$ 6.00	\$5.87	\$4.33
Third	\$15.38	\$ 7.28	\$6.97	\$3.75
Fourth	\$21.23	\$12.06	\$6.45	\$5.06

Holders

As of April 30, 2004, we estimate that there were 2,490 registered stockholders of record of our common stock.

Dividends

We have never declared or paid any cash dividends on our common stock. We anticipate that our future earnings will be retained for the operation and expansion of our business and do not anticipate paying cash dividends in the foreseeable future.

ITEM 6 SELECTED FINANCIAL DATA

The following selected financial data is derived from our Consolidated Financial Statements and should be read in conjunction with the Consolidated Financial Statements, related notes, and other financial information included herein.

	Year Ended				
	February 29, 2004	February 28, 2003	February 28, 2002	February 28, 2001	February 29, 2000
	(in thousands, except per share data)				
SELECTED STATEMENT OF OPERATIONS DATA					
Subscription and services revenue:					
Subscription:					
Enterprise technologies	\$ 68,930	\$ 30,438	\$ 17,734	\$ 16,260	\$ 2,354
Retail	12,914	14,833	19,054	20,604	12,875
Embedded	1,911	3,321	5,512	8,634	10,123
Total subscription revenue	83,755	48,592	42,300	45,498	25,352
Services:					
Enterprise technology services	37,764	38,522	24,354	16,002	3,879
Embedded development services	4,565	3,812	12,256	19,332	13,196
Total services revenue	42,329	42,334	36,610	35,334	17,075
Total subscription and services revenue	\$126,084	\$ 90,926	\$ 78,910	\$ 80,832	\$ 42,427
Hardware resale revenue	—	—	—	\$ 777	\$ 11,954
Gross profit	\$ 91,215	\$ 59,464	\$ 50,395	\$ 45,687	\$ 19,590
Income (loss) from continuing operations . . .	\$ 3,212	(\$ 17,164)	\$(135,049)	\$(95,178)	\$(43,913)
Other income, net	\$ 10,786	\$ 10,826	\$ 15,535	\$ 20,766	\$ 4,070
Loss from discontinued operations	—	—	\$ (10,355)	\$(12,303)	\$ (2,584)
Extraordinary item-loss on disposal of discontinued operations	—	\$ (261)	\$ (10,347)	—	—
Net income (loss)	\$ 13,998	\$ (6,599)	\$(140,216)	\$ (86,715)	\$ (42,427)
Basic Income (Loss) Per Common Share:					
Income (loss) from continuing operations before extraordinary item	\$ 0.08	\$ (0.04)	\$ (0.71)	\$ (0.45)	\$ (0.39)
Discontinued operations:					
Loss from discontinued operations	—	—	(0.06)	(0.08)	-0.02
Extraordinary item-loss on disposal of discontinued operations	—	(0.00)	(0.06)	(0.00)	(0.00)
Net income (loss)	\$ 0.08	\$ (0.04)	\$ (0.83)	\$ (0.53)	\$ (0.41)
Diluted Income (Loss) Per Common Share:					
Income (loss) from continuing operations before extraordinary item	\$ 0.08	\$ (0.04)	\$ (0.71)	\$ (0.45)	\$ (0.39)
Discontinued operations:					
Loss from discontinued operations	—	—	(0.06)	(0.08)	(0.02)
Extraordinary item-loss on disposal of discontinued operations	—	(0.00)	(0.06)	(0.08)	(0.02)
Net income (loss)	\$ 0.08	\$ (0.04)	\$ (0.83)	\$ (0.53)	\$ (0.41)
Weighted average shares outstanding (a)					
Basic	174,003	170,158	169,451	164,659	102,465
Diluted	182,913	170,158	169,451	164,659	102,465

	Year Ended				
	February 29, 2004	February 28, 2003	February 28, 2002	February 28, 2001	February 29, 2000
	(in thousands, except per share data)				
BALANCE SHEET DATA					
Total cash and investments in debt securities (short and long term)	\$ 941,384	\$292,340	\$286,977	\$302,681	\$349,497
Working capital	\$ 574,434	\$ 75,265	\$ 81,594	\$138,990	\$257,365
Working capital (plus long term investments in debt securities	\$ 907,217	\$277,139	\$272,175	\$293,547	\$329,719
Total assets	\$1,109,619	\$390,339	\$369,865	\$505,251	\$434,861
Capital lease obligations, net of current maturities	\$ 538	\$ 1,393	\$ 1,563	\$ 277	\$ 231
Convertible debentures	\$ 600,000	—	—	—	—
Stockholders' equity	\$ 409,207	\$336,421	\$327,549	\$464,282	\$401,167

- (a) All share and per share information for the fiscal years ended February 28, 2001 and February 29, 2000 have been retroactively restated to reflect the two-for-one splits of common stock on each of August 11, 1999 and January 7, 2000 and the acquisitions of Cygnus Solutions and Planning Technologies, Inc., using the pooling of interests method of accounting, on January 7, 2000 and February 23, 2001, respectively.

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

Forward-looking statements in this Annual Report on Form 10-K are made pursuant to the safe harbor provisions of Section 21E of the Securities Exchange Act of 1934. Investors are cautioned that statements in this Annual Report on Form 10-K that are not strictly historical statements, including, without limitation, statements regarding current or future financial performance, management's plans and objectives for future operations, product plans and performance, management's assessment of market factors, and statements regarding the strategy and plans of Red Hat and its strategic partners, constitute forward-looking statements. 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 in the future to differ materially from the forward-looking statements. These risks and uncertainties include, without limitation, the risks detailed below and in Red Hat's other filings with the Securities and Exchange Commission, copies of which may be accessed through the SEC's web site at <http://www.sec.gov>.

OVERVIEW

We are the global leader in providing an enterprise operating system and related systems management services based on open source technology for the information technology infrastructure requirements of large enterprises. Open source software is an alternative to proprietary software. There are no licensing fees associated with open source software. Therefore, we do not recognize any separate distinguishable value from the sale of the code itself. We derive the value from the sale of our open source solutions by the value we add through the integration and testing of Red Hat Enterprise Linux, guarantee of the levels of performance of Red Hat Enterprise Linux and rapid innovation of Red Hat Enterprise Linux in a method that allows this innovation to be consumed by our customers. In addition, we provide certain managed services for each of our technologies through Red Hat Network, a standard component of our subscriptions. We sell our technology through subscriptions to Red Hat Enterprise Linux ("RHEL") and we recognize our technology based revenue over the period of the technology subscription agreements with our customers. Our products and services are offered primarily to large enterprises, government organizations, and small and medium size businesses.

During the fiscal year ended February 28, 2002, we restructured our organization to sharpen our focus on Linux migration opportunities and to increase the amount of revenue that we generate from our Enterprise technologies. The restructuring included significant charges and the discontinuing of our network consulting business that was completed in February 2002.

We have focused on introducing and gaining acceptance for our Enterprise technologies, Red Hat Enterprise Linux AS, ES and WS and Red Hat Network for the past two fiscal years. In May 2002, we introduced our initial Red Hat Enterprise Linux offering, Red Hat Enterprise Linux AS, formerly called Advanced Server. Since its initial introduction, Red Hat Enterprise Linux has gained widespread ISV and IHV support. We have continued to focus on our enterprise line of technologies by expanding our enterprise operating platform offerings and introducing new systems management services. As discussed in our critical accounting policies below, these new offerings typically have twelve month revenue recognition periods which match the subscription periods.

For the fiscal year ended February 29, 2004, we sold approximately 169,500 subscriptions to our RHEL products compared to 36,500 in the previous year. This increase resulted from the increasing level of adoption of Red Hat Enterprise Linux AS as a primary operating system by larger enterprise customers and the introduction of two additional Red Hat Enterprise Linux offerings in March 2003, Red Hat Enterprise Linux ES and Red Hat Enterprise Linux WS. These two additional products are targeted at the lower end of the server market and the technical/developer workstation market and have less features and more limited service level agreements. We believe that our ability to continue to increase adoption rates of all three of our Red Hat Enterprise Linux products and maintain competitive pricing are critical to our success.

We derive our revenues and generate cash from customers from two sources: (i) subscription revenue, which includes retail, enterprise subscriptions, and embedded subscription revenue, and (ii) services revenue which includes enterprise services and embedded services described under “Critical Accounting Policies” below. For fiscal 2004 and 2003, our total revenues were \$126.1 million and \$90.9 million, respectively. The arrangements with our customers that create Enterprise subscription revenues are explained in detail under “Critical Accounting Policies” below and in NOTE 2—Summary of Significant Accounting Policies. These agreements typically involve the sale of subscriptions to Red Hat Enterprise Linux and in certain cases will include the sales of subscriptions to other Red Hat subscription offerings or Red Hat services. Our revenues are also affected by corporate, government and consumer spending levels. In evaluating the performance of our business, we consider a number of factors. These factors include total revenues, operating income and cash flows on a geographic basis. In addition, we also consider the following factors in our evaluation process:

Subscription volumes. Our RHEL products, AS, ES and WS, are sold under subscription agreements. These agreements typically have a one year subscription period. The base subscription entitles the end user to one year of maintenance, which entitles the end user to configuration support and updates and upgrades to the technology, when and if available, during the term of the subscription. Our customers have the ability to purchase higher levels of subscriptions that increase the level of support the customer is entitled to receive. Subscription volumes increased each quarter during fiscal 2004 and are being driven primarily by the market acceptance of using the Linux operating system in enterprise data centers and our expansion of sales channels during the year.

Sales by geography. We operate our business in three geographic regions; North America (U.S. and Canada); EMEA (Europe, Middle East and Africa); and Asia Pacific (Japan, Australia, Korea and China). In fiscal 2004, \$39.3 million or 31% of our revenue was generated outside North America compared to \$27.2 million or 30% in fiscal 2003. The percentage of our revenues generated from our international operations is expected to increase as our international sales force and channels become more mature and as we enter new locations or expand our presence in existing locations. The increase in our international revenues reflects the increasing adoption of the Linux operating system in both Europe and Japan. As noted in the Segment Reporting section of NOTE 2 in the Notes to the Consolidated Financial Statements, our revenue in both EMEA and Asia Pacific increased at higher percentages than in North America. In the past 12 months, we have entered new markets such as China, Belgium, Netherlands, and Eastern Europe and we expect our expansion to continue to be greater in these markets.

Deferred revenue balances. Our deferred revenue balance at February 29, 2004 was \$70.8 million. Because of our subscription model and revenue recognition policies, deferred revenues improve predictability of future revenues. Deferred revenues at February 29, 2004, have increased by more than 298% as compared to February 28, 2003.

Cash, cash equivalents and investments in debt securities. Cash, cash equivalents and investments in debt securities balances at February 29, 2004 totaled \$941.4 million. During fiscal 2004, we generated \$61.6 million in cash flow from operations primarily related to the increase in sales of subscriptions to Red Hat Enterprise Linux during the fiscal year. We also had positive cash flow provided by financing activities during the fiscal year of \$597.3 million. This primarily relates to the issuance of senior convertible debt in January 2004 which resulted in net proceeds of \$584.7 million to us. Our significant cash balance gives us the ability to take advantage of acquisition opportunities and increase investment in international opportunities.

In fiscal 2005, we are focused, on among other things, (i) continuing to build on the global market momentum behind the adoption of Linux as an operating system by enterprise customers; (ii) continue our market penetration through channel partners; (iii) drive high renewal rates of subscriptions sold in prior periods and (iv) increase the contribution to our subscription sales by Intel hardware vendors.

CRITICAL ACCOUNTING POLICIES

Our critical accounting policies include the following:

- Revenue recognition; and
- Impairment of long-lived assets

Revenue Recognition

We recognize revenue in accordance with Statement of Position No. 97-2, "Software Revenue Recognition" ("SOP 97-2"), as amended by SOP 98-4 and SOP 98-9, Emerging Issues Task Force No. 00-21 ("EITF 00-21") and Staff Accounting Bulletin No. 104 ("SAB 104") depending upon the nature of the arrangement. Revenue recognition in accordance with these pronouncements can be complex due to the nature and variability of our sales transactions.

Subscription Revenue

Subscription revenue is comprised of enterprise and embedded revenues.

Enterprise subscription revenue is comprised primarily of revenue from sales of Red Hat Enterprise Linux software solutions, however we also generate enterprise subscription revenue from sales of Red Hat Linux, software development tools, technical support and maintenance fees.

During fiscal 2003, we released the first versions of our Red Hat Enterprise Linux offerings, Red Hat Enterprise Linux AS, ES and WS. These technologies are sold under a subscription agreement with specified renewal rates. Our Red Hat Enterprise Linux ("RHEL") products have one and three year base subscription periods. The base subscription entitles the end user to the technology itself and post customer support services ("PCS") consisting of; security errata, updates to the technology, upgrades to new versions of RHEL on a when and if available basis during the term of the subscription, and various levels of Red Hat support. We recognize the revenue from the sale of our Red Hat Enterprise Linux offerings ratably over the period of the subscription. We do not sell the RHEL technology or the components of the PCS that are included in the subscription on a stand alone basis.

We sell Red Hat Enterprise Linux through four channels: distribution, direct sales, original equipment manufacturers ("OEMs") and the web. In the majority of our transactions, subscriptions to Red Hat Enterprise Linux are sold on a stand-alone basis. Our standard subscription term is one year. The revenue associated with the sale of subscription to Red Hat Enterprise Linux is recognized ratably over the period of the end users subscription.

Our subscription agreements with our large enterprise customers sometimes include multiple subscription and/or service elements. These arrangements typically include a subscription to Red Hat Enterprise Linux, Red Hat Network, training services and/or professional consulting. For these contracts, we separate the various elements and recognize revenue attributable to each element in the manner that best matches the delivery of value to our customer. Red Hat Enterprise Linux and Red Hat Network subscription revenues are recognized ratably over the subscription term, training services revenue is recognized when students attend class, and professional services revenue is recognized on a time and materials basis as the services are delivered. When possible, we allocate revenue to each component of the contract based on vendor specific objective evidence ("VSOE") of its fair value. VSOE for our Red Hat Enterprise Linux subscription agreements is created by the fact that we regularly sell RHEL subscriptions on a stand alone basis with renewal rates for year two equal to the amount paid in year one or there is a stated renewal rate in the contract. In contracts where VSOE exists for training or consulting services, such VSOE is demonstrated by either; the ability to purchase additional training or consulting services at specified rates and on a stand alone basis upon expiration of the original term of the

multiple element arrangement or regularly selling the training or consulting services on a stand alone basis at substantially the same rates as those charged in the multiple element arrangement. In certain multiple element arrangements where VSOE cannot be established, the entire value of the contract is recognized ratably over the term of the agreement. Our training and consulting services are not essential to the functionality of Red Hat Enterprise Linux. The majority of our customers purchase subscriptions to Red Hat Enterprise Linux without purchasing any training or consulting services.

In addition, our enterprise subscription revenue is partially derived from sales of our Red Hat Network service offerings. Red Hat Network is an internet-based set of services to assure the security, availability and reliability of all of our Red Hat software solutions. Red Hat Network is sold in the form of an annual subscription and revenues related to these are recognized ratably over the term of the subscription.

Embedded subscription revenue consists of revenue for technical support and maintenance services provided pursuant to software compiling, debugging and optimization agreements. Revenue is deferred and recognized ratably over the term of the agreement, which is typically 12 months.

Services Revenue

Services revenue is comprised of embedded development and enterprise services.

Enterprise services are comprised of revenue for consulting services, engineering services, and customer training and education. Consulting services are provided under agreements where customers are paying us on an hourly basis to assist in the deployment of our open source technologies. Revenue from customer training and education is recognized at the date the services are performed.

Embedded development services are contracts for compiling, debugging and optimization of various open source software technologies. Revenue is recognized on the percentage-of-completion method, provided that we have the ability to make reliable estimates of progress towards completion, the fee for such services is fixed and determinable and collection of the resulting receivable is probable.

Impairment of Long-Lived Assets

We evaluate the recoverability of our property and equipment and other assets in accordance with Statement of Financial Accounting Standards No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" ("SFAS 144"). SFAS 144 requires that one accounting model be used for long-lived assets to be disposed of by sale, whether previously held and used or newly acquired, and by broadening the presentation of discontinued operations to include more disposal transactions. An impairment loss is recognized when the net book value of such assets exceeds the estimated future undiscounted cash flows attributable to the assets or the business to which the assets relate. Impairment losses are measured as the amount by which the carrying value exceeds the fair value of the assets.

RESULTS OF OPERATIONS

	Year Ended		
	February 29, 2004	February 28, 2003	February 28, 2002
Subscription and services revenue:			
Subscription:			
Enterprise technologies	\$ 68,930	\$30,438	\$ 17,734
Retail	12,914	14,833	19,054
Embedded	1,911	3,321	5,512
Total subscription revenue	83,755	48,592	42,300
Services:			
Enterprise technologies	37,764	38,522	24,354
Embedded development services	4,565	3,812	12,256
Total services revenue	42,329	42,334	36,610
Total subscription and services revenue	126,084	90,926	78,910
Gross profit on enterprise technologies, retail and embedded revenue .	91,215	59,464	50,395
Operating expense:			
Sales and marketing	40,906	33,474	35,522
Research and development	26,483	22,439	20,535
General and administrative	20,450	17,907	22,217
Lease buyout costs	—	285	1,501
Amortization of goodwill	—	—	48,397
Amortization of intangibles	164	1,062	1,150
Restructuring charges	—	1,461	56,122
Total operating expense	88,003	76,628	185,444
Income (loss) from continuing operations	3,212	(17,164)	(135,049)
Other income (expense), net	10,786	10,826	15,535
Loss from continuing operations before extraordinary item	13,998	(6,338)	(119,514)
Discontinued operations:			
Loss from discontinued operations	—	—	(10,355)
Income (loss) before extraordinary item	13,998	(6,338)	(129,869)
Extraordinary item-loss on disposal of discontinued operations	—	(261)	(10,347)
Net income (loss)	\$ 13,998	\$ (6,599)	\$ (140,216)

Years Ended February 29, 2004 and February 28, 2003

Subscription revenue

Subscription revenue is comprised of revenue from enterprise technologies, retail product and embedded customers. Subscription revenue increased 72.4% to \$83.8 million for the year ended February 29, 2004 from \$48.6 million for the year ended February 28, 2003.

Enterprise technologies subscription

Enterprise technologies subscription revenue primarily relates to both direct and indirect sales of Red Hat Enterprise Linux and other related software subscriptions such as Red Hat Clustering Suite and Systems Management Services provided by Red Hat Network. Enterprise technologies subscription revenue increased 126.5% to \$68.9 million for the year ended February 29, 2004 from \$30.4 million for the year ended February 28, 2003. For the fiscal year ended February 29, 2004, we sold approximately 169,500 subscriptions to our Red Hat Enterprise Linux offerings compared to 36,500 subscriptions in the previous fiscal year. The average number of units that were deployed during the year ended February 29, 2004 approximated 68,000 compared to approximately 13,500 in the same period in the prior year. Our RHEL products, AS, ES and WS, are sold under subscription agreements. These arrangements typically have a one year subscription period. The base subscription generally entitles the end user to one year of maintenance, which entitles the end user to configuration support, and updates and upgrades to the technology, when and if available, during the term of the subscription. Subscription volumes increased each quarter during fiscal 2004. The increase in sales volume is being driven by the market acceptance of using the Linux operating system in mission critical areas of computing by the large enterprise, as well as our expansion of sales channels during the year.

Retail technologies

Retail revenue, which consists of sales of Red Hat Linux and Professional Workstation to consumers through either value added resellers or distributors, decreased 12.9% to \$12.9 million for the year ending February 29, 2004 from \$14.8 million for the year ended February 28, 2003. This decrease is due to our focus on the sale of subscriptions to our enterprise technologies to large enterprises rather than on the consumer market. This market is no longer a strategic source of revenue for us, therefore we expect our retail revenues to continue to decline in fiscal 2005 as we will not aggressively promote new products through this channel. We expect that our retail revenues will be less than \$5.0 million in fiscal 2005 unless we later decide to put new products into the retail channel. We do not believe that retail revenues are currently a significant component of our revenues.

Embedded subscription

Embedded subscription revenue decreased 42.5% to \$1.9 million for the year ended February 29, 2004 from \$3.3 million for the year ended February 28, 2003. The decrease in embedded subscription revenue is related to the expiration of support arrangements for semiconductor and telecommunication customers due to the weak performance of these industries in previous years that affected research and development spending. We are beginning to see additional interest in the use of Red Hat Enterprise Linux as an operating system for large devices such as network routing equipment and we believe there may be an opportunity to increase our participation in the embedded market.

Services revenue

Enterprise technologies services

Enterprise technologies services revenues include fees received from enterprise customers for deployment of Red Hat Enterprise technologies, customer training and education fees and fees received for adding certain functionality to Red Hat Enterprise Linux for our major hardware OEM partners. Enterprise technology services revenue decreased 2.0% to \$37.8 million in the year ended February 29, 2004 from \$38.5 million in the year ended February 28, 2003. The decrease in enterprise technologies services revenue is primarily due to a decrease in the revenues earned from agreements with our OEM partners of approximately \$4.6 million and a \$1.2 million decrease in consulting services related to services performed for large Enterprise customers for the deployment of Red Hat Enterprise Linux. These decreases were primarily offset by customer training and education services revenue which increased 41.1% to \$23.7 million in year ended February 29, 2004 from \$16.8 million in the year ended February 28, 2003. The increase is the direct result of the continued migration of larger enterprises to our Red Hat Enterprise Linux platform from a proprietary Unix platform, increasing the need to train system administrators and developers.

Embedded services

Embedded services revenue increased 19.8% to \$4.6 million for the year ended February 29, 2004 from \$3.8 million for the year ended February 28, 2003. The increase in embedded markets is due to the improvement in the semiconductor and telecommunications industries which has positively impacted research and development spending. We have maintained a small core team that maintains a strategic presence in this marketplace.

Cost of revenue

Cost of subscription revenue

The cost of enterprise technologies and retail subscription revenue primarily consists of expenses we incur to manufacture, package, distribute and support our solutions. These costs include expenses for physical media, literature and packaging, fulfillment and shipping, labor related costs to provide technical support and maintenance (of which the largest component is labor cost). Cost of subscription revenue increased 18.8% to \$10.2 million in the year ended February 29, 2004 from \$8.6 million in the year ended February 28, 2003. This increase was entirely related to an increase in the cost of providing technical support and maintenance of our enterprise products which is primarily email or telephone support to end users. The increase in support costs was due to the increased number of subscriptions to Red Hat Enterprise Linux that we sold during fiscal 2004, approximately 169,500 compared to 36,500 in the prior fiscal year. As the number of subscriptions for Red Hat Enterprise Linux continues to increase, our cost of subscription revenues will also increase.

Cost of services revenue

Cost of services revenue is primarily comprised of salaries and related costs—including non-cash, stock-based compensation charges—incurred for our personnel to deliver custom development, open source consulting engineering, training and education, and hardware certification services. Cost of services revenue increased 8.6% to \$24.3 million in the year ended February 29, 2004 from \$22.3 million in the year ended February 28, 2003. The increase is directly related to the increase in our Enterprise technologies services revenue. The cost of our customer training and education services increased \$3.8 million which is consistent with the increase in revenue. This increase was partially offset by a \$1.5 million decrease in our professional consulting costs related to headcount reductions to our consulting staff during fiscal 2004 as we have revised our consulting strategy to focus on strategic consulting and entered into agreements to provide people-intensive development consulting.

Gross profit

Gross profit increased 53.4% to \$91.2 million in the year ended February 29, 2004 from \$59.5 million in the year ended February 28, 2003. This increase was entirely due to the increase in revenue and profitability related to our high gross margin Red Hat Enterprise Linux offerings. The growth and profitability of our Enterprise business was offset by a slight decline in the Embedded segment which had gross profit of \$2.6 million in fiscal 2004 as compared to \$2.9 million in fiscal 2003.

Operating expenses

Sales and marketing

Sales and marketing expense consists primarily of salaries and other related costs—including non-cash, stock-based compensation charges—for sales and marketing personnel, sales commissions, travel, public relations and marketing materials and tradeshows. Sales and marketing expense increased 22.1% to \$40.9 million in the year ended February 29, 2004 from \$33.5 million in the year ended February 28, 2003. This increase was primarily due to a \$3.7 million increase in North America and \$4.9 million increase related to our international operations. We have increased our sales force in all geographies in the past twelve months. These increases were partially offset by lower spending on marketing.

Research and development

Research and development expense consists primarily of personnel and related costs—including non-cash, stock-based compensation charges—for development of software technologies and systems management offerings. Research and development expense increased 18.0% to \$26.5 million in the year ended February 29, 2004 from \$22.4 million in the year ended February 28, 2003. The increase in research and development expense resulted from increased spending related to adding enterprise engineers to support the development and integration of our Red Hat Enterprise Linux operating systems and Red Hat Network and costs of research and development personnel from the acquisition of Sistina, Inc. in late December 2004.

General and administrative

General and administrative expense consists primarily of personnel and related costs—including non-cash, stock-based compensation charges—for general corporate functions, including finance, accounting, legal, human resources, facilities and information systems expenses. General and administrative expense increased 14.2% to \$20.5 million in the year ended February 29, 2004 from \$17.9 million in the year ended February 28, 2003. This increase relates primarily to increased administrative costs of approximately \$800,000 as a result of international expansion activities and increased legal costs related to our various legal proceedings of approximately \$300,000. We expect our general and administrative expenses across all functional areas, including legal, finance and human capital, to continue to increase in future periods as our business continues to expand.

Amortization of intangibles

Amortization of goodwill and intangibles expense decreased to \$0.2 million in the year ended February 29, 2004 from \$1.1 million in the year ended February 28, 2003. Costs incurred for acquiring trademarks, copyrights and patents are capitalized as intangibles and amortized using the straight-line method over their estimated useful lives, which range from three to five years. The decrease in amortization of intangibles expense was due to previously capitalized costs being fully amortized in fiscal 2003.

Years Ended February 28, 2003 and February 28, 2002

Total revenue

Total revenue increased 15.2% to \$90.9 million for the year ended February 28, 2003 from \$78.9 million in the year ended February 28, 2002. The increase was driven by significant growth in our enterprise subscription and services revenues of our business partially offset by a decline in the embedded segment of our business.

Subscription revenue

Subscription revenue increased to \$48.6 million for the year ended February 28, 2003 from \$42.3 million for the year ended February 28, 2002.

Enterprise technologies subscription

Enterprise technologies revenue increased 71.6% to \$30.4 million for the year ended February 28, 2003 from \$17.7 million for the year ended February 28, 2002. For the fiscal year ended February 28, 2003, we sold approximately 36,500 subscriptions to our Red Hat Enterprise Linux AS operating system. This significantly exceeded management's expectations of the number of subscriptions to be sold in the initial year of the release of our Red Hat Enterprise Linux technologies. In addition, Red Hat Network, our systems management services offering, increased revenue by \$1.8 million for the year ended February 28, 2003. Our enterprise offerings are sold with annual renewable subscriptions and all have 12 month revenue recognition periods to match the subscription period. Therefore, we will continue to recognize revenue on these subscriptions through fiscal 2004 and expect to increase the number of subscriptions sold to Red Hat Enterprise technologies sequentially quarter over quarter during the next 12 months. We are focused on building the first layer of renewable enterprise subscriptions which will begin to renew in the third quarter of our fiscal 2004.

Retail technologies

Retail technologies revenue decreased 22.2% to \$14.8 million for the year ended February 28, 2003 from \$19.1 million for the year ended February 28, 2002. This decrease is due to our focus during fiscal 2003 on the sale of subscriptions to our enterprise technologies to large enterprise customers rather than on the consumer market. Retail technologies revenue has been separately stated on the accompanying Consolidated Statement of Operations as this market is no longer a strategic source of revenue for us but instead represents a channel for providing leading edge technology to sophisticated users. We are focused on the sale of subscriptions to our enterprise technologies to large enterprises rather than the consumer market.

Embedded subscription

Embedded subscription revenue decreased 39.7% to \$3.3 million for the year ended February 28, 2003 from \$5.5 million for the year ended February 28, 2002. The decrease in embedded markets is primarily due to the weak performance of the semiconductor and telecommunications industries that has affected research and development spending during this period.

Services revenue

Enterprise technologies service

Enterprise technologies services revenue increased 58.2% to \$38.5 million in the year ended February 28, 2003 from \$24.4 million in the year ended February 28, 2002. The increase in enterprise technology services revenue is primarily due to an increase in the revenue earned from our relationships with OEM vendors of approximately \$7.7 million and a \$2.9 million increase in consulting services related to services performed for large enterprise customers for the deployment of Red Hat Enterprise Linux. Customer training and education services revenue also increased 24.2% to \$17.9 million in year ended February 28, 2003 from \$14.4 million in the year ended February 28, 2002. The increase in all components of our services revenues is the direct result of the continued migration of larger enterprises to our Red Hat Enterprise Linux platform from a proprietary Unix operating system and the momentum behind the acceptance of Red Hat Enterprise Linux as a mission critical operating system for the large enterprise.

Embedded

Embedded services revenue decreased 68.9% to \$3.8 million for the year ended February 28, 2003 from \$12.3 million for the year ended February 28, 2002. The decrease in embedded services revenues is due to the continued weak performance of the semiconductor and telecommunications industries that has negatively affected research and development spending and due to our reduction in focus and decrease in the number of personnel dedicated to this business to a small core team that maintains a strategic presence in this marketplace.

Cost of revenue

Cost of subscription revenue

Cost of subscription revenue decreased 5.2% to \$8.6 million in the year ended February 28, 2003 from \$9.1 million in the year ended February 28, 2002. This decrease was related to a \$1.4 million reduction in expenses incurred for physical media, literature, packaging and fulfillment related to our retail product, which is consistent with the decline in retail revenues, partially offset by an increase in the cost of providing technical support and maintenance for our enterprise products.

Cost of services revenue

Cost of services revenue increased \$3.6 million or 19.9% to \$22.3 million in the year ended February 28, 2003 from \$18.6 million in the year ended February 28, 2002. The increase is directly related to the increase in

our enterprise technologies services revenue. The cost of our customer training and education services increased \$1.4 million and our enterprise consulting services increased by \$5.2 million related to headcount additions to our consulting staff. These increases were partially offset by a decrease of \$2.9 million in embedded development services costs as a result of the restructuring of this segment which was completed in February 2002.

Gross Profit

Gross profit increased 18.0% to \$59.5 million in the year ended February 28, 2003 from \$50.4 million in the year ended February 28, 2002. This increase was entirely due to the increase in revenue and profitability related to our Red Hat Enterprise Linux offerings which were introduced during the fiscal year ended February 28, 2003 and carry significantly higher gross margins than our retail and embedded product offerings. The strength in growth and profitability of our enterprise business was offset by the significant decline in the embedded segment which had gross profit of \$2.9 million in fiscal 2003 as compared to \$10.3 million in fiscal 2002.

Operating expenses

Sales and marketing

Sales and marketing expense decreased 5.8% to \$33.5 million in the year ended February 28, 2003 from \$35.5 million in the year ended February 28, 2002. This decrease was primarily due to a reduction in our spend on marketing activities of \$2.3 million partially offset by an increase in enterprise sales costs as we increased the size of our direct outside sales force.

Research and development

Research and development expense increased 9.3% to \$22.4 million in the year ended February 28, 2003 from \$20.5 million in the year ended February 28, 2002. The increase in research and development expense resulted from increased spending of \$4.8 million related to the addition of approximately 52 enterprise engineers during late fiscal 2002 and throughout fiscal 2003 to support the development and integration of our Red Hat Enterprise Linux operating system and Red Hat Network, and was partially offset by a decrease of \$2.9 million in non-cash stock-based compensation expenses as certain deferred compensation balances were fully amortized during fiscal 2003.

General and administrative

General and administrative expense decreased 19.4% to \$17.9 million in the year ended February 28, 2003 from \$22.2 million in the year ended February 28, 2002. This decrease resulted from a significant decrease in the number of companies acquired during fiscal 2003 resulting in, a decrease in merger and acquisition expenses to \$522,000 for the year ended February 28, 2003 from \$4.7 million for the year ended February 28, 2002 and a decrease in stock-based compensation expense of \$1.8 million, and was partially offset by increased health and directors and officers insurance costs and bad debt expenses.

Amortization of goodwill and intangibles

Amortization of goodwill and intangibles expense decreased to \$1.1 million in the year ended February 28, 2003 from \$49.5 million in the year ended February 28, 2002. The decrease in amortization of goodwill and intangibles is primarily due to the fact that for the year ended February 28, 2003, no amortization of goodwill was recorded as prescribed by new accounting principles. Costs incurred for acquiring trademarks, copyrights and patents as well as capitalized software are capitalized as intangibles and amortized using the straight-line method over their estimated useful lives, which range from three to five years. Amortization of intangibles expense was not materially different from year to year.

Restructuring charges

Restructuring charges for the year ended February 28, 2002, which totaled \$56.1 million, consist of an impairment of \$49.3 million in the carrying value of goodwill and intangibles related to acquisitions made in prior periods, various facility closings, and \$5.7 million in severance and related expenses. These restructuring charges were primarily due to a sharpening of our focus on providing an enterprise class operating system, Red Hat Enterprise Linux, to significant enterprises. As a result, we terminated certain employees of Planning Technologies, Inc., (“PTI”) and all employees of Hell’s Kitchen Systems, Inc., (“HKS”) and Akopia, Inc. (“Akopia”) during fiscal 2002 as these technologies were aimed at the small and medium business market. In total, we terminated 160 employees. In the fourth quarter of fiscal 2002, we completed the re-allocation of our resources to focus on the Global 2000 market which resulted in discontinuing our network consulting business. The additional restructuring charge in fiscal 2003 of \$1.5 million related to some additional severance for employees affected by the restructuring who were not notified of their termination until after February 28, 2002.

Other income (expense), net

Interest income (expense), net, decreased to \$10.8 million in the year ended February 28, 2003 from \$15.5 million in the year ended February 28, 2002. These amounts are net of interest expense of \$502,000 in the year ended February 28, 2003 and \$172,000 in the year ended February 28, 2002. The decrease in interest income (expense), net, from an average return on our investments of 5.2% in fiscal 2002 to a return of 4.3% in fiscal 2003, resulted from reinvestment of proceeds from the sales and maturities of fixed-income investments in a declining interest rate environment that existed throughout fiscal 2003. In addition, we incurred foreign currency losses of \$829,000 in our fourth quarter of fiscal 2003 as a result of the weakening U.S. Dollar against the Euro and the Japanese Yen which reduced our other income in fiscal 2003.

Discontinued operations

During January 2002, we adopted a formal plan to discontinue our network consulting operations because these operations were not strategic to our decision to focus on developing an enterprise class operating system for large enterprise customers. Accordingly, the network consulting operations were accounted for as a discontinued operation beginning with the fiscal year 2001 consolidated financial statements. We completed the disposal of the network consulting operations in February 2002 through termination of associated employees. The terminations resulted in approximately \$15.9 million in annual payroll and payroll related cost to us in future periods. Loss on disposal of discontinued operations of \$10.3 million in fiscal year 2002 included the write-off of goodwill recorded in PTI’s acquisition of Enterprise Network Systems, Inc., (“ENS”) of \$9.6 million, severance and related costs of \$0.4 million, and a provision against accounts receivable of \$0.3 million.

ACQUISITIONS

Sistina Software, Inc.

In December 2003, We completed the acquisition of all of the outstanding common stock of Sistina Software, Inc. (“Sistina”) in exchange for the issuance of 1,979,874 shares of our common stock and the assumption of all of the outstanding Sistina stock options valued, in the aggregate, at \$30.7 million. The fair value of net tangible and intangible assets acquired in the transaction were \$2.0 million and \$3.0 million, respectively. We engaged an independent valuation expert to determine the fair market value of the net tangible and intangible assets acquired. The excess of purchase price over the fair values of the net assets acquired of \$25.7 million has been recorded as goodwill. In addition, the transaction includes \$12.0 million of contingent consideration based on an earn-out structured in three tranches. The earn-out is based on the achievement of certain bookings targets for the technologies and services previously sold by Sistina over the period beginning on December 23, 2003 and ending March 31, 2005. The number of shares issued under the earn-out will be determined based on the average closing price of our common stock during the 10 trading days prior to issuance of each tranche of such earn-out shares. No contingent consideration was earned during the initial earn-out period, which ended on March 31, 2004.

One of the keys to our business strategy is to receive increasing annual subscription revenues on a per server basis by providing additional value to our customers in the form of layers of technology that will be provided on top of our Red Hat Enterprise Linux operating system and through providing additional systems management services. Sistina provides us with a global file system solution which is our initial entry into the storage management marketplace. We completed this acquisition in December 2003 and it is too early to assess the results of this acquisition.

Liquidity and Capital Resources

We have historically derived a significant portion of our liquidity and operating capital from the sale of equity securities, including private sales of preferred stock and the sale of common stock in our initial and secondary public offerings, and from cash flows from operations. At February 29, 2004, we had total cash and investments of \$941.4 million, which is comprised of \$544.9 million in cash and cash equivalents, \$63.7 million of short-term, fixed-income investments and \$332.8 million of long-term, fixed-income investments. At February 28, 2003 we had total cash and investments of approximately \$292.3 million. This significant increase in cash and investments during fiscal year 2004 is due to \$584.7 million in net proceeds raised from the issuance of convertible debentures in January 2004 and over \$61.0 million in cash generated from our operations during fiscal 2004.

At February 29, 2004, cash and cash equivalents totaled \$544.9 million, an increase of \$499.6 million as compared to February 28, 2003. The increase in cash and cash equivalents during fiscal 2004 resulted primarily from: the issuance of the convertible debentures in January 2004, net of issuance of costs, of \$584.7 million, cash provided by operations of \$61.6 million, a total of \$24.7 million in cash received from the exercise of common stock options and sale of common stock under our employee stock purchase plan, net cash acquired in the acquisition of Sistina of \$3.4 million, and \$4.1 million in employee income taxes withheld from the exercise of common stock options in February 2004 which were disbursed in March 2004. These sources of cash were offset by the purchase of investments in debt securities, net of sales of debt securities, of \$150.7 million, purchases of property and equipment of \$13.2 million, primarily related to the re-implemention of our Oracle instance, \$15.0 million of cash, net, used to pay down our line of credit and \$1.2 million of cash used to pay down capital lease obligations.

Cash provided by operations of \$61.6 million in the year ended February 29, 2004, represented the net income of \$14.0 million, an increase in deferred revenue of \$52.0 million, an increase in accounts payable of \$1.5 million, an increase in accrued expenses of \$2.0 million and net non-cash charges of \$12.4 million. These sources of cash were partially offset by an increase in accounts receivable of \$18.5 million and an increase in prepaid expenses and other current assets, including inventory, of \$1.3 million. The increase in accounts receivable and deferred revenue primarily resulted from an increase in the number of subscriptions sold to Red Hat Enterprise Linux to 87,000 subscriptions in the fourth quarter of fiscal 2004 as compared to the sale of 21,500 subscriptions to Red Hat Enterprise Linux in the fourth quarter of fiscal 2003. In the fiscal year ended February 28, 2003, cash used in operations was \$758,000. The significant improvement in our cash flow from operations in fiscal 2004 is a result of increased sales of annual subscriptions to Red Hat Enterprise Linux, which resulted in the \$52.0 million increase in deferred revenues, as well as management's continued focus on improved operating profits and preserving our cash balance. We do not believe that there are any collectibility or billing problems with our customers that have not been appropriately reserved at each balance sheet date.

Cash used in investing activities of \$160.5 million was comprised of the purchase of investments in debt securities, net of maturities, of \$150.7 million, purchases of property and equipment—mainly computer software, hardware and computer networking equipment—totaling \$13.2 million, offset by \$3.4 million, net, of cash acquired in the acquisition of Sistina in late December 2003. The significant majority of the purchases of investments occurred as a result of the investment of a portion of the approximately \$585 million in net proceeds received from the completion of the convertible debt offering in January 2004.

Cash provided by financing activities of \$597.3 million for the year ended February 29, 2004 was comprised of \$584.7 million in net proceeds from the issuance of convertible senior debentures in January 2004, \$4.1 million in employee income taxes withheld from the exercise of common stock options in February 2004 which were remitted to taxing authorities in March 2004 and \$24.7 million, combined, in proceeds received from the exercise of common stock options by employees and the sale of common stock under our employee stock purchase plan. These sources of cash were partially offset by \$15.0 million of repayments, net of borrowings, made against our line of credit and \$1.2 million in payments under capital lease obligations.

In January 2004, we issued \$600 million in convertible senior debentures. The debentures mature on January 15, 2024 and bear interest at a rate of 0.5% per annum, payable semiannually on January 15 and July 15 of each year. The debentures are senior unsecured obligations and rank equally in right of payment with all of our other existing and future unsecured and unsubordinated debt. The debentures are convertible into shares of our common stock under certain circumstances prior to maturity at a conversion rate of 39.0753 shares per \$1,000 principal amount of debentures (which represents a conversion price of approximately \$25.59 per share) subject to adjustment under certain conditions. We may redeem the debentures, in whole or in part, in cash at any time on or after January 15, 2009. Holders of the debentures may require us to redeem the debentures, in whole or in part, in cash on January 15 of 2009, 2014 and 2019. As of February 29, 2004, no debentures were redeemed. Accrued interest to the redemption date will be paid by us in any such redemption. No interest payments were made during the year ended February 29, 2004. Accrued interest at February 29, 2004 was \$0.4 million.

At February 28, 2003, cash and cash equivalents totaled \$45.2 million, a decrease of \$10.2 million as compared to February 28, 2002. The decrease in cash and cash equivalents during fiscal 2003 resulted primarily from the following sources: the purchase of investments in debt securities, net of sales of debt securities, of \$8.3 million, cash used by operations of \$755,000, purchases of property and equipment of \$6.8 million, cash used in the acquisition of a business of \$1.2 million, and \$764,000 used to fund stock repurchases. These uses of cash were offset by \$4.9 million of cash raised from borrowings, net of repayments, and \$3.0 million in cash received from the exercise of common stock options and sale of common stock under our employee stock purchase plan.

Cash used in operations of \$755,000 in the year ended February 28, 2003, represented the net loss of \$6.6 million, an increase in accounts receivable of \$8.0 million, an increase in prepaid expenses and other current assets of \$2.1 million, a decrease in accounts payable of \$1.0 million and a decrease in accrued expenses of \$6.3 million. These uses of cash were partially offset by an increase in deferred revenue of \$8.9 million, an increase in deferred lease credits of \$1.6 million and net non-cash charges of \$13.7 million. Cash used in operations during fiscal 2003 includes \$2.5 million for payments of restructuring costs which contributed to the \$6.3 million reduction in accrued expenses. In the fiscal year ended February 28, 2002, cash used in operations was \$7.5 million. The significant improvement in our cash flow used in operations in fiscal 2003 is a result of management's increased focus on improved operating results and preserving our cash balance, as well as a result of sales of annual subscriptions to Red Hat Enterprise Linux, which resulted in the \$8.9 million increase in our deferred revenues and the increase in our accounts receivable of \$8.3 million.

Cash used in investing activities of \$16.2 million was comprised of the purchase of investments in debt securities, net of maturities, of \$8.3 million, purchases of property and equipment—mainly computer software, hardware and computer networking equipment—totaling \$6.8 million, and \$1.2 million in cash used to acquire a business. As market interest rates declined throughout the fiscal year ended February 28, 2003, we used cash and cash equivalents to purchase fixed income debt securities to improve the yield on our investments. The \$1.2 million used to acquire a business relates to cash paid in October 2002 as part of the acquisition cost of NOCpulse, Inc.

Cash provided by financing activities of \$5.8 million for the year ended February 28, 2003 was comprised of \$4.9 million in net proceeds from borrowings from our line of credit and \$3.0 million in proceeds received from the sale of common stock under our employee stock purchase plan and from the exercise of common stock options. This was partially offset by \$764,000 used to purchase 200,000 shares of treasury stock during fiscal 2003, and \$1.3 million in payments under capital lease obligations.

We have experienced a substantial increase in our operating expenses since our inception in connection with the growth of our operations, the development of our Red Hat Enterprise Linux technologies, the expansion of our services operations and our acquisition activity. Our capital requirements during the year ending February 28, 2005 will depend on numerous factors including the amount of resources we devote to:

- funding the development of our Red Hat Enterprise Linux products, such as Red Hat Enterprise Linux AS, ES and WS;
- accelerating the development of our systems management services;
- improving and extending our services and the technologies used to deliver these services to our customers;
- pursuing strategic acquisitions and alliances; and
- making possible investments in businesses, products and technologies.

We have made substantial progress in improving cash flow from operations. In fiscal 2003, 2002 and 2001, we used \$.8 million, \$.75 million and \$39.6 million, respectively, to fund our operations. In fiscal 2004, we generated \$61.6 million in cash from our operations, more so than in any other fiscal period of our operating history. Our cash flow provided by operations for fiscal 2004, exceeded the expectations we had at the beginning of the fiscal year and is due to both the greatly increased demand for our products and services, which also affords us leverage in negotiating up front payments for annual subscriptions from customers, and the increase in the number of subscriptions sold for Red Hat Enterprise Linux in fiscal 2004 as compared to fiscal 2003.

Given the significant improvement we have made from using cash to fund our operations and the \$941.4 million of cash and investments held at February 29, 2004, we do not anticipate the need to raise cash to fund our operations either through the sale of additional equity or through the issuance of debt for the foreseeable future. However, we may take advantage of favorable capital market situations that may arise from time to time to raise additional capital.

We believe that cash flow from operations will continue to improve; however, there can be no assurances that we will improve our cash flow from operations from the current rate or that such cash flows will be adequate to fund other investments or acquisitions that we may choose to make. We may choose to accelerate the expansion of our business from our current plans, which may require us to raise additional funds through the sale of equity or debt securities or through other financing means. There can be no assurances that any such financing would occur in amounts or on terms favorable to us, if at all.

We have no off balance sheet financing arrangements and do not utilize any “structured debt”, “special purpose” or similar unconsolidated entities for liquidity or financing purposes.

As of February 29, 2004, our principal commitments consisted of obligations outstanding under capital and operating leases. The following table summarizes our principal contractual obligations at February 29, 2004 and the effect such obligations are expected to have on our liquidity and cash flow in future periods (in thousands):

	<u>Total</u>	<u>Less than 1 Year</u>	<u>1-3 Years</u>	<u>3-5 Years</u>	<u>More than 5 Years</u>
Capital lease obligations	\$ 1,522	\$1,109	\$ 413	\$ —	\$ —
Operating lease obligations	53,126	4,515	11,308	6,220	31,083
Senior convertible debentures	600,000	—	—	—	600,000
Total	<u>\$654,648</u>	<u>\$5,624</u>	<u>\$11,721</u>	<u>\$6,220</u>	<u>\$631,083</u>

RECENT ACCOUNTING PRONOUNCEMENTS

See discussion in NOTE 2 to the Consolidated Financial Statements.

RISK FACTORS

RISKS RELATED TO OUR BUSINESS

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

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

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

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

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

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

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

We do not exercise control over many aspects of the development of open source technology. Different groups of open source software programmers compete with one another to develop new technology. Typically, the technology developed by one group will become more widely used than that developed by others. If we adopt

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

Because of characteristics of open source software, there are few technology barriers to entry in the open source market by new competitors, which could make it easier for companies with greater resources than us to compete with us.

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

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

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

- the difficulty of integrating the operations and personnel of the acquired companies;
- the maintenance of acceptable standards, controls, procedures and policies;
- the potential disruption of our ongoing business and distraction of management;
- the impairment of relationships with employees and customers as a result of any integration of new management and other personnel;
- the inability to maintain a relationship with customers of the acquired business;
- the difficulty of incorporating acquired technology and rights into our products and services;
- the potential failure to achieve the expected benefits of the combination or acquisition;
- expenses related to the acquisition;
- potential unknown liabilities associated with acquired businesses; and
- unanticipated expenses related to acquired technology and its integration into existing technology.

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

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

We have expanded our operations rapidly in recent years. For example, our aggregate revenues increased from approximately \$90.9 million for the year ended February 28, 2003 to approximately \$126.1 million for the year ended February 29, 2004. As of March 31, 2004, we had 681 employees, up from 566 as of March 31, 2003. In addition, we continue to explore ways to extend our product and service offerings, and geographic reach. Our

growth has placed and may continue to place a strain on our management systems, information systems, resources and internal controls. Our ability to successfully offer products and services and implement our business plan requires adequate information systems and resources and oversight from our senior management. We have, with our audit committee, undertaken to review and improve our financial and managerial controls, reporting systems and procedures. We will need to continue to modify and improve these controls, systems and procedures and other internal controls and compliance procedures as we continue to grow and expand our business. As we grow, we must also continue to hire, train, supervise and manage new employees. We may not be able to hire, train, supervise and manage sufficient personnel or develop management and operating systems to manage our expansion effectively. If we are unable to manage our growth and improve our controls, systems and procedures, our operations and financial results could be adversely affected.

RISKS RELATED TO LEGAL UNCERTAINTY

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

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

Our subscription-based contract model may encounter customer resistance.

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

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

We have committed to all of our customers with valid, registered Red Hat Enterprise subscriptions that if any portion of our Red Hat Enterprise Linux product is found to infringe any third party intellectual property rights we will, at our expense and option: (i) obtain the right for the customer to continue to use the product consistent with their subscription agreement with us; (ii) modify the product so that it is non-infringing; or (iii) replace the infringing component with a non-infringing component. Although we cannot predict whether we will need to satisfy this commitment, and although our subscription agreements typically state that our liability thereunder shall not exceed the amount a customer paid to us during the previous 12 months, satisfying the commitment could be costly and time consuming and could materially and adversely affect our financial results. In addition, our insurance policies may not adequately cover our exposure to this type of claim.

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

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

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

Defending patent infringement, copyright infringement and/or trade secret claims, even claims without significant merit, can be expensive. An adverse legal decision affecting our intellectual property could materially harm our business.

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

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

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

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

Our most valuable intellectual property is our collection of trademarks. The protective steps we have taken in the past have been, and may in the future continue to be, inadequate to deter misappropriation of our

trademark rights. Although we do not believe that we have suffered any material harm from misappropriation to date, we may be unable to detect the unauthorized use of, or take appropriate steps to enforce, our trademark rights in a timely manner. We have registered some of our trademarks in the Americas, Europe, Asia and Australia and have other trademark applications pending in each of those regions. Effective trademark protection may not be available in every country in which we offer or intend to offer our products and services. Failure to adequately protect our trademark rights could damage or even destroy the Red Hat brand and impair our ability to compete effectively. Furthermore, defending or enforcing our trademark rights could result in the expenditure of significant financial and managerial resources.

RISKS RELATED TO OUR FINANCIAL RESULTS AND CONDITION

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

We have incurred net losses in seven of our previous nine fiscal years. As of February 29, 2004, we had an accumulated deficit of \$276.4 million. While we have achieved profitability in fiscal 2004 of \$14.0 million, we cannot be certain that we will be able to sustain profitability. Failure to remain profitable may adversely affect the market price of our common stock and our ability to raise capital and continue operations.

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

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

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

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

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

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

We depend on our key personnel.

Our future success depends on the continued services of a number of key officers, including our Chief Executive Officer and President, Matthew J. Szulik, our Executive Vice President-Engineering, Paul Cormier,

our Executive Vice President-Chief Financial Officer, Kevin B. Thompson and our Executive Vice President—Worldwide Sales, Alex Pinchev. The loss of the technical knowledge and industry expertise of any of these individuals could seriously impede our success. Moreover, the loss of one or a group of our key employees, particularly to a competitor, and any resulting loss of customers could reduce our market share and diminish the Red Hat brand.

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

In the market for operating systems, we face significant competition from larger companies with greater financial resources and name recognition than we have. These competitors, which offer hardware-independent multi-user operating systems for Intel platforms and/or UNIX-based operating systems, include Microsoft, Novell, IBM, Sun Microsystems, Hewlett-Packard and Unisys. In the future, these competitors may develop and market a competing open source operating system.

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

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

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

- we may have difficulty managing and administering a globally-dispersed business;
- fluctuations in exchange rates may negatively affect our operating results;
- we have to comply with a wide variety of foreign laws;
- we may not be able to adequately protect our intellectual property rights overseas due to the uncertainty of laws and enforcement in certain countries relating to the protection of intellectual property rights;
- export controls and times of crisis could prevent us from shipping our products into and out of certain markets;
- changes in import/export duties and quotas could affect the competitive pricing of our products and services and reduce our market share in some countries; and
- economic or political instability in some international markets could result in the forfeiture of some foreign assets and the loss of sums spent developing and marketing those assets.

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.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Interest Rate Risk

The primary objective of Red Hat's investment activities is to preserve principal and liquidity while at the same time maximizing yields without significantly increasing risk. To achieve this objective, we maintain our portfolio of cash equivalents, short-term and long-term investments in a variety of highly rated fixed-income securities, including both government and corporate obligations and money market funds. The following table presents the fair value balances of our cash equivalents and short-term and long-term investments that are subject to interest rate risk by year of expected maturity and average interest rates as of February 29, 2004 (in thousands):

	Year Ending					
	February 28, 2005	February 28, 2006	February 28, 2007	February 28, 2008	February 28, 2009	Total
Cash equivalents	\$544,889	—	—	—	—	\$544,889
Average interest rate	1.06%					
Investments	\$ 63,712	102,100	166,740	28,498	35,445	\$396,495
Average interest rates	3.75%	3.08%	3.22%	2.79%	2.78%	

Red Hat did not hold derivative financial instruments as of February 29, 2004, and has never held such investments.

Foreign Currency Risk

Approximately 31.0% of our fiscal 2004 revenues were generated by sales outside the United States. We are exposed to significant risks of foreign currency fluctuation primarily from receivables denominated in foreign currency and are subject to transaction gains and losses, which are recorded as a component in determining net income. Additionally, the assets and liabilities of our non-U.S. operations are translated into U.S. dollars at exchange rates in effect as of the applicable balance sheet dates, and the revenues and expenses of these operations are translated at average exchange rates during the month the transactions occur.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

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REPORT OF INDEPENDENT AUDITORS

To the Board of Directors and Stockholders of
Red Hat, Inc.:

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations, of stockholders' equity, and of cash flows present fairly, in all material respects, the financial position of Red Hat, Inc. and its subsidiaries at February 29, 2004 and February 28, 2003, and the results of their operations and their cash flows for each of the three years in the period ended February 29, 2004 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

/s/ PRICEWATERHOUSECOOPERS LLP

Raleigh, North Carolina
May 6, 2004

RED HAT, INC.
CONSOLIDATED BALANCE SHEETS
(in thousands—except share amounts)

	February 29, 2004	February 28, 2003
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 544,889	\$ 45,250
Investments in debt securities	63,712	45,216
Accounts receivable, net	38,346	17,429
Estimated earnings in excess of billings	4,326	6,978
Inventory	1,066	799
Prepaid expenses and other current assets	5,665	4,659
Total current assets	658,004	120,331
Property and equipment, net	29,448	22,972
Goodwill and identifiable intangibles, net	69,713	40,828
Investments in debt securities	332,783	201,874
Debt issue costs-convertible notes	15,103	—
Other assets, net	4,568	4,334
Total assets	<u>\$1,109,619</u>	<u>\$ 390,339</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 7,154	\$ 5,502
Accrued expenses	15,619	7,614
Deferred revenue	59,899	15,702
Short term payable	—	15,008
Current portion of capital lease obligations	898	1,240
Total current liabilities	83,570	45,066
Deferred lease credits	5,359	5,382
Long term deferred revenue	10,945	2,077
Capital lease obligations	538	1,393
Convertible notes	600,000	—
Commitments and contingencies	—	—
Stockholders' equity:		
Noncontrolling interest in subsidiary	359	115
Preferred stock, 5,000,000 shares authorized, none outstanding	—	—
Common stock, \$.0001 par value, 300,000,000 shares authorized, 183,803,289 and 172,917,782 shares issued, and 181,665,389 and 170,779,882 shares outstanding at February 28, 2004 and 2003, respectively	18	17
Additional paid-in capital	695,722	630,798
Deferred compensation	(9,293)	(2,403)
Accumulated deficit	(276,406)	(290,404)
Treasury stock, 2,137,900 shares at February 29, 2004 and February 28, 2003, respectively	(7,436)	(7,436)
Accumulated other comprehensive income	6,243	5,734
Total stockholders' equity	409,207	336,421
Total liabilities and stockholders' equity	<u>\$1,109,619</u>	<u>\$ 390,339</u>

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

RED HAT, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands—except per share amounts)

	Year Ended		
	February 29, 2004	February 28, 2003	February 28, 2002
Subscription and services revenue:			
Subscription:			
Enterprise technologies	\$ 68,930	\$ 30,438	\$ 17,734
Retail	12,914	14,833	19,054
Embedded	1,911	3,321	5,512
Total subscription revenue	83,755	48,592	42,300
Services:			
Enterprise technologies	37,764	38,522	24,354
Embedded development services	4,565	3,812	12,256
Total services revenue	42,329	42,334	36,610
Total subscription and services revenue	126,084	90,926	78,910
Cost of subscription and services revenue:			
Subscription:			
Enterprise technologies and retail	10,244	8,625	9,097
Embedded	357	496	790
Total cost of subscription revenue	10,601	9,121	9,887
Services:			
Enterprise technologies	20,733	18,595	11,963
Embedded development services	3,535	3,750	6,692
Stock-based embedded development services	—	(4)	(27)
Total cost of services revenue	24,268	22,341	18,628
Total cost of subscription and services revenue	34,869	31,462	28,515
Gross profit enterprise technologies and retail	88,631	56,573	40,082
Gross profit embedded	2,584	2,891	10,313
Gross profit on enterprise technologies, retail and embedded revenue	91,215	59,464	50,395
Operating expense:			
Sales and marketing	39,863	32,969	33,442
Stock-based sales and marketing expense	1,043	505	2,080
Research and development	25,562	21,274	16,429
Stock-based research and development expense	921	1,165	4,106
General and administrative	18,502	15,761	18,226
Stock-based general and administrative expense	1,948	2,146	3,991
Lease buyout costs	—	285	1,501
Amortization of goodwill	—	—	48,397
Amortization of intangibles	164	1,062	1,150
Restructuring charges	—	1,461	56,122
Total operating expense	88,003	76,628	185,444
Income (loss) from continuing operations	3,212	(17,164)	(135,049)
Other income (expense), net	10,786	10,826	15,535
Income (loss) from continuing operations before extraordinary item	13,998	(6,338)	(119,514)
Discontinued operations:			
Income (loss) from discontinued operations	—	—	(10,355)
Income (loss) before extraordinary item	13,998	(6,338)	(129,869)
Extraordinary item-loss on disposal of discontinued operations	—	(261)	(10,347)
Net income (loss)	\$ 13,998	\$ (6,599)	\$ (140,216)
Basic Income (Loss) Per Common Share:			
Income (loss) from continuing operations before extraordinary item	\$ 0.08	(\$ 0.04)	(\$ 0.71)
Discontinued operations:			
Loss from discontinued operations	—	—	(\$ 0.06)
Extraordinary item-loss on disposal of discontinued operations	—	—	(\$ 0.06)
Net income (loss)	\$ 0.08	(\$ 0.04)	(\$ 0.83)
Diluted Income (Loss) Per Common Share:			
Income (loss) from continuing operations before extraordinary item	\$ 0.08	(\$ 0.04)	(\$ 0.71)
Discontinued operations:			
Loss from discontinued operations	—	—	(\$ 0.06)
Extraordinary item-loss on disposal of discontinued operations	—	—	(\$ 0.06)
Net income (loss)	\$ 0.08	(\$ 0.04)	(\$ 0.83)
Weighted average shares outstanding			
Basic	174,003	170,158	169,451
Diluted	182,913	170,158	169,451

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

RED HAT, INC.
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(in thousands)

	Noncontrolling Interest In Subsidiary	Preferred Stock		Common Stock		Additional Paid-In Capital	Deferred Compensation	Accumulated Deficit	Treasury Stock	Accumulated Other Comprehensive Income (Loss)	Total Stockholders' Equity
	Shares	Amount	Shares	Amount							
Balance at February 28, 2001	\$—		168,486	\$ 17	\$643,712		\$ (36,051)	\$ (143,589)	\$ —	\$ 193	\$ 464,282
Minority interest	74	—	—	—	—	—	—	—	—	—	74
Net loss	—	—	—	—	—	—	—	(140,216)	—	—	(140,216)
Other comprehensive income:											
Unrealized loss on investments in marketable securities	—	—	—	—	—	—	—	—	—	(2,016)	—
Foreign currency translation adjustment	—	—	—	—	—	—	—	—	—	(891)	—
Other comprehensive income (loss)	—	—	—	—	—	—	—	—	—	(2,907)	(2,907)
Comprehensive income (loss)	—	—	—	—	—	—	—	—	—	—	(143,123)
Exercise of common stock options and warrants	—	—	—	1,956	2,548	—	—	—	—	—	2,548
Issuance of common stock under Employee Stock Purchase Plan	—	—	—	161	634	9	—	—	—	—	634
Common stock issued for acquisition earnouts	—	—	1,056	—	—	—	—	—	—	—	9
Common stock repurchase	—	—	—	—	—	—	—	—	(6,672)	—	(6,672)
Write-off of deferred compensation related to acquisitions	—	—	—	—	(21,281)	—	21,281	—	—	—	—
Deferred compensation related to stock options	—	—	—	—	(2,529)	—	2,529	—	—	—	—
Deferred compensation related to restricted stock	—	—	—	—	3,540	—	(3,540)	—	—	—	—
Amortization of deferred compensation	—	—	—	—	—	—	9,797	—	—	—	9,797
Balance at February 28, 2002	74	—	171,659	17	626,633	—	(5,984)	(283,805)	(6,672)	(2,714)	327,549
Minority interest	41	—	—	—	—	—	—	—	—	—	41
Net loss	—	—	—	—	—	—	—	(6,599)	—	—	(6,599)
Other comprehensive income:											
Unrealized gain on investments in marketable securities	—	—	—	—	—	—	—	—	—	7,410	7,410
Foreign currency translation adjustment	—	—	—	—	—	—	—	—	—	1,038	1,038
Other comprehensive income	—	—	—	—	—	—	—	—	—	8,448	8,448
Comprehensive income	—	—	—	—	—	—	—	—	—	—	1,849
Exercise of common stock options	—	—	—	762	2,415	—	—	—	—	—	2,415
Issuance of common stock under Employee Stock Purchase Plan	—	—	—	161	576	—	—	—	—	—	576
Common stock issued for acquisitions	—	—	336	—	1,288	—	—	—	—	—	1,288
Common stock repurchase	—	—	—	—	—	—	—	—	(764)	—	(764)
Deferred compensation related to stock options	—	—	—	—	(114)	—	114	—	—	—	—
Amortization of deferred compensation	—	—	—	—	—	—	3,467	—	—	—	3,467
Balance at February 28, 2003	115	—	172,918	17	630,798	—	(2,403)	(290,404)	(7,436)	5,734	336,421
Minority interest	244	—	—	—	—	—	—	13,998	—	—	244
Net Income	—	—	—	—	—	—	—	—	—	—	13,998
Other comprehensive income:											
Unrealized loss on investments in marketable securities	—	—	—	—	—	—	—	—	—	(1,263)	(1,263)
Foreign currency translation adjustment	—	—	—	—	—	—	—	—	—	1,772	1,772
Other comprehensive income	—	—	—	—	—	—	—	—	—	509	509
Comprehensive income	—	—	—	—	—	—	—	—	—	—	14,507
Exercise of common stock options	—	—	—	8,675	1	23,657	—	—	—	—	23,658
Issuance of common stock under Employee Stock Purchase Plan	—	—	—	230	1,014	—	—	—	—	—	1,014
Common stock issued for acquisitions	—	—	1,980	—	30,685	—	—	—	—	—	30,685
Deferred compensation related to acquisitions	—	—	—	—	—	—	(466)	—	—	—	(466)
Deferred compensation related to stock options	—	—	—	—	3,233	—	(3,233)	—	—	—	—
Deferred compensation related to restricted stock	—	—	—	—	6,335	—	(6,335)	—	—	—	—
Amortization of deferred compensation	—	—	—	—	—	—	3,144	—	—	—	3,144
Balance at February 29, 2004	359	—	183,803	18	\$695,722	—	\$ (9,293)	\$ (276,406)	\$ (7,436)	\$ 6,243	\$ 409,207

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

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

	Year Ended		
	February 29, 2004	February 28, 2003	February 28, 2002
Cash flows from operating activities:			
Net income (loss)	\$ 13,998	\$ (6,599)	\$(140,216)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:			
Depreciation and amortization	6,871	6,519	59,720
Stock-based compensation expense	3,144	3,466	9,766
Noncash restructuring charges	—	1,359	1,887
Write-off of goodwill	—	—	48,958
Loss on disposal of discontinued operations	—	—	10,347
Noncontrolling interest in subsidiary	244	41	74
Write-down of equity investments	—	—	4,250
Noncash interest expense	9	147	40
Amortization of debt issuance costs	393	—	—
Provision for doubtful accounts	1,678	2,107	1,533
Provision for inventory obsolescence	40	88	—
Loss on abandonment of property and equipment	—	290	1,859
Changes in operating assets and liabilities:			
Accounts receivable	(18,487)	(8,326)	9,405
Inventory	(307)	(2)	(146)
Prepaid expenses	(1,010)	(2,114)	396
Intangibles and other assets	(458)	(888)	(420)
Accounts payable	1,496	(1,031)	(3,945)
Accrued expenses	1,999	(6,334)	(7,460)
Deferred revenue	51,988	8,915	(3,527)
Deferred lease credits	(23)	1,604	—
Net cash provided by (used in) operating activities	<u>61,575</u>	<u>(758)</u>	<u>(7,479)</u>
Cash flows from investing activities:			
Purchase of investment securities	(278,177)	(151,725)	(393,031)
Proceeds from sales and maturities of investment securities	127,509	143,463	376,909
Acquisitions of businesses, net of cash acquired	3,380	(1,222)	(994)
Purchase of property and equipment	(13,209)	(6,766)	(6,752)
Net cash used in investing activities	<u>(160,497)</u>	<u>(16,250)</u>	<u>(23,868)</u>
Cash flows from financing activities:			
Proceeds from notes payable	67,957	68,380	35,956
Repayments of notes payable	(82,971)	(63,520)	(28,746)
Issuance of notes receivable	—	—	(866)
Proceeds from issuance of convertible debt	600,000	—	—
Offering costs – issuance of convertible debt	(15,278)	—	—
Proceeds from issuance of common stock under Employee Stock Purchase Plan	1,014	576	634
Proceeds from exercise of common stock options and warrants	27,764	2,415	2,589
Purchase of treasury stock	—	(764)	(6,672)
Payment of capital lease obligations	(1,230)	(1,335)	(402)
Net cash provided by financing activities	<u>597,256</u>	<u>5,752</u>	<u>2,493</u>
Effect of foreign currency exchange rates on cash and cash equivalents	1,305	1,038	(891)
Net decrease in cash and cash equivalents	499,639	(10,218)	(29,745)
Cash and cash equivalents at beginning of year	45,250	55,468	85,213
Cash and cash equivalents at end of year	<u>\$ 544,889</u>	<u>\$ 45,250</u>	<u>\$ 55,468</u>

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

RED HAT, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1—Organization

Red Hat, Inc. together with its subsidiaries (“Red Hat” or the “Company”) is the recognized global technology and brand leader in providing an enterprise operating platform based on open source technology for the information technology infrastructure of the Global 2000. The Company applies its technology leadership to create its enterprise operating platform, Red Hat Enterprise Linux and related layered infrastructure technology solutions, based on open source technology. The Company’s enterprise solutions meet the functionality requirements and performance demands of the large enterprise and the third-party computer hardware and software applications that are critical to the large enterprise. In April 2002, the Company launched the first in a line of Red Hat Enterprise Linux solutions for large enterprise customers, Red Hat Enterprise Linux AS. Red Hat Enterprise Linux AS was available for shipment in May 2002. Red Hat Enterprise Linux AS was developed to compete with proprietary Unix and Windows 2000 as the primary operating platform for applications in the middle tier and data center of the information technology infrastructure of large enterprises. In March 2003, the Company launched three additional technology solutions in the Red Hat Enterprise Linux line: Red Hat Enterprise Linux ES, Red Hat Enterprise Linux WS and Red Hat Network. Red Hat Enterprise Linux ES and WS broaden the areas of the information technology infrastructure to which the Company’s enterprise operating platforms are relevant. The Company provides the chief information officers of the largest companies in the world with the choice of a Red Hat Enterprise Linux operating platform for all application areas including the technical/developer workstation, edge of the network applications, the middle tier of the information technology infrastructure (applications such as database ERP and large file systems) and the data center. Red Hat Network provides an integrated management service that allows Red Hat Enterprise Linux technologies to be updated, configured, and the performance of these technologies to be monitored in an automated fashion. These technology solutions, and the enterprise technology and systems management offerings that will follow them, reflect the Company’s commitment to provide an enterprise-wide infrastructure platform based on open source technology.

Red Hat, Inc. is incorporated in Delaware. During January 2002, the Company adopted a formal plan to discontinue its network consulting operations. Accordingly, the Consolidated Statements of Operations for fiscal 2002 presents the results of the network consulting operations separately from continuing operations (see NOTE 4) for periods prior to and including such date.

NOTE 2—Summary of Significant Accounting Policies

Principles of Consolidation

The accompanying consolidated financial statements include the accounts of the Company and all of its wholly-owned subsidiaries. Entities which are not wholly-owned, but for which a controlling financial interest is maintained by the Company, are consolidated. The non-controlling interest of these entities is presented as a separate component of stockholders’ equity. All significant intercompany accounts and transactions are eliminated in consolidation.

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 date and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Reclassifications

Certain prior year amounts were reclassified to conform with current year presentation.

RED HAT, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Cash and Cash Equivalents

The Company considers investments purchased with a maturity period of three months or less at the date of purchase to be cash equivalents.

Investments in Debt Securities

The Company's investments at February 29, 2004 and February 28, 2003 are in debt securities which are classified as available for sale and carried at market value in accordance with Statement of Financial Accounting Standards No. 115 "Accounting for Certain Investments in Debt and Equity Securities" ("SFAS 115"). These investments are classified as either a cash equivalent, current asset (Investments in debt securities-current) or long-term asset (Investments in debt securities-long term) based on their time to maturity at date of purchase by the Company. Investments with a maturity date of one year or less from the balance sheet date are classified as a current asset and those with a maturity date of greater than one year are classified as a long-term asset. The average maturity period of the Company's investment in debt securities was 1 year at February 29, 2004. The Company's investments are considered available for sale as these securities could be sold at any time in response to needs for liquidity, changes in the availability of and the yield on alternative instruments or changes in funding sources or terms. The Company has an unrealized gain of \$5.4 million and \$6.7 million related to these investments at February 29, 2004 and February 28, 2003, respectively, which is recorded as other comprehensive income, a separate component of stockholders' equity. The Company's average rate of realized return on its investments portfolio was 4.1% in fiscal 2004.

Inventory

The costs incurred for duplicating the computer software, documentation, and training materials sold by the Company from the product masters and costs of packaging these products for distribution are capitalized as inventory at the lower of cost or market using the weighted average method and charged to cost of sales when revenue from the sale of units is recognized. Management periodically evaluates the realizability of inventory based on planned release dates of product and training updates and records a reserve for obsolescence when necessary. The reserve for inventory obsolescence was approximately \$0.2 million and \$94,000 at February 29, 2004 and February 28, 2003, respectively.

Internal Use Software

In accordance with Statement of Position No. 98-1, "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use" ("SOP 98-1"), the Company capitalized \$5.2 million and \$5.9 million in costs related to the development of internal use software for its website, enterprise resource planning system, and systems management applications during the years ended February 29, 2004 and February 28, 2003, respectively. The Company amortizes the costs of computer software developed for internal use on a straight-line basis over its estimated useful life of five years. The carrying value of internal use software is included in property and equipment on the Consolidated Balance Sheets (see NOTE 6).

Capitalized Software Costs

Capitalization of software development costs for products to be sold to third parties begins upon the establishment of technological feasibility and ceases when the product is available for general release. The establishment of technological feasibility and the ongoing assessment of recoverability of capitalized software development costs requires considerable judgment by management concerning certain external factors including, but not limited to, technological feasibility, anticipated future gross revenue, estimated economic life and

RED HAT, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

changes in software and hardware technologies. As a result of the Company's practice of releasing source code that it has developed on a weekly basis for unrestricted download on the Internet, there is generally no passage of time between achievement of technological feasibility and the availability of the Company's product for general release. Therefore, the Company has no capitalized software development costs at February 29, 2004 and February 28, 2003.

Property and Equipment

Property and equipment is primarily comprised of furniture, computer equipment, computer software and leasehold improvements which are recorded at cost and depreciated using the straight-line method over their estimated useful lives as follows: furniture and fixtures, seven years; computer equipment, three years; computer software, five years; leasehold improvements, over the lesser of the remaining useful life of the asset or the remaining term of the lease. Expenditures for maintenance and repairs are charged to operations as incurred; major expenditures for renewals and betterments are capitalized and depreciated. Property and equipment acquired under capital leases are being depreciated over their estimated useful lives or the respective lease term, if shorter.

Debt Issue Costs

The costs related to the issuance of the convertible debt offering which was closed on January 13, 2004 were capitalized and will be amortized to interest expense using the effective interest rate method over the life of the related debt. Issuance cost for the convertible debt offering totalled \$15.5 million and primarily consisted of investment banker fees, legal and other professional fees. Amortization expense was \$0.4 million for the year ended February 29, 2004.

Other Assets

Other assets includes security deposits which are expected to be refunded to the Company upon termination of certain leases, and investments in other companies accounted for using the cost method of accounting.

Impairment of Long-Lived Assets

The Company evaluates the recoverability of its property and equipment and other assets in accordance with Statement of Financial Accounting Standards No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" ("SFAS 144"). SFAS 144 requires that one accounting model be used for long-lived assets to be disposed of by sale, whether previously held and used or newly acquired, and broadens the presentation of discontinued operations to include more disposal transactions. An impairment loss is recognized when the net book value of such assets exceeds the estimated future undiscounted cash flows attributable to the assets or the business to which the assets relate. Impairment losses are measured as the amount by which the carrying value exceeds the fair value of the assets. The Company had no impairments of its long lived assets in fiscal 2004.

Revenue Recognition

The Company recognizes revenue in accordance with Statement of Position No. 97-2, "Software Revenue Recognition" ("SOP 97-2"), as amended by SOP 98-4 and SOP 98-9, and Staff Accounting Bulletin No. 101 ("SAB 101"). Revenue recognition in accordance with these pronouncements can be complex due to the nature and variability of sales transactions. The Company establishes persuasive evidence of an arrangement for each type of revenue based on either a signed contract with the end customer, a click-through contract on the

RED HAT, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Company's website, whereby the customer agrees to the Company's standard subscription terms, distribution contracts with OEM's and resellers, or, in the case of individual training seats, through receipt of payment which indicates acceptance of the Company's training agreement terms.

Subscription Revenue

Subscription revenue is comprised of enterprise and embedded revenues.

Enterprise subscription revenue is comprised primarily of revenue from sales of Red Hat Enterprise Linux software solutions, however the Company also generates enterprise subscription revenue from sales of Red Hat Linux, software development tools, technical support and maintenance fees.

During fiscal 2003, the Company released the first versions of its Red Hat Enterprise Linux offerings, Red Hat Enterprise Linux AS, ES and WS. These technologies are sold under a subscription agreement with specified renewal rates. Red Hat Enterprise Linux ("RHEL") products have one and three year base subscription periods. The base subscription entitles the end user to the technology itself and post customer support services ("PCS") consisting of security errata, updates to the technology, upgrades to new versions of RHEL on a when and if available basis during the term of the subscription, and various levels of Red Hat support. The Company recognizes the revenue from the sale of our Red Hat Enterprise Linux offerings ratably over the period of the subscription. The Company does not sell the RHEL technology or the components of the PCS that are included in the subscription on a stand alone basis.

The Company sells Red Hat Enterprise Linux through four channels: distribution, direct sales, original equipment manufacturers ("OEMs") and the web. In the majority of the Company's transactions, subscriptions to Red Hat Enterprise Linux are sold on a stand-alone basis. The Company's standard subscription term is one year. The revenue associated with the sale of subscription to Red Hat Enterprise Linux is recognized ratably over the period of the end users subscription.

The Company's subscription agreements with its large enterprise customers sometimes include multiple subscription and/or service elements. These arrangements typically include a subscription to Red Hat Enterprise Linux, Red Hat Network, training services and/or professional consulting. For these contracts, the Company separates the various elements and recognize revenue attributable to each element in the manner that best matches the delivery of value to its customer. Red Hat Enterprise Linux and Red Hat Network subscription revenues are recognized ratably over the subscription term, training services revenue is recognized when students attend class, and professional services revenue is recognized on a time and materials basis as the services are delivered. When possible, the Company allocates revenue to each component of the contract based on vendor specific objective evidence ("VSOE") of its fair value. VSOE for the Company's Red Hat Enterprise Linux subscription agreements is created by the fact that it regularly sells RHEL subscriptions on a stand alone basis with renewal rates for year two equal to the amount paid in year one or there is a stated renewal rate in the contract. In contracts where VSOE exists for training or consulting services, such VSOE is demonstrated by either the ability to purchase additional training or consulting services at specified rates and on a stand alone basis upon expiration of the original term of the multiple element arrangement or regularly selling the training or consulting services on a stand alone basis at substantially the same rates as those charged in the multiple element arrangement. In certain multiple element arrangements where VSOE cannot be established, the entire value of the contract is recognized ratably over the term of the agreement. The Company's training and consulting services are not essential to the functionality of Red Hat Enterprise Linux. The majority of its customers purchase subscriptions to Red Hat Enterprise Linux without purchasing any training or consulting services.

RED HAT, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

In addition, the Company's enterprise subscription revenue is partially derived from sales of its Red Hat Network offerings. Red Hat Network is an internet-based set of services to assure the security, availability and reliability of all of the Company's Red Hat software solutions. Red Hat Network is sold in the form of an annual subscription and revenues related to these are recognized ratably over the term of the subscription.

Through the Company's retail distributors, the Company has historically sold Red Hat Linux consumer products. The retail product is currently offered in one version: Red Hat Professional Workstation. During fiscal 2004, Red Hat sold two different versions of Red Hat Linux (9 and Professional Workstation). In accordance with SOP 97-2, the Company recognizes all of the revenue from the sale of Red Hat Linux ratably over the period that the subscription services are provided. A reserve for sales returns is recognized for sales of retail software products to distributors, who have a right of return, based on the Company's historical experience of sell-through to the end user by the distributor. The return rate experienced by the Company over its last three retail product releases has averaged 18.0%. The fee is fixed and determinable, collection of the resulting receivable is probable and product returns are estimable. The Company's retail customers do not receive the right to future upgrades or new versions of its technology.

Embedded subscription consists of revenue for technical support and maintenance services provided pursuant to software compiling, debugging, and optimization agreements. Revenue is recognized ratably over the term of the agreement, which is typically 12 months.

Services Revenue

Services revenue is comprised of enterprise technology services and embedded development. Enterprise technology services are comprised of revenue for enterprise consulting and engineering services, and customer training and education. Enterprise technology services are provided under agreements where customers pay the Company on a fixed fee or hourly basis to assist in the deployment and optimization of our enterprise technologies. Enterprise technology engineering services represent revenues earned under fixed fee arrangements with the Company's OEM vendors to add functionality to our Red Hat Enterprise Linux line of technologies. Revenues under hourly arrangements are recognized as work is performed. Revenues under fixed fee arrangements are recognized either on a percentage of completion basis or upon passage of time dependent upon the terms of each individual engagement. Revenue from customer training and education is recognized at the date the services are performed.

Embedded development services are contracts for software compiling, debugging, and optimization. Revenue is recognized on the percentage-of-completion method, provided that the Company has the ability to make reliable estimates of progress towards completion, the fee for such services is fixed and determinable and collection of the resulting receivable is probable.

Stock-Based Compensation

The Company accounts for stock-based compensation based on the provisions of Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB 25"), which states that no compensation expense is recorded for stock options or other stock-based awards to employees that are granted with an exercise price equal to or above the market value per share of the Company's common stock on the grant date. Deferred compensation is amortized to compensation expense over the vesting period of the stock option. The Company recognized \$3.1 million, \$3.5 million and \$9.8 million in non-cash stock-based compensation expense related to amortization of deferred compensation during the years ended February 29, 2004, and February 28, 2003 and 2002, respectively. In addition, the Company classifies the employer portion of tax

RED HAT, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

liabilities paid upon exercise of non-qualified stock options and warrants as stock-based compensation expense. The Company paid \$0.8 million and \$352,000 in tax liabilities related to stock options and warrants exercised during the years ended February 29, 2004 and February 28, 2002, respectively.

The Company recorded deferred compensation of \$3.7 million, \$5,000, and \$120,000 during the years ended February 29, 2004, and February 28, 2003 and 2002, respectively, to reflect the difference between the aggregate market value of the underlying shares of stock and the exercise price of all stock options granted with an exercise price below the fair value of the Company's common stock at the date of the grant, and stock options granted under acquired stock option plans. Deferred compensation recorded during the year ended February 29, 2004 includes 500,000 stock options granted to the Chairman and Chief Executive Officer of the Company. At the date of grant, these stock options had an exercise price and fair market value of \$6.70 per share and \$13.17 per share, respectively. Deferred compensation on the consolidated balance sheet was reduced by \$109,000 and \$2.4 million of reductions in the years ended February 28, 2003 and 2002, respectively, to record the termination of employees prior to complete vesting of stock options for which deferred compensation was originally recorded. Deferred compensation on the consolidated balance sheet in the year ended February 28, 2002 was further reduced by \$21.3 million to record the termination of employees prior to satisfaction of employment requirements pursuant to certain acquisitions. During the years ended February 29, 2004 and February 28, 2002, the Company recorded \$6.3 million and \$3.5 million, respectively, in deferred compensation related to a restricted stock award granted to the Chairman and Chief Executive Officer of the Company. The fiscal 2004 restricted stock award consisted of 500,000 shares of stock having a purchase price and fair market value of \$0.50 per share and \$13.17 per share, respectively. The fiscal 2002 restricted stock award consisted of 1,000,000 shares of stock having a purchase price and fair market value of \$0.50 per share and \$4.04 per share, respectively. These restricted stock awards vest ratably over a period of two years and are reflected in the combined stock option activity. Amortization of deferred compensation totaled \$3.1 million, \$3.5 million and \$9.8 million during the years ended February 29, 2004 and February 28, 2003 and 2002, respectively.

SFAS 123, as amended by SFAS 148, requires the Company to disclose pro forma information regarding stock option grants and warrants issued to its employees. SFAS 123 specifies certain valuation techniques that produce estimated compensation charges that are included in the pro forma results below. These amounts have not been reflected in the Company's Consolidated Statement of Operations because APB 25 specifies that no compensation charge arises when the exercise price of employees' stock options and warrants equal the market value of the underlying stock at the grant date, as in the case of options and warrants granted to the Company's employees. The fair value of options and warrants was estimated using the following assumptions for the years ended February 29, 2004, and February 28, 2003 and 2002:

	Year Ended February 29, 2004	Year Ended February 28, 2003	Year Ended February 28, 2002
Expected dividend yield	0.00%	0.00%	0.00%
Risk-free interest rate	2.94%	3.59%	4.46%
Expected volatility	90.88%	97.74%	102.08%
Expected life (in years)	5	5	5

RED HAT, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

The following table illustrates the effect on net income (loss) and earnings per share if the Company had applied the fair value recognition provisions of SFAS 123 to stock based employee compensation:

	Year Ended February 29, 2004	Year Ended February 28, 2003	Year Ended February 28, 2002
Net income (loss), as reported	\$ 13,998	\$ (6,599)	\$(140,216)
Add: book compensation expense	3,144	3,467	9,797
Deduct: total stock-based employee compensation expense determined under the fair value based method for all awards, net of related tax effects	(79,251)	(31,520)	(60,365)
Pro forma net loss	\$(62,109)	\$(34,652)	\$(190,784)
Earnings per share data basic and diluted:			
Basic—as reported	\$ 0.08	\$ (0.04)	\$ (0.83)
Diluted—as reported	\$ 0.08	\$ (0.04)	\$ (0.83)
Basic and diluted—pro forma	\$ (0.36)	\$ (0.20)	\$ (1.13)

The weighted average estimated fair value of employee stock options granted was \$7.61, \$4.22 and \$4.78 per share during the years ended February 29, 2004, and February 28, 2003 and 2002, respectively.

Sales and Marketing Expenses

Sales and marketing expenses consist of costs, including salaries, sales commissions, and related expenses such as travel, of all personnel involved in the sales and marketing process. Sales and marketing expenses also include costs of advertising, sales lead generation programs, cooperative marketing arrangements, and trade shows. All costs of advertising, including cooperative marketing arrangements, are expensed as incurred. Advertising expense totaled \$1.2 million, \$1.2 million and \$2.6 million for the years ended February 29, 2004 and February 28, 2003 and 2002, respectively.

Research and Development Expenses

Research and development expenses include all direct costs, primarily salaries for Company personnel and outside consultants, related to the development of new software products, significant enhancements to existing software products, and the portion of costs of development of internal use software required to be expensed. Research and development costs are charged to operations as incurred with the exception of those software development costs that are required to be capitalized.

Income Taxes

The Company accounts for income taxes using the liability method which requires the recognition of deferred tax assets or liabilities for the temporary differences between financial reporting and tax bases of the Company's assets and liabilities and for tax carryforwards at enacted statutory tax rates in effect for the years in which the differences are expected to reverse. The effect on deferred taxes of a change in tax rates is recognized in income in the period that includes the enactment date. In addition, valuation allowances are established when necessary to reduce deferred tax assets to the amounts expected to be realized.

Foreign Currency Translation

The Euro has been determined to be the functional currency for the Company's European operations and local currencies have been determined to be the functional currencies for the Company's Asian operations. Foreign exchange gains and losses, which result from the process of remeasuring foreign currency transactions into the appropriate functional currency, are included in other income (expense), net in the Company's

RED HAT, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Consolidated Statements of Operations. The translation of foreign currency financial statements into U.S. Dollars is included in other comprehensive income, which is a separate component of stockholders' equity. Net foreign exchange gains (losses), included in other income, were (\$140,000), (\$800,000) and \$397,000 for the years ended February 29, 2004 and February 28, 2003 and 2002, respectively.

Significant Customers and Credit Risk

Financial instruments which potentially subject the Company to concentrations of credit risk consist principally of temporary cash investments and trade receivables. The Company primarily places its temporary cash investments with high-credit quality financial institutions which invest predominantly in U.S. Government instruments, investment grade corporate bonds and certificates of deposit guaranteed by banks which are members of the FDIC. Cash deposits are primarily in financial institutions in the United States. However, cash for monthly operating costs of international operations are deposited in banks outside the United States. Deposits of cash outside the United States totaled \$17.6 million and \$3.5 million at February 29, 2004 and February 28, 2003, respectively.

The Company performs ongoing credit evaluations to reduce credit risk and requires no collateral from its customers. Management estimates the allowance for uncollectible accounts based on their historical experience and credit evaluation. The Company's standard credit terms are net 30 days in the U.S., net 45 days in EMEA, and range from net 30 to net 60 days in Asia Pacific. One customer accounted for 17% of the Company's accounts receivable at February 28, 2003.

No individual customer accounted for more than 10% of the Company's revenue in the fiscal years ended February 29, 2004 and February 28, 2003 and 2002.

Supplemental Cash Flow Information

The Company made cash payments for interest of \$294,000, \$142,000 and \$88,000 for the years ended February 29, 2004 and February 28, 2003 and 2002, respectively. The Company made no cash payments for income taxes during the years ended February 29, 2004 and February 28, 2003 and 2002.

The Company acquired property and equipment through the assumption of capital lease obligations amounting to \$34,000 and \$2.9 million for the years ended February 29, 2004 and February 28, 2003, respectively.

Net Income (Loss) Per Common Share

The Company computes net income (loss) per common share in accordance with Statement of Financial Accounting Standards No. 128, "Earnings Per Share," ("SFAS 128") and SEC Staff Accounting Bulletin No. 98 ("SAB 98"). Under the provisions of SFAS 128 and SAB 98, basic net income (loss) per common share ("Basic EPS") is computed by dividing net income (loss) available to common stockholders by the weighted average number of common shares outstanding. Diluted net income (loss) available to common stockholders per common share ("Diluted EPS") is computed by dividing net income (loss) available to common stockholders by the weighted average number of common shares and dilutive potential common share equivalents then outstanding. Potential common shares consist of shares issuable upon the exercise of stock options. The calculation of diluted net income (loss) per share available to common stockholders does not include 8,437,951, and 8,816,080 potential shares of common stock equivalents for the years ended February 28, 2003 and 2002, respectively, as their impact on net income (loss) per share would be antidilutive.

Segment Reporting

Management identifies the Company's operating segments primarily based on differences in the nature of its products and services and on geographic location. The Company's operating segments are enterprise and

RED HAT, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

embedded. These segments reflect the Company's primary focus, sales of Red Hat Enterprise Linux and Red Hat Network subscriptions to large enterprises, and the fact that management has decided to maintain a small but strategic presence in the embedded systems market. Retail subscription revenue is included in the enterprise segment because results of retail subscription sales are not reviewed on a disaggregated basis from the Company's other enterprise subscriptions. Performance of these segments is evaluated based on their respective gross profit margins as disclosed in the Company's Consolidated Statements of Operations.

Management evaluates the Company's assets on a consolidated basis only. Accordingly, no information has been provided and no allocations have been made related to segment assets.

The Company has international sales offices in the United Kingdom, France, Italy, Ireland, Germany, Hong Kong, Korea, Australia, India and Japan. The Company manages its international business on a Europe-wide and Asia Pacific-wide basis. The following disclosure aggregates individually immaterial international operations and separately discloses the significant international operations at and for the years ended February 29, 2004 and February 28, 2003 and 2002 (in thousands):

	North America	Europe	Asia Pacific and Japan	Total
Year Ended February 29, 2004				
Revenue from unaffiliated customers	\$ 86,774	\$22,398	\$16,912	\$ 126,084
Net income (loss) available to common stockholders	\$ 20,122	\$ (3,175)	\$ (2,949)	\$ 13,998
Total assets	\$1,068,106	\$22,794	\$18,719	\$1,109,619
Year Ended February 28, 2003				
Revenue from unaffiliated customers	\$ 63,715	\$15,436	\$11,775	\$ 90,926
Net income (loss) available to common stockholders	\$ (13,757)	\$ 4,295	\$ 2,863	\$ (6,599)
Total assets	\$ 373,661	\$10,132	\$ 6,546	\$ 390,339
Year Ended February 28, 2002				
Revenue from unaffiliated customers	\$ 55,546	\$11,597	\$11,767	\$ 78,910
Net income (loss) available to common stockholders	\$ (141,287)	\$ 1,385	\$ (314)	\$ (140,216)
Total assets	\$ 357,708	\$ 8,337	\$ 3,820	\$ 369,865

Comprehensive Income

The Company's items of other comprehensive income (loss) are comprised of an unrealized gain (loss) on investments in marketable securities of (\$1.3), \$7.4 million, and (\$2.0) million during years ended February 29, 2004 and February 28, 2003 and 2002, respectively, and a foreign currency translation adjustment of \$1.8 million, \$1.0 million, and (\$891,000) during years ended February 29, 2004 and February 28, 2003 and 2002, respectively.

Recent Accounting Pronouncements

The Financial Accounting Standards Board ("FASB") issued Interpretation No. 46 ("FIN 46"), "Consolidation of Variable Interest Entities," in January 2003 and amended the Interpretation in December 2003. FIN 46 requires an investor with a majority of the variable interests ("primary beneficiary") in a variable interest entity ("VIE") to consolidate the entity and also requires majority and significant variable interest investors to provide certain disclosures. A VIE is an entity in which the voting equity investors do not have a controlling financial interest or the equity investment at risk is insufficient to finance the entity's activities without receiving additional subordinated financial support from the other parties. Development-stage entities that have sufficient equity invested to finance the activities they are currently engaged in and entities that are businesses, as defined in the Interpretation, are not considered VIEs. The provisions of FIN 46 were effective immediately for all

RED HAT, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

arrangements entered into with new VIEs created after January 31, 2003, and the Company is required to apply the remaining provisions of the Interpretation for the period ending February 28, 2005. The Company has begun a review of its investments in both non-marketable and marketable equity securities, as well as other arrangements, to determine whether the Company is the primary beneficiary of any VIEs. The Company is currently unaware of any relationship with VIEs in which it is the primary beneficiary. Once the Company's review is completed, there may be material relationships that require accounting for in accordance with FIN 46.

The Company has applied the disclosure provisions of FIN 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others," to its agreements that contain guarantee or indemnification clauses. These disclosure provisions expand those required by SFAS No. 5, by requiring a guarantor to disclose certain types of guarantees, even if the likelihood of requiring the guarantor's performance is remote. The following is a description of arrangements in which the Company is the guarantor.

The Company is a party to a variety of agreements pursuant to which it may be obligated to indemnify the other party with respect to certain matters or modify infringing software. Typically, these obligations arise in the context of contracts entered into by the Company, under which the Company customarily agrees to hold the other party harmless against losses arising from a breach of representations and covenants related to such matters as title to assets sold, certain IP rights, specified environmental matters, and certain income taxes. In each of these circumstances, payment by the Company is conditioned on the other party making a claim pursuant to the procedures specified in the particular contract, which procedures typically allow the Company to challenge the other party's claims. Further, the Company's obligations under these agreements may be limited in terms of time and/or amount, and in some instances, the Company may have recourse against third parties for certain payments made by the Company.

It is not possible to predict the maximum potential amount of future payments under these or similar agreements due to the conditional nature of the Company's obligations and the unique facts and circumstances involved in each particular agreement. Historically, payments made by the Company under these agreements did not have a material effect on the Company's business, financial condition or results of operations. The Company believes that if it were to incur a loss in any of these matters, such loss should not have a material effect on the Company's business, financial condition or results of operations.

NOTE 3—Business Combinations

In December 2003, the Company completed the acquisition of all of the outstanding common stock of Sistina Software, Inc. ("Sistina") in exchange for issuance of 1,979,874 shares of the Company's common stock and the assumption of all of the outstanding Sistina stock options valued, in the aggregate, at \$30.7 million, including net tangible and intangible assets of \$2.0 million and \$3.0 million, respectively. The Company engaged an independent valuation expert to determine the fair market value of the net tangible and intangible assets acquired. The excess of purchase price over the fair values of the net assets acquired of \$25.7 million has been recorded as goodwill. In addition, the transaction includes \$12.0 million of contingent consideration based on an earnout carved into three tranches. The earnout is based on the achievement of certain bookings targets for the technologies and services previously sold by Sistina over the period beginning on December 23, 2003 and ending March 31, 2005. Shares issued under the earnout will be determined based on the average closing price of the Company's common stock during the 10 trading days prior to issuance of each tranche of such earnout shares. No contingent consideration was earned during the initial earnout period, which ended on March 31, 2004.

The following unaudited pro forma consolidated financial information reflects the results of operations of the Company for the years ended February 29, 2004 and February 28, 2003 as if the acquisition of Sistina had

RED HAT, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

occurred on March 1, 2002, after giving effect to certain purchase accounting adjustments. These pro forma results are not necessarily indicative of what the Company's operating results would have been had the acquisitions actually taken place on March 1, 2002 (in thousands):

	Year Ended February 29, 2004	Year Ended February 28, 2003
Revenue	\$126,707	\$ 91,267
Net income (loss) before extraordinary item-loss on disposal of discontinued operations	\$ 14,337	\$(11,205)
Net income (loss)	\$ 14,337	\$(11,466)
Basic net income (loss) per common share	\$ 0.08	\$ (0.07)
Diluted net income (loss) per common share	\$ 0.08	\$ (0.07)

In October 2002, the Company completed the acquisition of all of the outstanding common stock of NOCpulse, Inc. in exchange for 322,312 shares of the Company's common stock valued at \$1.2 million, plus the assumption of \$2.7 million in net liabilities. The excess of purchase price over the fair values of the net liabilities acquired of \$3.9 million has been recorded as goodwill based on a valuation performed by an independent valuation expert.

In January 2002, the Company completed the acquisition of \$816,000 and \$400,000 of net tangible and intangible assets, respectively, from an unrelated third party in return for the assumption of a capital lease obligation in the amount of \$1.2 million. The acquisition of these assets was made in order to provide content management and enterprise collaboration expertise to the Company.

NOTE 4—Discontinued Operations

During January 2002, the Company adopted a formal plan to discontinue its network consulting operations. Accordingly, the network consulting operations were accounted for as a discontinued operation beginning with the fiscal year 2001 Consolidated Statement of Operations. The Company completed the disposal of the network consulting operations in February 2002 through termination of associated employees. Loss on disposal of discontinued operations of \$10.3 million in fiscal year 2002 included the write-off of goodwill of \$9.6 million, severance and related costs of \$0.4 million, and a provision against accounts receivable of \$0.3 million. Network consulting revenues were \$8.7 million during the year ended February 28, 2002.

NOTE 5—Accounts Receivable

Accounts receivable are presented net of an allowance for doubtful accounts. The activity in the Company's allowance for doubtful accounts for the years ended February 29, 2004, and February 28, 2003 and 2002 is presented in the following table (in thousands):

	Balance at beginning of period	Charged to income or expense	Deductions (a)	Balance at end of period
2002	\$1,835	\$1,533	\$(2,231)	\$1,137
2003	\$1,137	\$2,107	\$(1,366)	\$1,878
2004	\$1,878	\$1,441	\$(2,005)	\$1,314

(a) Represents amounts written-off as uncollectible accounts receivable.

RED HAT, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

NOTE 6—Property and Equipment

The Company's property and equipment consisted of the following (in thousands):

	<u>February 29, 2004</u>	<u>February 28, 2003</u>
Computer equipment	\$ 24,409	\$ 18,747
Software, including software developed for internal use	24,404	15,869
Furniture and fixtures	1,863	1,923
Leasehold improvements	6,813	6,258
	<u>57,489</u>	<u>42,797</u>
Less: accumulated depreciation	(28,041)	(19,825)
Property and equipment, net	<u>\$ 29,448</u>	<u>\$ 22,972</u>

Depreciation expense was \$6.7 million, \$5.5 million and \$5.5 million for the years ended February 29, 2004 and February 28, 2003 and 2002, respectively.

NOTE 7—Goodwill and Identifiable Intangible Assets

Identifiable intangible assets consist primarily of purchased technologies, trademarks, copyrights and patents, which are amortized over the estimated useful life ranging from three to 15 years. Amortization expense associated with identifiable intangible assets was \$160,000, \$1.1 million and \$1.2 million for the years ended February 29, 2004 and February 28, 2003 and 2002, respectively. Estimated amortization of identifiable intangible assets in future periods is not expected to be material. The following is a summary of identifiable intangible assets (in thousands):

	<u>As of February 29, 2004</u>			<u>As of February 28, 2003</u>		
	<u>Gross Amount</u>	<u>Accumulated Amortization</u>	<u>Net Amount</u>	<u>Gross Amount</u>	<u>Accumulated Amortization</u>	<u>Net Amount</u>
Trademarks, copyrights and patents	\$3,436	\$(2,495)	\$ 941	\$4,196	\$(3,465)	\$731
Purchased technologies	\$3,000	\$ (100)	\$2,900	—	—	—

In accordance with SFAS 142, the Company completed the annual impairment test as of February 29, 2004 and no goodwill impairment was deemed necessary. The following is a summary of goodwill by segment for the years ended February 29, 2004 and February 28, 2003 (in thousands):

	<u>Enterprise</u>	<u>Embedded</u>	<u>Consolidated</u>
Balance at February 28, 2002	\$15,204	\$19,516	\$34,720
Add: acquisition	4,572	—	4,572
Less: impairment	—	—	—
Impact of foreign currency fluctuations	805	—	805
Balance at February 28, 2003	<u>20,581</u>	<u>19,516</u>	<u>40,097</u>
Add: acquisition	25,718	—	25,718
Less: impairment	—	—	—
Impact of foreign currency fluctuations	57	—	57
Balance at February 29, 2004	<u>\$46,356</u>	<u>\$19,516</u>	<u>\$65,872</u>

RED HAT, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

During the year ended February 28, 2002, the Company impaired \$58.6 million in goodwill, including \$9.6 million from disposal of discontinued operations and \$49.0 million related to the Company's restructuring in August 2001, associated with acquisitions completed in prior years. The Company's decision not to pursue technologies under development by acquired companies led to operating results that were less than had been anticipated at the time of the Company's acquisitions. No impairments were required to be recognized during the years ended February 29, 2004 and February 28, 2003. Goodwill amortization expense was \$53.0 million for the year ended February 28, 2002.

Through February 28, 2002, goodwill was amortized on a straight-line basis over three years. Effective, March 1, 2002, the Company adopted SFAS 142 and no longer amortizes goodwill. The following is a summary of reported net loss and net loss per share, adjusted to exclude goodwill amortization expense (in thousands, except per share amounts):

	Year Ended February 28, 2002
Net loss	\$(140,216)
Add: goodwill amortization	53,015
Adjusted net loss	<u>\$ (87,201)</u>
Adjusted net loss per share basic and diluted	<u>\$ (0.51)</u>

NOTE 8—Other Assets

Other assets were comprised of the following (in thousands):

	February 29, 2004	February 28, 2003
Cost-basis investments	\$3,800	\$3,800
Notes receivable	—	75
Security deposits	755	298
Other	13	161
	<u>\$4,568</u>	<u>\$4,334</u>

Fair value for non-marketable cost-basis investments in equity securities is estimated based on prices recently paid for shares in that company, as well as changes in market conditions. The estimated fair values are not necessarily representative of the amounts that the Company could realize in a current transaction.

NOTE 9—Fair Value of Financial Instruments

The carrying values of cash and cash equivalents, accounts receivable, and accounts payable at February 29, 2004 and February 28, 2003 approximated their fair values due to the short-term nature of these items.

The fair values of the Company's short-term and long-term investments in debt securities at February 29, 2004 and February 28, 2003, differed from their historical cost by \$5.4 million and \$6.7 million, respectively. The Company had realized gains on sales of investments in debt securities of approximately \$1.4 million, \$892,000 and \$1.1 million during the years ended February 29, 2004 and February 28, 2003 and 2002,

RED HAT, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

respectively. Following is a summary of the historical cost, unrealized gain (loss) and fair values of the Company's investments at February 29, 2004 and February 28, 2003 (in thousands):

February 29, 2004			
	Cost	Unrealized Gain	Fair Value
Short-term corporate debt securities	\$ 48,651	\$ 689	\$ 49,340
Short-term government debt securities	14,361	11	14,372
	<u>63,012</u>	<u>700</u>	<u>63,712</u>
Long-term corporate debt securities	229,899	4,842	234,741
Long-term government debt securities	98,176	(134)	98,042
	<u>328,075</u>	<u>4,708</u>	<u>332,783</u>
	<u><u>\$391,087</u></u>	<u><u>\$5,408</u></u>	<u><u>\$396,495</u></u>

February 28, 2003			
	Cost	Unrealized Gain	Fair Value
Short-term corporate debt securities	\$ 34,730	\$ 347	\$ 35,077
Short-term government debt securities	10,055	84	10,139
	<u>44,785</u>	<u>431</u>	<u>45,216</u>
Long-term corporate debt securities	179,961	6,153	186,114
Long-term government debt securities	15,673	87	15,760
	<u>195,634</u>	<u>6,240</u>	<u>201,874</u>
	<u><u>\$240,419</u></u>	<u><u>\$6,671</u></u>	<u><u>\$247,090</u></u>

NOTE 10—Restructuring Charge

In fiscal years 2003 and 2002, the Company recorded restructuring charges of \$1.5 million and \$56.1 million, respectively. These restructuring charges were primarily due to a sharpening of the Company's focus on providing Red Hat Enterprise Linux and related technologies to the large enterprise. During fiscal 2003 and 2002, the Company terminated a total of 220 employees. Restructuring charges in fiscal 2002 consist of an impairment of \$49.3 million in the carrying value of goodwill and intangibles related to acquisitions made in annual periods prior to fiscal 2002, various facility closings, and \$6.9 million in severance and related expenses. All restructuring actions were substantially completed in the first quarter of fiscal year 2003.

Details of the restructuring charge are as follows (in thousands):

	Writedown of Intangible Assets, Including Goodwill	Employee Severance and Termination Benefits	Facility Exit Costs
Original restructuring charge	\$ 49,311	\$ 5,707	\$1,104
Non-cash charges	(49,311)	—	—
Fiscal year 2002 cash payments	<u>—</u>	<u>(4,084)</u>	<u>(981)</u>
Remaining liability at February 28, 2002	—	1,623	123
Fiscal year 2003 restructuring charge	—	1,233	228
Fiscal year 2003 cash payments	<u>—</u>	<u>(2,856)</u>	<u>(351)</u>
Remaining liability at February 28, 2003	<u><u>\$ —</u></u>	<u><u>\$ —</u></u>	<u><u>\$ —</u></u>

RED HAT, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

NOTE 11—Accrued Expenses

Accrued expenses were comprised of the following (in thousands):

	February 29, 2004	February 28, 2003
Wages and other compensation	\$ 5,320	\$4,263
Trade	5,494	1,250
Taxes	4,571	599
Other	234	1,502
	<u>\$15,619</u>	<u>\$7,614</u>

NOTE 12—Convertible Debentures

In January 2004, the Company issued \$600 million in Convertible Senior Debentures (“Debentures”). The Debentures mature on January 15, 2024 and bear interest at a rate of 0.5% per annum, payable semiannually on January 15 and July 15 of each year. The Debentures are senior unsecured obligations and rank equally in right of payment with all of the Company’s other existing and future unsecured and unsubordinated debt. The Debentures are convertible into shares of the Company’s common stock under certain circumstances prior to maturity at a conversion rate of 39.0753 shares per \$1,000 principal amount of debentures (which represents a conversion price of approximately \$25.59 per share) subject to adjustment under certain conditions. The Company may redeem the Debentures, in whole or in part, in cash at any time on or after January 15, 2009. Holders of the Debentures may require the Company to redeem the Debentures, in whole or in part, in cash on January 15 of 2009, 2014 and 2019. As of February 29, 2004, no Debentures were redeemed. Accrued interest to the redemption date will be paid by the Company in any such redemption. No interest payments were made during the year ended February 29, 2004. Accrued interest at February 29, 2004, was \$0.4 million.

In connection with the issuance of the Debentures, the Company incurred \$15.5 million of issuance costs, which primarily consisted of investment banker fees, legal and other professional fees. These costs are being amortized using the effective interest rate method over the remaining term of the Debentures. Amortization expense related to the issuance costs was \$0.4 million for the year ended February 29, 2004. At February 29, 2004, net debt issuance costs associated with the Debentures was \$15.1 million.

NOTE 13—Income Taxes

The components of the Company’s provision for income taxes consisted of the following (in thousands):

	February 29, 2004	February 28, 2003	February 28, 2002
Current:			
Foreign	\$—	\$—	\$—
Federal	—	—	—
State	—	—	—
Current tax expense	—	—	—
Deferred:			
Foreign	—	—	—
Federal	—	—	—
State	—	—	—
Deferred tax expense	—	—	—
Net provision for income taxes	<u>\$—</u>	<u>\$—</u>	<u>\$—</u>

RED HAT, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Significant components of the Company's deferred tax assets and liabilities at February 29, 2004 and February 28, 2003, consisted of the following (in thousands):

	<u>February 29, 2004</u>	<u>February 28, 2003</u>
Deferred tax assets:		
Domestic net operating loss carryforwards	\$ 162,363	\$ 135,531
Foreign net operating loss carryforwards	6,766	6,929
Accounts receivable	462	664
Allowance for inventory obsolescence	12	96
Other accruals and liabilities	22	36
Intangibles	350	378
Research and development credit	1,452	1,452
Foreign tax credit	—	—
Goodwill	12,347	13,430
Compensation-related accruals	<u>962</u>	<u>774</u>
Total deferred tax assets	184,736	159,290
Valuation allowance for deferred tax assets	<u>(179,350)</u>	<u>(156,267)</u>
Total deferred tax assets	5,386	3,023
Deferred tax liabilities:		
Fixed and intangible assets	<u>5,386</u>	<u>3,023</u>
Total deferred tax liabilities	<u>5,386</u>	<u>3,023</u>
Net deferred taxes	<u>\$ —</u>	<u>\$ —</u>

As of February 29, 2004 and February 28, 2003, the Company provided a full valuation allowance against its net deferred tax assets since realization of these benefits cannot be reasonably assured. An increase in the valuation allowance was recorded during the years ended February 29, 2004 and February 28, 2003 to reserve the increase in total deferred tax assets during such periods due to uncertainty of realizability.

As of February 29, 2004, the Company had Federal and state net operating loss carryforwards of approximately \$406.9 million and \$396.2 million, respectively. These net operating loss carryforwards expire in varying amounts beginning in 2009 and 2004 for Federal and state income tax purposes, respectively. The utilization of the Federal net operating loss carryforwards may be subject to limitation under the rules regarding a change in stock ownership as determined by the Internal Revenue Code. If the Company's utilization of its net operating loss carryforwards is limited and the Company has taxable income which exceeds the permissible yearly net operating loss utilization, the Company could incur a Federal income tax liability even though its net operating loss carryforwards exceed its taxable income. A portion of the net operating loss carryforwards is reflected in additional paid-in capital with a full valuation allowance as these net operating loss carryforwards are generated by deductions related to stock options and warrants.

The Company's foreign net operating loss carryforwards expire in varying amounts beginning in 2005. The Company's research and development credits begin to expire in varying amounts in 2009.

RED HAT, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Taxes computed at the statutory Federal income tax rate of 34% are reconciled to the provision for income taxes for the years ended February 29, 2004, and February 28, 2003 and 2002 as follows (in thousands):

	February 29, 2004	February 28, 2003	February 28, 2002
Effective rate	0.00%	0.00%	0.00%
United States Federal tax benefit at statutory rate	\$ 4,759	\$(2,244)	\$(44,155)
State tax benefit (net of Federal tax)	554	(80)	(1,856)
Foreign taxes	—	—	—
Foreign rate differential	—	632	—
Change in valuation reserves	(5,364)	1,684	28,173
Acquisition related expenses	—	—	17,814
Nondeductible items	51	8	24
Provision for income taxes	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>

NOTE 14—Short Term Payable

In August 2001, the Company obtained a \$10.0 million line of credit from a financial institution to use to meet the Company's working capital needs and subsequently increased this line to \$15 million in May 2002. Borrowings under this line of credit bear interest at the 30-day LIBOR rate plus 1.00% (2.09% at February 29, 2004). The line of credit expires in August 2004 and is secured by an amount of the Company's investments in debt securities equal to the outstanding balance on the line of credit which is held in an investment account managed by this financial institution. At February 28, 2003, \$15.0 million was outstanding under the line of credit. There were no amounts outstanding under the line of credit as of February 29, 2004.

NOTE 15—Common and Preferred Stock

Common Stock

The Company has authorized 300,000,000 shares of common stock with a par value of \$0.0001 per share. Holders of these shares have one vote per share. Upon the dissolution, liquidation or winding up of the Company, holders of common stock will be entitled to receive the assets of the Company after satisfaction of the preferential rights of the outstanding preferred stock or any other outstanding stock ranking on liquidation senior to or on parity with the common stock.

The Company purchased 200,000 and 1,937,900 shares of its common stock during the fiscal years ended February 28, 2003 and 2002, respectively, at an aggregate cost of \$0.8 million and \$6.7 million, respectively. This amount is recorded as treasury stock on the Company's Consolidated Balance Sheets.

Preferred Stock

At February 29, 2004, the Company has authorized 5,000,000 shares of preferred stock with a par value of \$0.0001 per share. No shares of preferred stock were outstanding as of February 29, 2004 or February 28, 2003.

NOTE 16—Stock Options and Warrants

Stock Options

The Company has a stock option plan that provides for the granting of either incentive stock options, non-qualified stock options, or shares of restricted stock. As of February 29, 2004, 27,111,105 shares of common

RED HAT, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

stock were reserved for issuance upon exercise of options granted to any employee, officer or director or consultant of the Company at terms and prices to be determined by the Board of Directors. The plan provides that the purchase price per share for each non-qualified option should be set by the Board of Directors on the date of grant. The purchase price per share for each Incentive Stock Option (“ISO”) shall not be less than the fair market value of the common stock on the date of grant. The maximum term for an option granted is ten years from the date of grant. Options granted under the plan generally vest 25% upon completion of one full year of service and 6.25% on the first day of each subsequent three-month period.

Combined Stock Option Activity

The activity for the stock option plans for the three years ended February 29, 2004 is presented in the following table:

	Shares Underlying Options	Weighted Average Exercise Price Per Share
Outstanding at February 28, 2001	17,355,783	\$12.07
Granted	11,514,134	4.78
Exercised	(1,015,039)	2.49
Forfeited	(3,294,746)	11.21
Outstanding at February 28, 2002	24,560,132	9.17
Granted	7,001,500	5.63
Exercised	(821,063)	3.21
Forfeited	(3,403,491)	11.17
Outstanding at February 28, 2003	27,337,078	8.19
Granted	4,341,176	7.25
Exercised	(8,630,977)	2.72
Forfeited	(1,393,985)	15.24
Outstanding at February 29, 2004	<u>21,653,292</u>	<u>\$ 9.67</u>

The following summarizes information about the Company’s outstanding stock options at February 29, 2004:

Exercise Prices	Options Outstanding			Options Exercisable	
	Number Outstanding	Weighted Average Contractual Life	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price
\$ 0.00-\$ 13.40	17,699,182	7.70	\$ 4.80	7,396,183	\$ 3.38
\$13.40-\$ 26.79	2,001,984	7.20	\$ 19.29	1,318,998	\$ 20.87
\$26.79-\$ 40.19	1,430,929	5.50	\$ 27.62	1,281,767	\$ 27.66
\$40.19-\$ 53.59	149,975	5.10	\$ 42.89	149,411	\$ 42.89
\$53.59-\$ 66.98	13,100	6.00	\$ 55.75	12,280	\$ 55.75
\$66.98-\$ 80.38	68,187	5.60	\$ 72.95	68,187	\$ 72.95
\$80.38-\$ 93.78	13,800	5.90	\$ 92.50	13,800	\$ 92.50
\$93.78-\$1,020.06	276,135	5.80	\$118.76	276,135	\$118.76
	<u>21,653,292</u>	<u>7.40</u>	<u>\$ 9.67</u>	<u>10,516,761</u>	<u>\$ 12.75</u>

RED HAT, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

NOTE 17—Commitments and Contingencies

As of February 29, 2004, the Company leased office space and certain equipment under various non-cancelable operating and capital leases. Future minimum lease payments required under the operating and capital leases at February 29, 2004 are as follows (in thousands):

<u>Fiscal Year</u>	<u>Operating Leases</u>	<u>Capital Leases</u>
2005	\$ 4,515	\$1,109
2006	4,521	289
2007	3,598	91
2008	3,189	33
2009	3,110	—
Thereafter	34,193	—
Total minimum lease payments	<u>\$53,126</u>	1,522
Less amount representing interest (at rates ranging from 3.2% to 9.3%)		<u>(86)</u>
Present value of minimum lease payments		1,436
Less current portion		<u>(898)</u>
Long-term portion		<u>\$ 538</u>

Rent expense under operating leases was \$5.3 million, \$4.2 million and \$4.5 million for the years ended February 29, 2004, and February 28, 2003 and 2002, respectively.

In June 2001, the Company entered into a financing arrangement with a bank for approximately \$500,000, the proceeds of which were used to purchase certain networking equipment. This arrangement, which effectively functions as a loan, is secured by a certificate of deposit held at the bank for an equal amount. The financing arrangement has a term of four years and bears interest at a rate of 6% annually. At February 29, 2004, the outstanding balance under this financing arrangement was approximately \$185,000. The certificate of deposit renews periodically and allows for the amount therein to be reduced each year to correspond to the outstanding balance under the financing arrangement at the renewal date.

In September 2001, the Company entered into a \$3.0 million master lease facility (the “Facility”) with a bank to finance various equipment purchases made by the Company. The Facility had an initial term of one year. The term of the Facility was extended by one year to September 2003 and, as of February 29, 2004, is no longer available for additional borrowings. The facility is secured by a marketable debt security with a fair value of \$5.0 million as of February 29, 2004. Each separate lease under the Facility may have a term up to five years and incurs interest at a rate determined at the commencement of each separate lease schedule based on current money market conditions. At February 29, 2004, \$1.1 million was outstanding under the Facility.

In January 2002, the Company assumed the lease obligation of an unrelated third party for an office building which serves as the Company’s headquarters. This lease terminates in June 2020. As compensation to the Company for assuming this obligation, the third party paid rent on the Company’s behalf from the commencement of the sublease until February 2003, is allowing the Company the use of all furniture and fixtures, including building improvements, that were in the building at the time of the commencement of the sublease, and paid the Company a certain monthly amount through October 2002, to offset the operating expenses of this building, all of which was valued in the aggregate at \$5.9 million. As a result of receiving these economic inducements, the Company capitalized \$3.6 million of furniture and fixtures on its balance sheet and

RED HAT, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

initially recorded a long-term deferred lease credit of \$3.8 million. As of February 29, 2004, the long-term deferred lease credit was valued at \$5.4 million. This credit balance began to amortize, as a reduction to related rent expense, in fiscal 2004 and will continue to do so until the lease terminates in June 2020. The furniture and fixtures are being depreciated over a period of seven years.

NOTE 18—Legal Proceedings

Red Hat Professional Consulting, Inc., formerly PTI, a wholly-owned subsidiary of the Company acquired in February 2001, along with its former directors and some of its former principal shareholders is a defendant in a suit brought in the Superior Court of DeKalb County, State of Georgia, by a former employee. The plaintiff asserts, among other things, breach of various employment agreements and seeks monetary damages. PTI has filed an answer, affirmative defenses and counterclaims denying all liability and has filed a motion to dismiss which remains pending. All discovery in the matter is complete. The Company has been indemnified in this matter by the former PTI shareholders and further believes that the likelihood of a material loss is remote.

Commencing on or about March 29, 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. On August 8, 2001, Chief Judge Mukasey of the federal district court for the Southern District of New York issued an order that transferred all of the so-called IPO allocation actions, including the complaints involving the Company, to one judge for coordinated pre-trial proceedings. The court has consolidated the actions by issuer, and the Red Hat actions have been consolidated into a single action. 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. No discovery has occurred to date. The individual director and officer defendants have been dismissed from the case without prejudice. The Company believes these complaints are without merit and will defend itself vigorously in this matter. No assurance can be given, however, that this matter will be resolved in the Company's favor. The Company, among other issuers, the plaintiffs, and the insurers have agreed, in concept, to a proposed settlement whereby the Company would be released from this litigation. That proposed settlement has not been submitted to the court for its consideration, and there is no certainty that the court will approve the settlement.

Commencing May 23, 2002, the Company was named as defendant in a suit brought by The Monotype Corporation in federal district court for the Northern District of Illinois alleging copyright and trademark infringement. The plaintiff contended that the Company infringed certain of plaintiff's font software copyrights and related trademarks in the Company's retail distributions, versions 5.2 through the initial release of version 7.3. On December 4, 2002, the plaintiff filed a second amended complaint adding allegations of violations of the Lanham Act, as well as the state unfair and deceptive trade practices acts under Illinois and North Carolina law. The relief sought consisted of unspecified damages. The Company counterclaimed alleging plaintiff's copyrights and trademarks are unenforceable and/or invalid. In December 2003, the parties entered into a license agreement at a total cost of \$3.5 million for which provides the Company the right to distribute a number of Monotype's commercial fonts over a 5 year period. The Company recorded a charge of \$500,000 in the third quarter of fiscal 2004 related to this license agreement to reflect an allocation of a portion of this costs to the alleged infringements in prior years. In conjunction with the license, the parties entered into a mutual release and all claims asserted by each party were dismissed with prejudice.

Commencing August 4, 2003, the Company filed suit against The SCO Group, Inc. ("SCO") in the U.S. District Court for the District of Delaware (Civil Action No. 03-722 SLR) (the "Action") seeking a declaratory

RED HAT, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

judgment that the Company is not infringing any of SCO's intellectual property rights. In addition, the Company has asserted claims against SCO under Delaware and federal law, including deceptive trade practices, unfair competition, tortious interference with prospective business opportunities, trade libel and violations of the Lanham Act. The Company contends that SCO has made false and misleading public statements alleging that software code, in which SCO claims to own copyrights and trade secrets, was misappropriated and incorporated into the Company's product and has threatened legal action. On September 15, 2003, SCO filed a Motion to Dismiss contending, among other things, that there exists no actual controversy that would warrant the declaratory judgment the Company seeks. On April 6, 2004, the Court denied SCO's Motion to Dismiss but stayed further action in the case pending the resolution of litigation pending in the U.S. District Court for the District of Utah between SCO and IBM. On April 20, 2004, Red Hat filed a Motion for Reconsideration contending that a stay based on the Utah case would be inappropriate and SCO has filed an opposition to that motion. That motion is now pending before the Court. At this early stage of the proceedings no assurance can be given as to the outcome.

In addition to the litigation described above, the Company experiences other routine litigation in the normal course of our business. The Company believes that the outcome of this routine litigation will not have a material adverse impact on its consolidated financial position or results of operations.

NOTE 19—Employee Benefit Plans

401(k) Plan

The Company provides a retirement plan qualified under Section 401(k) of the Internal Revenue Code of 1986, as amended ("IRC"). Participants may elect to contribute a portion of their annual compensation to the plan, after complying with certain limitations set by the IRC. Employees are eligible to participate in the plan if they are over 21 years of age. If, however, an employee was employed by the Company prior to February 1999, the 401(k) plan covers such employee regardless of age. The Company has the option to make contributions to the plan and contributed \$277,000 to the plan for the year ended February 29, 2004. The Company did not make any contributions to the plan for the years ended February 28, 2003 or 2002.

Employee Stock Purchase Plan

In 1999, the Company's stockholders approved the 1999 Employee Stock Purchase Plan (the "Plan"), under which 1,500,000 shares of the Company's common stock could be sold to employees. All full-time U.S. and certain non-U.S. employees are eligible to participate in the Plan. The Plan provides that participants may authorize the Company to withhold up to 10% of their earnings, on a semi-annual basis, to purchase shares of stock at a price equal to the lesser of 85% of the fair value of the stock as of the first business day of the period or the last business day of the period. The Plan will terminate at the earlier of the date that all 1,500,000 shares have been sold or at June 2, 2009. During the years ended February 29, 2004, and February 28, 2003 and 2002, 230,358, 160,477 and 161,025 shares, respectively, of the Company's common stock were sold under the Plan.

RED HAT, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

NOTE 20—Unaudited Quarterly Results

Year Ended February 29, 2004				
	4th Quarter	3rd Quarter	2nd Quarter	1st Quarter
	(in thousands, except per share data)			
Subscription and services revenue:				
Subscription:				
Enterprise technologies	\$ 23,944	\$ 17,779	\$ 14,918	\$ 12,289
Retail	1,604	3,727	3,121	4,462
Embedded	309	466	490	646
Total subscription revenue	25,857	21,972	18,529	17,397
Services:				
Enterprise technologies	9,691	9,887	9,147	9,039
Embedded development services	1,417	1,229	1,173	746
Total services revenue	11,108	11,116	10,320	9,785
Total subscription and services revenue	\$ 36,965	\$ 33,088	\$ 28,849	\$ 27,182
Gross profit	\$ 27,941	\$ 23,976	\$ 20,868	\$ 18,430
Income (loss) from continuing operations	\$ 2,534	\$ 1,500	\$ 240	\$ (1,062)
Other income, net	\$ 2,463	\$ 2,645	\$ 3,097	\$ 2,581
Net income	\$ 4,997	\$ 4,145	\$ 3,337	\$ 1,519
Net income per common share (a):				
Basic	\$ 0.03	\$ 0.02	\$ 0.02	\$ 0.01
Diluted	\$ 0.03	\$ 0.02	\$ 0.02	\$ 0.01
Weighted average shares outstanding:				
Basic	178,847	173,996	172,127	171,146
Diluted	191,641	184,210	182,377	180,671

RED HAT, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

	Year Ended February 28, 2003			
	4th	3rd	2nd	1st
	Quarter	Quarter	Quarter	Quarter
	(in thousands, except per share data)			
Subscription and services revenue:				
Subscription:				
Enterprise technologies	\$ 10,777	\$ 6,987	\$ 6,645	\$ 6,029
Retail	2,845	5,461	2,941	3,586
Embedded	810	709	761	1,041
Total subscription revenue	14,432	13,157	10,347	10,656
Services:				
Enterprise technologies	10,691	10,071	9,943	7,817
Embedded development services	768	1,050	945	1,049
Total services revenue	11,459	11,121	10,888	8,866
Total subscription and services revenue	\$ 25,891	\$ 24,278	\$ 21,235	\$ 19,522
Gross profit	\$ 17,503	\$ 16,090	\$ 13,618	\$ 12,253
Loss from continuing operations	\$ (2,358)	\$ (2,894)	\$ (4,699)	\$ (7,213)
Other income, net	\$ 2,085	\$ 3,108	\$ 2,747	\$ 2,886
Extraordinary item-loss on disposal of discontinued operations ..	—	—	—	\$ (261)
Net income (loss)	\$ (273)	\$ 214	\$ (1,952)	\$ (4,588)
Basic income (loss) per common share (a):				
Net income (loss) from continuing operations	\$ (0.00)	\$ (0.00)	\$ (0.01)	\$ (0.03)
Discontinued operations:				
Extraordinary item-loss on disposal of discontinued operations ..	—	—	—	\$ (0.00)
Net income (loss)	\$ (0.00)	\$ 0.00	\$ (0.01)	\$ (0.03)
Diluted income (loss) per common share (a):				
Net income (loss) from continuing operations	\$ (0.00)	\$ (0.00)	\$ (0.01)	\$ (0.03)
Discontinued operations:				
Extraordinary item-loss on disposal of discontinued operations ..	—	—	—	\$ (0.00)
Net income (loss)	\$ (0.00)	\$ 0.00	\$ (0.01)	\$ (0.03)
Weighted average shares outstanding:				
Basic	170,656	170,183	169,977	169,826
Diluted	170,656	178,268	169,977	169,826

- (a) Earnings per common share are computed independently for each of the quarters presented. Therefore, the sum of the quarterly per common share information may not equal the annual earnings per common share.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None

ITEM 9A. CONTROLS AND PROCEDURES

Controls Evaluation and Related CEO and CFO Certifications

We conducted an evaluation of the effectiveness of the design and operation of our “disclosure controls and procedures”, (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the “Exchange Act”) (the “Disclosure Controls”) as of the end of the period covered by this Annual Report under the supervision with the participation of our management, including our Chief Executive Officer, or CEO, and Chief Financial Officer, or CFO.

Attached as exhibits to this Annual Report are certifications of the CEO and the CFO, which are required in accordance with Rule 13a-14 of the Exchange Act. This “Controls and Procedures” section includes the information concerning the controls evaluation referred to in the certifications, and it should be read in conjunction with the certifications for a more complete understanding of the topics presented.

Definition of Disclosure Controls

Disclosure Controls are controls and procedures designed to reasonably assure that information required to be disclosed in our reports filed under the Exchange Act, such as this Annual Report, is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission’s rules and forms. Disclosure Controls are also designed to reasonably assure that such information is accumulated and communicated to our management, including the CEO and CFO, as appropriate to allow timely decisions regarding required disclosure. Our Disclosure Controls include components of our internal control over financial reporting, which consists of control processes designed to provide reasonable assurance regarding the reliability of our financial reporting and the preparation of financial statements in accordance with generally accepted accounting principles in the U.S. To the extent that components of our internal control over financial reporting are included within our Disclosure Controls, they are included in the scope of our quarterly controls evaluation.

Limitations on the Effectiveness of Controls

Our management, including our CEO and CFO, does not expect that our Disclosure Controls or our internal control over financial reporting will prevent all error and all fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system’s objectives will be met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty and that breakdowns can occur because of simple error or mistake. Controls can also be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the controls. The design of any system of controls is based in part on certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Over time, controls may become inadequate because of changes in conditions or deterioration in the degree of compliance with policies or procedures. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

Scope of the Controls Evaluation

The evaluation of our Disclosure Controls included a review of the controls’ objectives and design, our implementation of the controls and the effect of the controls on the information generated for use in this Annual

Report. In the course of the controls evaluation, we sought to identify data errors, control problems or acts of fraud and confirm that appropriate corrective action, including process improvements, were being undertaken. This type of evaluation is performed on a quarterly basis so that the conclusions of our management, including our CEO and CFO, concerning the effectiveness of the controls can be reported in our Quarterly Reports on Form 10-Q and to supplement our disclosures made in our Annual Report on Form 10-K. Many of the components of our Disclosure Controls are also evaluated on an ongoing basis by other personnel in our Finance organization, as well as our independent auditors who evaluate them in connection with determining their auditing procedures related to their report on our annual financial statements and not to provide assurance on our controls. The overall goals of these various evaluation activities are to monitor our Disclosure Controls, and to modify them as necessary. Our intent is to maintain the Disclosure Controls as dynamic systems that change as conditions warrant.

Among other matters, we also considered whether our evaluation identified any “significant deficiencies” or “material weaknesses” in our internal control over financial reporting, and whether we had identified any acts of fraud involving personnel with a significant role in our internal control over financial reporting. This information was important both for the controls evaluation generally, and because item 5 in the certifications of the CEO and CFO requires that the CEO and CFO disclose that information to our Board’s Audit Committee and to our independent auditors. In the professional auditing literature, “significant deficiencies” are referred to as “reportable conditions,” which are deficiencies in the design or operation of controls that could adversely affect our ability to record, process, summarize and report financial data in the financial statements. Auditing literature defines “material weakness” as a particularly serious reportable condition in which the internal control does not reduce to a relatively low level the risk that misstatements caused by error or fraud may occur in amounts that would be material in relation to the financial statements and the risk that such misstatements would not be detected within a timely period by employees in the normal course of performing their assigned functions. We also sought to address other controls matters in the controls evaluation, and in each case if a problem was identified, we considered what revision, improvement and/or correction to make in accordance with our ongoing procedures.

Changes in Internal Control

No change in our internal control over financial reporting (as defined in Rules 13a-15d-15(f) under the Exchange Act) occurred during the fiscal quarter ended February 29, 2004 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting. However, in connection with the audit of our financial statements for the fiscal year ended February 29, 2004, by the Company’s independent auditors and their issuance of an unqualified opinion on our consolidated financial statements for the year ended February 29, 2004, the Company’s independent auditors informed the Audit Committee and management that it had identified a deficiency in our internal control structure that was considered a reportable condition, but not a “material weakness,” as defined under standards of the American Institute of Certified Public Accountants. The reportable condition related to the fact that while we had policies and procedures in place related to the review of all significant contracts to determine the appropriate accounting treatment for each element of these contracts, the Company’s independent auditors advised the Audit Committee and management of the need for more formal documented policies and procedures for reviewing significant contracts and more formal documentation of all the considerations and conclusions made by us as the result of the review of these significant contracts. In response, we have increased the level of formal documentation of our policies and procedures for reviewing significant contracts and the level of formal documentation of considerations made and conclusions reached as a result of this review.

Conclusions

Based upon the controls evaluation, our CEO and CFO have concluded that, subject to the limitations noted above, as of the end of the period covered by this Annual Report, our Disclosure Controls were (1) designed to ensure that material information relating to the Company, including its consolidated subsidiaries, is made known to our CEO and CFO by others within those entities, particularly during the period in which this report was being prepared and (2) effective, in that they provide reasonable assurance that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the periods specified in the SEC’s rules and forms.

PART III

ITEM 10 Directors and Executive Officers

The following table sets forth for each of our Class I, Class II and Class III Directors and each of our executive officers, their present positions with us, and as of August 5, 2004, the date of the Annual Meeting of Stockholders, their ages:

<u>Name</u>	<u>Age</u>	<u>Position</u>
Matthew J. Szulik (1)	47	Chairman of the Board of Directors, President, Chief Executive Officer (Class II Director)
Joanne Rohde (1)	45	Executive Vice President Worldwide Operations
Kevin B. Thompson (1)	39	Executive Vice President, Chief Financial Officer and Treasurer
Paul J. Cormier (1)	47	Executive Vice President—Engineering
Mark H. Webbink (1)	53	Senior Vice President, General Counsel and Secretary
Alex Pinchev (1)	54	Executive Vice President, Worldwide Sales
Dr. W. Steve Albrecht (2)(3)	57	Class I Director
Dr. Marye Anne Fox (3)(4)	56	Class I Director
General H. Hugh Shelton, U.S. Army Retired (2)(4) . . .	62	Class II Director
Eugene J. McDonald (2)(3)	72	Class II Director
William S. Kaiser (3)(4)	49	Class III Director
Robert F. Young	49	Class III Director

- (1) Our officers are elected annually by our Board of Directors and serve until the next Annual Meeting of our Board of Directors and until their respective successors are elected and qualified or until their earlier resignation or removal. Pursuant to our certificate of incorporation, our Board of Directors is divided into three classes. There are two directors currently serving in each of Class I and Class III. There are three directors currently serving in Class II. Each director serves for a three-year term, with one class of directors being elected at each Annual Meeting. The term of each Class II Director will expire at this Annual Meeting. All directors will hold office until their successors have been duly elected and qualified.
- (2) Member of Compensation Committee.
- (3) Member of Audit Committee.
- (4) Member of Nominating and Corporate Governance Committee.

Executive Officers

Matthew J. Szulik was elected Chairman of the Board of Directors in April 2002, and he has served as Chief Executive Officer since November 1999, as President since November 1998 and as a director since April 1999. Mr. Szulik also served as Chief Operating Officer from November 1998 to April 1999. From September 1997 to October 1998, Mr. Szulik served as President of Relativity Technologies, a computer software company. Prior to joining Relativity Technologies, Mr. Szulik served as an executive with Sapiens International and MapInfo Corp.

Joanne Rohde has served as Executive Vice President, Worldwide Operations since March 2004. From March 1999 until March of 2004, Mrs. Rohde was a managing director of UBS Investment Bank, a division of UBS AG where she served as Global Head, Investment Banking Information Technology and Chief Procurement Officer from 2002 until 2004.

Kevin B. Thompson has served as Executive Vice President since February 2001 and Chief Financial Officer since November 2000. From November 2000 to February 2001, Mr. Thompson served as Senior Vice President. From September 2000 to November 2000, Mr. Thompson served as Vice President—Operations. From

June 2000 until September 2000, Mr. Thompson was a Technology Partner with the international accounting firm of PricewaterhouseCoopers, LLP. Mr. Thompson joined PricewaterhouseCoopers in January 1998. From May 1988 to January 1998, Mr. Thompson was a Senior Manager with the international accounting firm of Andersen, LLP, formerly known as Arthur Andersen. Mr. Thompson is a certified public accountant.

Paul J. Cormier has served as Executive Vice President—Engineering since May 2001. From March 1999 to May 2001, Mr. Cormier served as Senior Vice President, Research and Development at BindView Development Corporation, a network management software company. From June 1998 to March 1999, Mr. Cormier served as Chief Technology Officer for Netect Internet Software Company, a network security vendor. From January 1996 to June 1998, Mr. Cormier served as Director of Engineering, Internet Security and Collaboration Product and then Senior Director of Software Product Development, Internet Security Products for AltaVista Internet Software, a web portal and internet services company.

Mark H. Webbink has served as Senior Vice President since February 2001, Secretary since July 2000, and General Counsel since May 2000. From September 1994 to April 2000, Mr. Webbink was an attorney with the law firm of Moore & Van Allen, PLLC where he practiced in the areas of licensing, intellectual property transactions, general corporate and trademarks, representing numerous technology companies. Effective June 2004, Mr. Webbink will change positions and become Deputy General Counsel – Intellectual Property and Public Policy.

Alex Pinchev has served as Red Hat's Executive Vice President, Worldwide Sales and President, International Operations since April 2003. From June 2002 until December 2002, Mr. Pinchev served as Executive Vice President with MRO Software, Inc. Prior to that, Mr. Pinchev was the Chairman, CEO, President of MainControl, Inc., a technology infrastructure management software provider from July 1996 until MainControl, Inc. was acquired by MRO Software, Inc. Mr. Pinchev is on the advisory board of George Mason University.

Directors

Robert F. Young co-founded Red Hat and has served as a director since its inception. Mr. Young has also served as the Chief Executive Officer of Lulu, Inc. since March 2002. Mr. Young served as Chairman of the Board of Directors of Red Hat from November 1998 to April 2002. From November 1998 to November 1999, he served as our Chief Executive Officer. Mr. Young is also a director of Tucows, Inc. (NASDAQ:TCOW).

Eugene J. McDonald has served as Director of Red Hat since August 2000. Mr. McDonald serves as Executive Vice President and Investment Counsel to Duke University, and also serves as Principal and Chief Investment Officer of Quellos Private Capital Markets, LLC. He served as Founding President of Duke Management Company, the asset management division of the University from 1990-2000. Mr. McDonald has held several positions at Duke University in Durham, North Carolina since he joined in 1977 as University Counsel and Vice President. For six years, Mr. McDonald served as Executive Vice President of the university, discharging the responsibilities of Chief Financial Officer and Chief Non-Academic Administrative Officer. Prior to his tenure at Duke, Mr. McDonald served as an international business executive in London, a practicing attorney in San Francisco, and a faculty member at Georgetown University Law Center. He currently serves as a director of Incara Pharmaceuticals Corporation (NASDAQ:INCR), and on the Board of Key Bank's Victory Funds.

Dr. Marye Anne Fox has served as a director since January 2002. Dr. Fox has been appointed to be the Chancellor of the University of California, San Diego effective as of August 16, 2004. Since August 1998, Dr. Fox has served as Chancellor of North Carolina State University. Prior to joining North Carolina State University, Dr. Fox served as the Vice President for Research at the University of Texas at Austin, where she also held the M. June and J. Virgil Waggoner Regents Chair in Chemistry, positions she held from 1994 and 1992, respectively. Dr. Fox is an elected member of the National Academy of Sciences and currently

serves on the President's Council of Advisors on Science and Technology and as a board member of the Microelectronics Center of North Carolina. Dr. Fox also serves on the board of directors of PPD, Inc. (NASDAQ:PPDI), a biotechnology development services company. Dr. Fox is also a director of W.R. Grace & Co. (NYSE:GRA) and Boston Scientific Corporation (NYSE:BSX).

William S. Kaiser has served as a director since September 1998. Mr. Kaiser has been employed by Greylock Management Corporation, a venture capital firm, since May 1986 and has been a general partner of the Greylock Limited Partnerships since January 1988.

Dr. W. Steve Albrecht has served as a director since April 2003. Dr. Albrecht serves as the Associate Dean of the Marriott School of Management and Arthur Andersen Professor at Brigham Young University. Prior to becoming Associate Dean, Dr. Albrecht served as the director of the School of Accountancy and Information Systems at Brigham Young University for eight years. Dr. Albrecht is a certified public accountant, a certified internal auditor and a certified fraud examiner. Dr. Albrecht is also on the board of directors of Cypress Semiconductor Corp. (NYSE:CY), SkyWest, Inc. (NASDAQ:SKYW), ICON Health and Fitness, Inc., a home fitness equipment manufacturer, and Bonneville International Corporation, an owner of radio and television stations.

General H. Hugh Shelton, U.S. Army (Retired) has served as a director since April 2003. General Shelton has been the President, International Operations, for M.I.C. Industries, an international manufacturing company since January 2002. General Shelton served as the 14th Chairman of the Joint Chiefs of Staff from October 1997 until September 2001. Prior to that, he served in the U.S. Army for 34 years as a specialist in airborne strategies and special operation tactics, including service as Commander in Chief of the U.S. Special Operations Command from 1996-1997. General Shelton also serves on the Board of Directors of Anheuser Busch Companies, Inc. (NYSE:BUD) and Anteon International Corp. (NYSE:ANT).

Audit Committee

The Board of Directors has determined that W. Steve Albrecht is an "audit committee financial expert" as defined in Item 401(h) of Regulation S-K. The standing audit committee of the Board of Directors consists of W. Steve Albrecht, Eugene McDonald, William Kaiser and Dr. Marye Anne Fox. The Board of Directors has determined that all of the members of the Audit Committee are independent as defined under the new rules of the Nasdaq Stock Market that become applicable to us on the date of our Annual Meeting of stockholders, including the independence requirements contemplated by Rule 10A-3 under the Exchange Act. In addition, all members of the Audit Committee are independent as defined by the rules of the Nasdaq Stock Market that apply to us until the date of our Annual Meeting of Stockholders.

Section 16(A) Beneficial Ownership Reporting Compliance

Section 16(a) of the Exchange Act requires our directors, executive officers and holders of more than 10% of a registered class of our equity securities (collectively, "Reporting Persons") to file with the SEC initial reports of ownership and reports of changes in ownership of our common stock. Such persons are required by regulations of the SEC to furnish us with copies of all such filings. Based on our review of the copies of such filings received by us with respect to the fiscal year ended February 29, 2004, we believe that all filings required to be made by Reporting Persons in the fiscal year ended February 29, 2004, were timely made, with the following exceptions: Dr. Fox was granted an option to purchase 15,000 shares on July 31, 2003 which was reported on a Form 4 filed on August 15, 2003; Messrs. Kaiser and McDonald were each granted an option to purchase 10,000 shares on July 31, 2003 which were reported on Form 4s filed on October 22, 2003; Messrs. Thompson and Webbink were each granted an option on July 22, 2003 (100,000 shares for Mr. Thompson and 50,000 shares for Mr. Webbink) which were reported on Form 4s filed on August 21, 2003; and Mr. Wellman was granted an option to purchase 20,000 shares on July 31, 2003 which was reported on a Form 4 filed on August 13, 2004.

Code of Business Conduct and Ethics

We adopted a written Code of Business Conduct and Ethics that applies to our directors, officers and employees, including our principal executive officer, principal financial officer, principal accounting officer or controller, or persons performing similar functions. We have posted a current copy of the code on our website, which is located at www.redhat.com. In addition, we intend to post on our website all disclosures that are required by law or NASDAQ stock market listing standards concerning any amendments to, or waivers from, any provision of the code.

Director Candidates

The Board of Directors has a standing Nominating and Corporate Governance Committee. The members of the Nominating and Corporate Governance Committee are Dr. Fox, General Shelton and Mr. Kaiser. The process followed by the Nominating and Corporate Governance Committee to identify and evaluate director candidates includes requests to members of the Board of Directors and others for recommendations, meetings from time to time to evaluate biographical information and background material relating to potential candidates and interviews of selected candidates by members of the Committee and the Board.

In considering whether to recommend any particular candidate for inclusion in the Board's slate of recommended director nominees, the Nominating and Corporate Governance Committee will apply the criteria set forth in our Corporate Governance Guidelines. These criteria include the candidate's integrity, business acumen, knowledge of our business and industry, age, experience, diligence, conflicts of interest and the ability to act in the interests of all stockholders. In addition, any director who reaches the age of 75 while serving as a director will retire from the Board at the end of his or her term. The Committee does not assign specific weights to particular criteria and no particular criterion is a prerequisite for each prospective nominee. We believe that the backgrounds and qualifications of our directors, considered as a group, should provide a composite mix of experience, knowledge and abilities that will allow the Board to fulfill its responsibilities.

Stockholders may recommend individuals to the Nominating and Corporate Governance Committee for consideration as potential director candidates by submitting their names, together with appropriate biographical information and background materials and a statement as to whether the stockholder or group of stockholders making the recommendation has beneficially owned more than 5% of our common stock for at least a year as of the date such recommendation is made, to Nominating and Corporate Governance Committee, c/o Corporate Secretary. Assuming that appropriate biographical and background material has been provided on a timely basis, the Committee will evaluate stockholder-recommended candidates by following substantially the same process, and applying substantially the same criteria, as it follows for candidates submitted by others.

ITEM 11 Executive Compensation

The following table sets forth the annual and long-term compensation for each of the past three fiscal years of our (i) Chief Executive Officer (ii) each of our four most highly compensated executive officers who were serving as of February 29, 2004 and whose annual compensation exceeded \$100,000, and (iii) two additional officers who were no longer serving as executive officers as of February 29, 2004, but for whom disclosure would have been provided if such persons were serving as executive officers on February 29, 2004 (collectively, the “Named Officers”).

Summary Compensation Table

<i>Name and Principal Position</i>	Annual Compensation(1)			Long-Term Compensation		
	Fiscal Year	Salary (\$)	Bonus \$(2)	Restricted Stock Awards (\$)	Securities Underlying Options (#)	All Other Compensation
Matthew J. Szulik President and Chief Executive Officer	2004	350,000	174,675	—	1,000,000	1,704(4)
	2003	350,000	—	—	1,000,000	—
	2002	350,000	72,500	—	2,000,000	—
Paul J. Cormier Executive Vice President— Engineering	2004	275,000	59,172	—	100,000	—
	2003	275,000	—	—	100,000	—
	2002	225,112	10,000	—	425,000	—
Kevin B. Thompson Executive Vice President, Chief Financial Officer and Treasurer	2004	250,000	59,172	—	100,000	50,000
	2003	250,000	—	—	100,000	50,000
	2002	250,000	55,567	—	500,000	50,000
Alex Pinchev Executive Vice President, Worldwide Sales and President, International Operations	2004	219,872	51,516	—	700,000	3,585(4)
	2003(3)	—	—	—	—	—
	2002(3)	—	—	—	—	—
Timothy J. Buckley Former Executive Vice President and Chief Operating Officer	2004	188,500	71,006	—	—	20,192(5)
	2003	250,000	—	—	—	—
	2002	250,000	30,000	—	—	—
Mark H. Webbink Senior Vice President, General Counsel and Secretary	2004	185,000	33,582	—	50,000	2,189(4)
	2003	185,000	—	—	50,000	—
	2002	185,000	25,875	—	225,000	—
Anthony Moretto Vice President, Global Support Services	2004	190,000	22,485	—	50,000	1,432(4)
	2003	142,400	20,000	—	200,000	50,000(6)
	2002(6)	—	—	—	—	—

(1) Excludes perquisites and other personal benefits, the aggregate annual amount of which for each officer was less than the lesser of \$50,000 or 10% of the total salary and bonus reported.

(2) Bonuses are reported in the year earned, even if actually paid in a subsequent year.

(3) Not employed during that fiscal year.

(4) 401(k) matching our contribution.

(5) Accrued vacation pay.

(6) Relocation compensation

Option Grants in Last Fiscal Year

The following table sets forth grants of stock options granted during the fiscal year ended February 29, 2004 to the Named Officers.

Option Grants In Last Fiscal Year

Name	Individual Grants(1)					Potential Realizable Value at Assumed Annual Rates of Stock Price Appreciation for Option Term(3)	
	Number of Securities Underlying Options Granted (#)	Percent of Total Options Granted to Employees in Fiscal Year(2)	Exercise or Base Price (\$/Sh)	Market Price Per Share	Expiration Date	5%(\$)	10%(\$)
Matthew J. Szulik . . .	500,000	11.79%	\$6.70(4)	\$13.17	12/17/13	\$7,375,000.00	\$13,730,000.00
	500,000	11.79%	\$0.50(5)	\$13.17	12/17/13	\$10,475,000.00	\$16,830,000.00
Paul Cormier	100,000	2.36%	\$6.05	\$6.05	01/21/13	\$380,000.00	\$964,000.00
	100,000	2.36%	\$6.76	\$6.76	07/22/13	\$425,000.00	\$1,077,000.00
Kevin Thompson . . .	100,000	2.36%	\$6.76	\$6.76	07/22/13	\$425,000.00	\$1,077,000.00
	350,000	8.26%	\$6.15	\$6.15	04/23/13	\$1,354,500.00	\$3,430,000.00
Alex Pinchev	350,000	8.26%	\$13.53	\$13.53	11/07/13	\$2,978,500.00	\$7,546,000.00
	50,000	1.18%	\$6.76	\$6.76	07/22/13	\$212,500.00	\$538,500.00
Mark Webbink	50,000	1.18%	\$13.53	\$13.53	11/07/13	\$425,500.00	\$1,078,000.00
Timothy J. Buckley .	—	—	—	—	—	—	—

- (1) Except as noted, stock options were granted under our 1999 Stock Option and Incentive Plan (the “1999 Plan”) at an exercise price equal to the fair market value of our common stock on the date of grant.
- (2) Represents all options granted to the individual during the fiscal year ended February 29, 2004 as a percentage of all options granted to employees during the fiscal year ended February 29, 2004.
- (3) Amounts reported in these columns represent amounts that may be realized upon exercise of the options immediately prior to the expiration of their term assuming the specified compounded rates of appreciation (5% and 10%) on the market value of our common stock on the date of option grant over the term of the options. These numbers are calculated based on rules promulgated by the SEC and do not reflect our estimate of future stock price growth. Actual gains, if any, on stock option exercises and common stock holdings are dependent on the timing of such exercise and the future performance of our common stock. There can be no assurance that the rates of appreciation assumed in this table can be achieved or that the amounts reflected will be received by the individuals.
- (4) Option to purchase 500,000 shares for \$6.70 per share. Fair market value on the date of grant was \$13.17, resulting in deferred compensation of \$3,235,000 that is being amortized over the life of the option grant.
- (5) Option to purchase 500,000 shares for \$0.50 per share issued pursuant to Restricted Stock Agreement. Fair market value on the date of grant was \$13.17, resulting in deferred compensation of \$6,335,000 that is being amortized over the life of the option grant.

Option Exercises and Fiscal Year-End Values

The following table sets forth information with respect to options to purchase our common stock granted to the Named Officers, including (i) the number of shares of common stock purchased upon exercise of options in the fiscal year ended February 29, 2004; (ii) the net value realized upon such exercise; (iii) the number of unexercised options outstanding at February 29, 2004; and (iv) the value of such unexercised options at February 29, 2004.

Aggregated Option Exercises In Last Fiscal Year And Fiscal Year-End Option Values

<u>Name</u>	<u>Shares Acquired on Exercise (#)</u>	<u>Value Realized (\$)</u>	<u>Number of Securities Underlying Unexercised Options at February 29, 2004 (#) Exercisable/Unexercisable</u>	<u>Value of Unexercised In-the-Money Options at February 29, 2004 \$(1) Exercisable/Unexercisable</u>
Matthew J. Szulik	1,400,232	\$26,759,729	3,819,907/1,625,001	\$53,273,386/\$27,135,000
Timothy J. Buckley	850,000	\$8,343,750	174,999/0	0/0
Kevin B. Thompson	200,000	\$791,358	368,750/406,250	\$6,670,687/\$7,349,062.50
Paul J. Cormier	80,000	\$895,000	237,187/307,813	\$4,290,713/\$5,568,337
Alex Pinchev	—	—	0/700,000	\$0/\$5,775,000
Mark H. Webbink	102,000	\$547,312	146,436/176,564	\$1,037,914/\$2,996,156
Anthony Moretto	35,000	\$369,350	40,000/175,000	\$506,000/\$1,809,250

- (1) Amounts disclosed in this column do not reflect amounts actually received by the Named Executive Officers but are calculated based on the difference between the fair market value of our common stock on the date of exercise and the exercise price of the options. The Named Executive Officers will receive cash only if and when they sell the common stock issued upon exercise of the options, and the amount of cash received by such individuals is dependent on the price of our common stock at the time of such sale. Value is based on the difference between the option exercise price and the fair market value at February 29, 2004, the fiscal year-end (\$18.09 per share as quoted on the NASDAQ National Market for February 27, 2004), multiplied by the number of shares underlying the option.

Compensation of Directors

In April 2004 the Board of Directors revised the compensation program for independent directors. Under the new compensation program, independent directors will receive both cash equity compensation. In addition, directors will continue to be reimbursed for reasonable out-of-pocket expenses incurred in attending meetings of the Board of Directors and for meetings of any committees of the Board of Directors on which they serve. Until August 5, 2004, cash compensation of current independent directors will continue to be limited to the following: The Chairman of the Audit Committee and the director designated as the Lead Director by the independent directors each are paid \$10,000 per year in equal quarterly installments. Effective April 2004 for any newly elected independent directors and effective August 5, 2004, for all current independent directors, such independent directors will receive cash fees, paid in equal quarterly amounts, as follows:

- Each independent director will receive an annual cash fee of \$30,000 for board service;
- the Lead Director will receive an additional annual cash fee of \$20,000;
- each independent director serving on a standing committee will receive an annual cash retainer of \$10,000 (Audit Committee) or \$5,000 (Compensation or Nominating Committee) for each standing committee on which they serve; and

- each chair of a standing committee (other than the Lead Director if he/she also serves as a committee chair) will receive an annual cash fee of \$20,000 (Audit Committee) or \$10,000 (Compensation or Nominating Committee) for each standing committee on which they serve as chair.

In addition, directors may choose to defer all or a portion of their cash compensation into fully vested deferred stock units, which represent the right to receive shares of our common stock, at the earlier of (1) termination of the director's board service or (2) a future date, at least one year following the date of issuance of the deferred stock unit, as designated by the director on or before the issuance of the deferred stock unit.

Independent directors are also eligible to receive equity compensation under Red Hat's 1999 Stock Option and Incentive Plan and any successor plans. Until August 6, 2004, current independent directors will continue to those stock option grants set forth under the grant plan for non-employee directors in effect prior to April 2004. Under that program: (a) those independent directors re-elected at the 2004 Annual Meeting will receive options to purchase 20,000 shares of our common stock at the fair market value on the date of grant and vesting over a three-year period; and (b) those independent directors who have completed one year of service as of the 2004 Annual Meeting will receive options to purchase 10,000 shares of our common stock at the fair market value on the date of grant and vesting immediately. For all new independent directors elected after April 2004 and for all current independent directors continuing service after the 2004 Annual Meeting, such independent directors shall receive equity compensation under our then effective stock option plan as follows:

- Upon initial election to the board, options to purchase 40,000 shares of our common stock at the fair market value on the date of grant and vesting over a three-year period; and
- At the date of each annual stockholder's meeting, for those independent directors who have completed at least 8 months of service, options to purchase 10,000 shares of our common stock at the fair market value on the date of grant and fully vested at the time of grant.

In addition, directors may choose to receive any portion of their equity compensation in the form of deferred stock units at the ratio of 35 deferred stock units for every 100 shares of options granted. The deferred stock units vest on the same terms as the underlying grant, and they may be converted into shares of our common stock at the earlier of (1) termination of the director's board service or (2) a future date, at least one year following the date of issuance of the deferred stock unit but not before vesting, as designated by the director on or before the issuance of the deferred stock unit. The following table sets forth the options granted to non-employee directors during the fiscal year ended February 29, 2004.

Option Grants To Non-Employee Directors In Last Fiscal Year

<u>Name</u>	<u>Type</u>	<u>No. of Shares</u>	<u>Exercise Price</u>
Eugene J. McDonald	Annual	10,000	\$6.32
William S. Kaiser	Annual	10,000	\$6.32
F. Selby Wellman	Re-Election	20,000	\$6.32
Marye Anne Fox	Re-Election	20,000	\$6.32
W. Steve Albrecht	New Election	40,000	\$6.15
H. Hugh Shelton	New Election	40,000	\$6.15

Executive Employment Arrangements

Effective July 24, 2002, we entered into an Employment Agreement with Matthew J. Szulik, our Chief Executive Officer and President, which will remain in effect until terminated in accordance with the agreement. Mr. Szulik's arrangement includes an annual salary of \$350,000, subject to increase, annual incentive cash bonus equal to the greater of \$200,000 or fifty percent of his salary as well as annual stock option awards of at least 500,000 shares which shall vest in equal amounts on a quarterly basis over a four year period following the date

of grant. Upon a Change of Control (as defined in the agreement), all of Mr. Szulik's stock options shall vest. The agreement also requires us to purchase a \$1,000,000 term life insurance policy on behalf of Mr. Szulik. In the event of involuntary termination without Cause (as defined in the agreement) or voluntary termination with Good Reason (as defined in the agreement), we will pay Mr. Szulik's base salary plus average bonus for a period of two years and any unvested options granted during the term of the agreement will continue to vest during the calendar year of Mr. Szulik's termination. If the termination follows a Change of Control, then Mr. Szulik shall instead be entitled to receive a lump sum cash payment equal to three times the sum of the base salary plus an amount equal to the average annual bonus paid in the two previous years. In the event that compensation paid to Mr. Szulik by us is subject to tax imposed by Section 4999 of the Internal Revenue Code, we will increase the amount paid to cover such additional taxes.

Mr. Szulik is also a party to a restricted stock purchase agreement dated June 27, 2001, which provides for the forfeiture of purchase rights and/or Red Hat's repurchase right as to any purchased but unvested shares upon his voluntary termination of employment. Under the restricted stock purchase agreement, the share restrictions lapse ratably over a period of two years. These shares are fully vested. In addition, on December 17, 2003, Mr. Szulik was granted a restricted stock grant under the same terms as the earlier restricted stock grant.

Kevin B. Thompson owes us \$20,833 remaining on a \$200,000 relocation advance made in 2001. The advance is non-interest bearing and is forgiven (a) ratably over four years provided Mr. Thompson remains in our employment or (b) immediately upon any termination of Mr. Thompson's employment without cause.

On April 23, 2003, the Board of Directors adopted a policy with respect to accelerated vesting of options upon a change of control which applies to the Named Officers. Pursuant to this policy, in the event of a change of control involving us, any Named Officer who is terminated as a result of such change of control, either involuntarily or constructively, without cause within twelve months of the change of control, shall immediately vest in 100% of his/her remaining unvested options and such options shall be immediately exercisable, subject to any established trading window policy that may apply. This policy will supercede the terms of any written contract we have with any Named Officer to the extent that this policy provides a greater benefit to the Named Officer than the written contract.

Compensation Committee Interlocks and Insider Participation

The compensation committee of the Board of Directors is composed of the three outside and independent directors, as was the case during the fiscal year ended February 29, 2004. Compensation Committee members do not have any non-trivial professional, familial or financial relationship with our Chief Executive Officer or other executive officers, other than his directorship.

ITEM 12. Security Ownership of Certain Beneficial Owners and Management

The following table sets forth, as of February 29, 2004, the number of shares of our common stock authorized to be issued, the weighted average exercise price of such shares and the number of shares remaining available for future issuance, aggregated as follows: (i) all compensation plans previously approved by our stockholders and (ii) all compensation plans not previously approved by our stockholders and (iii) total of (i) and (ii).

<u>Plan Category(1)</u>	<u>(a) Number of Securities to be issued upon exercise of outstanding options, warrants and rights</u>	<u>(b) Weighted-average exercise price of outstanding options, warrants and rights</u>	<u>(c) Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))</u>
Equity compensation plans			
approved by security holders	21,222,255(2)	\$7.5488	7,687,396(3)
Equity compensation plans not			
approved by security holders	—	—	—
Total	21,222,255(2)	\$7.5488	7,687,396(3)

- (1) This table excludes an aggregate of 403,481 shares of our common stock with a weighted-average exercise price of \$8.767 are issuable upon exercise of options issued under compensation plans of the following entities: Akopia, Inc., BlueCurve, Inc., C2Net Software, Inc., Cygnus Solutions, Inc., Planning Technologies, Inc., Sistina Software, Inc. and Wirespeed Communications Corporation (collectively, the “Acquired Companies”). We assumed these options in connection with the acquisition of the Acquired Companies. No additional shares of our common stock remain available for future issuance under the Acquired Companies’ compensation plans.
- (2) Consists of 18,697,065 shares of our common Stock issuable upon exercise of options outstanding under the 1999 Plan and 2,525,190 shares of our common Stock issuable upon exercise of options outstanding under our 1998 Stock Option Plan, as amended.
- (3) Consists of 6,777,745 shares of our common stock remaining available for future issuance under the 1999 Plan (excluding shares reflected in column (a)) and 909,651 shares of our common stock remaining available for issuance under the 1999 Employee Stock Purchase Plan, as amended on October 23, 2002.

Security Ownership of Certain Beneficial Owners and Management

The following table sets forth as of February 29, 2004 (unless otherwise indicated), certain information regarding beneficial ownership of our common stock (i) by each person who is known to beneficially own 5% of the outstanding common stock, (ii) by each of our directors, (iii) by each Named Officer and (iv) by all of our directors and executive officers as a group.

The number of shares of common stock beneficially owned by each 5% stockholder, director or executive officer is determined under rules of the SEC. Under such rules, beneficial ownership includes any shares as to which the individual or entity has sole or shared voting power or investment power and includes any shares of common stock which the individual had the right to acquire on or before April 29, 2004 through the exercise of options, and any reference in the footnotes to this table to shares subject to options refers only to options that are so exercisable. For purposes of computing the percentage of outstanding shares of common stock held by each person or entity, any shares which that person or entity had the right to acquire on or before April 29, 2004 are deemed to be outstanding but are not deemed to be outstanding for the purpose of computing the percentage ownership of any other person. As of February 29, 2004, we had approximately 170,821,328 shares outstanding.

<u>Name and Address (1)</u>	<u>Title(s)</u>	<u>Amount and Nature of Beneficial Ownership(2)</u>	<u>Percent of Common Stock Outstanding</u>
FMR Corporation (3) 82 Devonshire Street Boston, MA 02109	5% Beneficial Owner	25,882,257	17.86%
Wellington Management Co., LLP (4) 75 State Street Boston, MA 02109	5% Beneficial Owner	13,837,959	8.81%
T. Rowe Price (5) 100 East Pratt Street Baltimore, MD 21202	5% Beneficial Owner	9,796,000	6.08%
Mazama Capital Management, Inc. (6) One S.W. Columbia, Suite 1500 Portland, OR 97258	5% Beneficial Owner	8,187,398	5.03%
Robert F. Young (7)	Director and 5% Beneficial Owner	9,270,377	5.74%
Matthew Szulik (8)	Chairman of the Board, President, and Chief Executive Officer	6,414,420	3.90%
Timothy J. Buckley (9) 4805 Wynneford Way Raleigh, NC 27614	Executive Vice President and Chief Operating Officer	174,999	*
William S. Kaiser (10)	Director	852,496	*
Anthony Moretto (11)	Vice President	52,499	*
Kevin B. Thompson (12)	Executive Vice President, Chief Financial Officer and Treasurer	393,000	*

<u>Name and Address (1)</u>	<u>Title(s)</u>	<u>Amount and Nature of Beneficial Ownership(2)</u>	<u>Percent of Common Stock Outstanding</u>
Alex Pinchev (13)	Executive Vice President, International Sales/Operations and President of the Red Hat International Division	87,500	*
Paul J. Cormier (14)	Executive Vice President—Engineering	243,437	*
Mark H. Webbink (15)	Senior Vice President, General Counsel, and Secretary	135,236	*
Eugene J. McDonald (16)	Director	76,666	*
Marye Anne Fox (17)	Director	33,124	
Dr. W. Steve Albrecht (18)	Director	13,333	
Gen. H. Hugh Shelton, U.S. Army Retired (19)	Director	13,333	
All executive officers and directors as a group (13 persons) (20)		17,760,420	11.60%

* Less than one percent of the outstanding common stock.

- (1) Unless otherwise indicated, the address for each beneficial owner is c/o Red Hat, Inc., 1801 Varsity Drive, Raleigh, North Carolina 27606.
- (2) The persons named in the table have sole voting and investment power with respect to all shares shown as beneficially owned by them, except as noted in the footnotes below and subject to community property laws, if applicable. The inclusion herein of any shares of common stock deemed beneficially owned does not constitute an admission of beneficial ownership of those shares.
- (3) Based on a Schedule 13G filed with the SEC on February 16, 2004.
- (4) Based on a Schedule 13G filed with the SEC on December 31, 2003.
- (5) Based on Schedule 13G filed with the SEC on February 13, 2004.
- (6) Based on Schedule 13G filed with the SEC on September 19, 2003.
- (7) Includes 3,063,718 shares held of record by Nancy Young, Mr. Young's wife, 223,860 shares held of record by the Young Family Trust dated April 28, 1999 and 2,293,380 shares held of record by trusts for the benefit of Mr. Young's children. Mr. Young disclaims beneficial ownership of these shares.
- (8) Includes 72,000 shares held of record by trusts for the benefit of Mr. Szulik's children. Mr. Szulik disclaims beneficial ownership of these shares. Also includes 16,472 shares held of record by the Matthew J. Szulik GRAT dated May 26, 1999. Also includes 4,028,436 shares of common stock issuable upon exercise of stock options and restricted stock.
- (9) Includes 149,998 shares of common stock issuable upon exercise of stock options.
- (10) Includes 81,666 shares of common stock issuable upon exercise of stock options.
- (11) Includes 52,499 shares of common stock issuable upon exercise of stock options.
- (12) Includes 393,000 shares of common stock issuable upon exercise of stock options.
- (13) Includes 87,500 shares of common stock issuable upon exercise of stock options.
- (14) Includes 243,437 shares of common stock issuable upon exercise of stock options.
- (15) Includes 134,249 shares of common stock issuable upon exercise of stock options.
- (16) Includes 76,666 shares of common stock issuable upon exercise of stock options.
- (17) Includes 33,124 shares of common stock issuable upon exercise of stock options.
- (18) Includes 13,333 shares of common stock issuable upon exercise of stock options.
- (19) Includes 13,333 shares of common stock issuable upon exercise of stock options.
- (20) Includes 1,278,805 shares of common stock issuable upon exercise of stock options and 1,062,500 shares of common stock issuable upon exercise of restricted stock purchase rights.

ITEM 13. Certain Relationships and Related Transactions

During fiscal year 2001, Kevin B. Thompson received a \$200,000 relocation advance from us in connection with his employment as our Chief Financial Officer. The advance is non-interest bearing and is forgiven (a) ratably over four years provided Mr. Thompson remains in our employment or (b) immediately upon any termination of Mr. Thompson's employment without cause. During the fiscal year 2004, \$50,000 of this advance was forgiven. As of February 29, 2004, Mr. Thompson owed us \$20,833 of this relocation expense.

ITEM 14. Principal Accountant Fees and Services

The following table summarizes the fees of PricewaterhouseCoopers, LLP our independent auditor, billed to us for each of the last two fiscal years for audit services and billed to us in each of the last two fiscal years for other services:

<u>Fee Category</u>	<u>Fiscal Year Ended February 29, 2004</u>	<u>Fiscal Year Ended February 29, 2003</u>
Audit Fees (1)	\$361,045	\$293,000
Audit-Related Fees (2)	\$319,275	\$ —
Tax Fees (3)	\$ 750	\$ 14,800
All Other Fees (4)	\$ —	\$ —
Total Fees	<u>\$681,070</u>	<u>\$307,800</u>

- (1) Audit fees consist of fees for the audit of our financial statements, the review of the interim financial statements included in our quarterly reports on Form 10-Q, and other professional services provided in connection with statutory and regulatory filings or engagements.
- (2) Audit-related fees consist of fees for assurance and related services that are reasonably related to the performance of the audit and the review of our financial statements and which are not reported under "Audit Fees." These services relate to services provided in connection with (a) registration statements filed to register shares issued in acquisitions, (b) the Sistina acquisition, and (c) the \$600 million convertible debt offering in January 2004.
- (3) Tax fees consist of fees for tax compliance, tax advice and tax planning services. Tax compliance services, which relate to the preparation of original and amended tax returns, accounted for all of the total tax fees billed in 2003 and 2004.

Pre-Approval Policies and Procedures

The Audit Committee has adopted policies and procedures relating to the approval of all audit and non-audit services that are to be performed by our independent auditor. This policy generally provides that we will not engage our independent auditor to render audit or non-audit services unless the service is specifically approved in advance by the Audit Committee or the engagement is entered into pursuant to one of the pre-approval procedures described below.

From time to time, the Audit Committee may pre-approve specified types of services that are expected to be provided to us by our independent auditor during the next 12 months. Any such pre-approval is detailed as to the particular service or type of services to be provided and is also generally subject to a maximum dollar amount.

The Audit Committee has also delegated to the chairman of the Audit Committee the authority to approve any audit or non-audit services to be provided to us by our independent auditor. The Audit Committee may delegate this pre-approval authority to other individual members of the Audit Committee from time to time. Any approval of services by a member of the Audit Committee pursuant to this delegated authority is reported on at the next meeting of the Audit Committee.

PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES, AND REPORTS ON FORM 8-K.

(a) The following documents are filed as part of this Report under “Item 8-Financial Statements and Supplementary Data”:

1. Financial Statements:

Report of Independent Auditors	39
Consolidated Balance Sheets at February 29, 2004 and February 28, 2003	40
Consolidated Statements of Operations for the years ended February 29, 2004, and February 28, 2003 and 2002	41
Consolidated Statements of Stockholders’ Equity for the years ended February 29, 2004, and February 28, 2003 and 2002	42
Consolidated Statements of Cash Flows for the years ended February 29, 2004, and February 28, 2003 and 2002	43
Notes to Consolidated Financial Statements	44

2. Financial Statement Schedules:

All other schedules for which provision is made in the applicable accounting regulations of the Securities and Exchange Commission are not required under the related instructions or are inapplicable and therefore have been omitted.

3. List of Exhibits:

<u>Exhibit No.</u>	<u>Description of Exhibit</u>
3.1	Third Amended and Restated Certificate of Incorporation, as amended, of the registrant (incorporated by reference to Exhibit 3.1 to the registrant’s Registration Statement on Form S-1 (File no. 333-94775))
3.2	Amended and Restated By-laws, as amended, of the registrant (incorporated by reference to Exhibit 3.2 to the registrant’s Registration Statement on Form S-1 (File no. 333-94775))
4.1	Specimen certificate representing the common stock of the registrant (incorporated by reference to Exhibit 4.1 to the registrant’s Registration Statement on Form S-1 (File no. 333-80051))
4.2	See Exhibits 3.1 and 3.2 for provisions of the Certificate of Incorporation and By-laws of the registrant defining the rights of holders of common stock of the registrant
4.3	Registration Rights Agreement, dated January 12, 2004, between the registrant and UBS Securities LLC
4.4	Indenture, dated as of January 12, 2004, by and between the registrant, as issuer, and U.S. Bank Trust N.A., as trustee, for the 0.50% Convertible Senior Debentures due 2024, including the form of 0.50% Convertible Senior Debentures due 2024 attached thereto as Exhibit A
10.1*	Red Hat, Inc. 1998 Stock Option Plan, as amended (incorporated by reference to Exhibit 10.1 to the registrant’s Registration Statement on Form S-1 (File no. 333-80051))
10.2*	Red Hat, Inc. 1999 Stock Option and Incentive Plan, as amended (incorporated by reference to Exhibit 10.1 to the registrant’s Quarterly Report on Form 10-Q filed with the SEC on June 27, 2003)
10.3*	Red Hat, Inc. 1999 Employee Stock Purchase Plan (incorporated by reference to Exhibit 10.3 to the registrant’s Registration Statement on Form S-1 (File no. 333-80051))

<u>Exhibit No.</u>	<u>Description of Exhibit</u>
10.4	First Amended and Restated Investor Rights Agreement by and among the registrant and the Investors and Founders listed therein, dated as of February 25, 1999, as amended (incorporated by reference to Exhibit 10.7 to the registrant's Registration Statement on Form S-1 (File no. 333-80051))
10.5*	Non-Qualified Stock Option Agreement by and between the registrant and Matthew Szulik (incorporated by reference to Exhibit 10.9 to the registrant's Registration Statement on Form S-1 (File no. 333-80051))
10.6*	Incentive Stock Option Agreement by and between the registrant and Matthew Szulik (incorporated by reference to Exhibit 10.10 to the registrant's Registration Statement on Form S-1 (File no. 333-80051))
10.7*	Non-Qualified Stock Option Agreement by and between the registrant and Timothy Buckley (incorporated by reference to Exhibit 10.11 to the registrant's Registration Statement on Form S-1 (File no. 333-80051))
10.8*	Incentive Stock Option Agreement by and between the registrant and Timothy Buckley (incorporated by reference to Exhibit 10.12 to the registrant's Registration Statement on Form S-1 (File no. 333-80051))
10.9	GNU General Public License (incorporated by reference to Exhibit 10.13 to the registrant's Registration Statement on Form S-1 (File no. 333-80051))
10.10*	Employment Agreement by and between the registrant and Matthew Szulik dated July 24, 2002 (incorporated by reference to Exhibit 10.10 to the registrant's Annual Report on Form 10-K filed with the SEC on May 29, 2003)
10.11*	Restricted Stock Award Agreement by and between the registrant and Matthew Szulik dated June 27, 2001 (incorporated by reference to Exhibit 10.10 to the registrant's Annual Report on Form 10-K filed with the SEC on May 29, 2003)
10.12*	Restricted Stock Award Agreement by and between the registrant and Matthew Szulik dated December 17, 2003
21.1	Subsidiaries of Red Hat, Inc.
23.1	Consent of PricewaterhouseCoopers LLP
31.1	Certification of the registrant's Chief Executive Officer pursuant to Rule 13a-14(a)/Rule 15(d)-14(a) under the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of the registrant's Chief Financial Officer pursuant to Rule 13a-14(a)/Rule 15(d)-14(a) under the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification of Principal Executive Officer and Principal Financial Officer pursuant to 18 U.S.C. Section 1350 dated May 29, 2003

* Indicates a management contract or compensatory plan, contract or arrangement

(b) Reports on Form 8-K:

On December 18, 2003, we filed a Current Report on Form 8-K with the SEC for the purpose of furnishing under Item 12 (Results of Operations and Financial Condition) a copy of our earnings release for the quarter ended November 30, 2003.

On December 18, 2003, we filed a Current Report on Form 8-K with the SEC under Item 5 (Other Events and Required FD Disclosure) announcing our merger with Sistina.

On January 6, 2004, we filed a Current Report on Form 8-K with the SEC under Items 2 (Acquisition or Disposition of Assets) and 7 (Financial Statements, Pro Forma Financial Information and Exhibits) announcing the closing of our merger with Sistina.

On January 6, 2004, we filed a Current Report on Form 8-K with the SEC under Item 5 (Other Events and Required FD Disclosure) announcing our intention to offer \$400 million (plus up to an additional \$80 million pursuant to an option granted to the initial purchaser) of convertible senior debentures due 2024 pursuant to Rule 144A under the Securities Act of 1933, as amended.

On January 7, 2004, we filed a Current Report on Form 8-K with the SEC under Item 5 (Other Events and Required FD Disclosure) announcing the pricing of \$500 million aggregate principal amount of convertible senior debentures due 2024, to be sold pursuant to Rule 144A under the Securities Act of 1933, as amended (plus up to an additional \$100 million pursuant to an option granted to the initial purchaser).

On January 9, 2004, we filed a Current Report on Form 8-K/A with the SEC under Item 5 (Other Events and Required FD Disclosure) to correct a typographical error in the Form 8-K filed on January 7, 2004.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

RED HAT, INC.

By: /s/ MATTHEW J. SZULIK
Matthew J. Szulik
President and Chief Executive Officer

Date: May 14, 2004

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

<u>Signature</u>	<u>Title</u>	<u>Date</u>
<u> /s/ MATTHEW J. SZULIK </u> Matthew J. Szulik	Chief Executive Officer, President and Chairman of the Board of Directors (principal executive officer)	May 14, 2004
<u> /s/ KEVIN B. THOMPSON </u> Kevin B. Thompson	Executive Vice President and Chief Financial Officer (principal financial and accounting officer)	May 14, 2004
<u> /s/ ROBERT F. YOUNG </u> Robert F. Young	Director	May 14, 2004
<u> /s/ EUGENE McDONALD </u> Eugene McDonald	Director	May 14, 2004
<u> /s/ WILLIAM S. KAISER </u> William S. Kaiser	Director	May 14, 2004
<u> /s/ MARYE ANNE FOX, PH.D. </u> Marye Anne Fox, Ph. D.	Director	May 14, 2004
<u> /s/ W. STEVE ALBRECHT </u> W. Steve Albrecht	Director	May 14, 2004
<u> /s/ HENRY HUGH SHELTON </u> Henry Hugh Shelton	Director	May 14, 2004

REGISTRATION RIGHTS AGREEMENT

THIS REGISTRATION RIGHTS AGREEMENT (the “Agreement”) is made and entered into as of January 12, 2004, by and between Red Hat, Inc., a Delaware corporation (the “Company”), and UBS Securities LLC (the “Initial Purchaser”) pursuant to that certain Purchase Agreement, dated as of January 6, 2004 (the “Purchase Agreement”), between the Company and the Initial Purchaser.

In order to induce the Initial Purchaser to enter into the Purchase Agreement, the Company has agreed to provide the registration rights set forth in this Agreement. The execution of this Agreement is a condition to the closing under the Purchase Agreement.

The Company agrees with the Initial Purchaser (i) for its benefit as Initial Purchaser and (ii) for the benefit of the beneficial owners (including the Initial Purchaser) from time to time of the Debentures (as defined herein) and the beneficial owners from time to time of the Underlying Common Stock (as defined herein) issued upon conversion of the Debentures (each of the foregoing a “Holder” and together the “Holders”), as follows:

Section 1. *Definitions.* Capitalized terms used herein without definition shall have their respective meanings set forth in the Purchase Agreement. As used in this Agreement, the following terms shall have the following meanings:

“Affiliate” means with respect to any specified person, an “affiliate,” as defined in Rule 144, of such person.

“Amendment Effectiveness Deadline Date” has the meaning set forth in Section 2(d) hereof.

“Applicable Conversion Price” means, as of any date of determination, \$1,000 divided by the Conversion Rate then in effect as of the date of determination or, if no Debentures are then outstanding, the Conversion Rate that would be in effect were Debentures then outstanding.

“Business Day” means each day on which the Nasdaq National Market is open for trading.

“Common Stock” means the shares of common stock, par value \$0.0001 per share, of the Company and any other shares of capital stock as may constitute “Common Stock” for purposes of the Indenture, including the Underlying Common Stock.

“Conversion Rate” has the meaning assigned to such term in the Indenture.

“Damages Accrual Period” has the meaning set forth in Section 2(e) hereof.

“Damages Payment Date” means each interest payment date under the Indenture in the case of Debentures, and each January 15 and July 15 in the case of the Underlying Common Stock.

“Debentures” means the 0.50% Convertible Senior Debentures due 2024 of the Company to be purchased pursuant to the Purchase Agreement.

“Effectiveness Deadline Date” has the meaning set forth in Section 2(a) hereof.

“Effectiveness Period” means a period (subject to extension pursuant to Section 3(i) hereof) from the original issuance of the Debentures until the earlier of (1) the date on which each of the Registrable Securities has been effectively registered under the Securities Act and disposed of in accordance with the Shelf Registration Statement; (2) the date on which each of the Registrable Securities not held by Affiliates is saleable pursuant to Rule 144(k) under the Securities Act; (3) the date on which all the Registrable Securities have been resold pursuant to Rule 144 under the Securities Act; and (4) the second anniversary of the latest date of issuance of any Debentures (including any Debentures issued pursuant to the initial purchaser’s option).

“Event” has the meaning set forth in Section 2(e) hereof.

“Event Date” has the meaning set forth in Section 2(e) hereof.

“Exchange Act” means the Securities Exchange Act of 1934, as amended, and the rules and regulations of the SEC promulgated thereunder.

“Filing Deadline Date” has the meaning set forth in Section 2(a) hereof.

“Holder” has the meaning set forth in the third paragraph of this Agreement.

“Indenture” means the Indenture, dated as of January 12, 2004, between the Company and US Bank Trust, National Association, as trustee, pursuant to which the Debentures are being issued.

“Initial Purchaser” has the meaning set forth in the preamble hereto.

“Initial Shelf Registration Statement” has the meaning set forth in Section 2(a) hereof.

“Issue Date” means the first date of original issuance of any of the Debentures.

“Liquidated Damages Amount” has the meaning set forth in Section 2(e) hereof.

“Material Event” has the meaning set forth in Section 3(i) hereof.

“Notice and Questionnaire” means a written notice and questionnaire delivered to the Company containing substantially the information called for by the Selling Securityholder Notice and Questionnaire attached as Annex A to the Offering Memorandum dated January 6, 2004, relating to the Debentures.

“Notice Holder” means, on any date, any Holder that has delivered a Notice and Questionnaire to the Company on or prior to such date, so long as all of their Registrable Securities that have been registered for resale pursuant to a Notice and Questionnaire have not been sold in accordance with a Shelf Registration Statement.

“Purchase Agreement” has the meaning set forth in the preamble hereof.

“Prospectus” means the prospectus included in any Shelf Registration Statement (including, without limitation, a prospectus that discloses information previously omitted from a prospectus filed as part of an effective registration statement in reliance upon Rule 415 promulgated under the Securities Act), as amended or supplemented by any amendment or prospectus supplement, including post-effective amendments, and all materials incorporated by reference or explicitly deemed to be incorporated by reference in such Prospectus.

“Record Holder” means (i) with respect to any Damages Payment Date relating to any Debentures as to which any such Liquidated Damages Amount has accrued, the holder of record of such Debenture on the record date with respect to the interest payment date under the Indenture on which such Damages Payment Date shall occur and (ii) with respect to any Damages Payment Date relating to the Underlying Common Stock as to which any such Liquidated Damages Amount has accrued, the registered holder of such Underlying Common Stock fifteen (15) days prior to such Damages Payment Date.

“Registrable Securities” means the Debentures until such Debentures have been converted into the Underlying Common Stock and, at all times the Underlying Common Stock and any securities of the Company into or for which such Underlying Common Stock has been converted, and any security issued with respect thereto upon any stock dividend, split or similar event until, in the case of any such security, the earliest of (x) the date on which such security has been effectively registered under the Securities Act and disposed of, whether or not in accordance with the Shelf Registration Statement and (y) the date on which such security is sold to the public pursuant to Rule 144 under the Securities Act or is saleable pursuant to Rule 144(k) under the Securities Act.

“Registration Expenses” has the meaning set forth in Section 5 hereof.

“Registration Statement” means any registration statement of the Company that covers any of the Registrable Securities pursuant to the provisions of this Agreement including the Prospectus, amendments and supplements to such registration statement, including post-effective amendments, all exhibits, and all materials incorporated by reference or explicitly deemed to be incorporated by reference in such registration statement.

“Rule 144” means Rule 144 under the Securities Act, as such Rule may be amended from time to time, or any similar rule or regulation hereafter adopted by the SEC.

“Rule 144A” means Rule 144A under the Securities Act, as such Rule may be amended from time to time, or any similar rule or regulation hereafter adopted by the SEC.

“SEC” means the Securities and Exchange Commission.

“Securities Act” means the Securities Act of 1933, as amended, and the rules and regulations of the SEC promulgated thereunder.

“Shelf Registration Statement” has the meaning set forth in Section 2(a) hereof.

“Subsequent Shelf Registration Statement” has the meaning set forth in Section 2(b) hereof.

“Suspension Notice” has the meaning set forth in Section 3(i) hereof.

“Suspension Period” has the meaning set forth in Section 3(i) hereof.

“TIA” means the Trust Indenture Act of 1939, as amended.

“Trustee” means US Bank Trust National Association, the Trustee under the Indenture.

“Underlying Common Stock” means the Common Stock into which the Debentures are convertible or issued upon any such conversion.

Section 2. *Shelf Registration.* (a) The Company shall prepare and file or cause to be prepared and filed with the SEC, by the date (the “Filing Deadline Date”) that is one hundred twenty (120) days after the Issue Date, a Registration Statement for an offering to be made on a delayed or continuous basis pursuant to Rule 415 of the Securities Act (a “Shelf Registration Statement”) registering the resale from time to time by Holders thereof of all of the Registrable Securities (the “Initial Shelf Registration Statement”). The Initial Shelf Registration Statement shall be on Form S-1 or S-3 or another appropriate form permitting registration of such Registrable Securities for resale by such Holders in

accordance with the reasonable methods of distribution elected by the Holders, approved by the Company, and set forth in the Initial Shelf Registration Statement. The Company shall use its reasonable best efforts to cause the Initial Shelf Registration Statement to be declared effective under the Securities Act by the date (the “Effectiveness Deadline Date”) that is two hundred ten (210) days after the Issue Date, and to use its reasonable best efforts to keep the Initial Shelf Registration Statement (or any Subsequent Shelf Registration Statement) continuously effective under the Securities Act until the expiration of the Effectiveness Period. At the time the Initial Shelf Registration Statement is declared effective, each Holder that became a Notice Holder on or prior to the date that is ten (10) Business Days prior to such time of effectiveness shall be named as a selling securityholder in the Initial Shelf Registration Statement and the related Prospectus in such a manner as to permit such Holder to deliver such Prospectus to purchasers of Registrable Securities in accordance with applicable law.

(b) If the Initial Shelf Registration Statement or any Subsequent Shelf Registration Statement ceases to be effective for any reason at any time during the Effectiveness Period, the Company shall use its reasonable best efforts to obtain the prompt withdrawal of any order suspending the effectiveness thereof, and in any event shall within forty-five (45) days of such cessation of effectiveness to use its reasonable best efforts to amend the Shelf Registration Statement in a manner reasonably expected to obtain the withdrawal of the order suspending the effectiveness thereof, or use its reasonable best efforts to file an additional Shelf Registration Statement covering all of the securities that as of the date of such filing are Registrable Securities (a “Subsequent Shelf Registration Statement”). If a Subsequent Shelf Registration Statement is filed, the Company shall use its reasonable best efforts to cause the Subsequent Shelf Registration Statement to become effective as promptly as is reasonably practicable after such filing and to keep such Shelf Registration Statement (or subsequent Shelf Registration Statement) continuously effective until the end of the Effectiveness Period.

(c) The Company shall supplement and amend the Shelf Registration Statement if required by the rules, regulations or instructions applicable to the registration form used by the Company for such Shelf Registration Statement, if required by the Securities Act or as reasonably requested by the Initial Purchaser or by the Trustee on behalf of the Holders of the Registrable Securities covered by such Shelf Registration Statement to correct material misstatements with respect to a Holder or as necessary to name a Notice Holder as a selling securityholder in accordance with Section 2(d) below.

(d) Each Holder of Registrable Securities agrees that if such Holder wishes to sell Registrable Securities pursuant to a Shelf Registration Statement and related Prospectus, it will do so only in accordance with this Section 2(d) and Section 3(i). Each Holder of Registrable Securities wishing to sell Registrable Securities pursuant to a Shelf Registration Statement and related Prospectus

agrees to deliver a completed and executed Notice and Questionnaire to the Company prior to any attempted or actual distribution of Registrable Securities under the Shelf Registration Statement; provided that Holders of Registrable Securities shall have at least twenty (20) Business Days from the date on which the Notice and Questionnaire is first sent to such Holders by the Company to complete and return the Notice and Questionnaire to the Company. From and after the date the Initial Shelf Registration Statement is declared effective, the Company shall, as promptly as reasonably practicable after the date a Notice and Questionnaire is delivered, and in any event within the later of (x) ten (10) Business Days after such date or (y) ten (10) Business Days after the expiration of any Suspension Period (1) in effect when the Notice and Questionnaire is delivered or (2) put into effect within ten (10) Business Days of such delivery date, (i) if required by applicable law, use reasonable best efforts to file with the SEC a post-effective amendment to the Shelf Registration Statement or, if required by applicable law, use reasonable best efforts to prepare and file a supplement to the related Prospectus or a supplement or amendment to any document incorporated therein by reference or use reasonable best efforts to file any other required document so that the Holder delivering such Notice and Questionnaire is named as a selling securityholder in the Shelf Registration Statement and the related Prospectus in such a manner as to permit such Holder to deliver such Prospectus to purchasers of the Registrable Securities in accordance with applicable law and, if the Company shall file a post-effective amendment to the Shelf Registration Statement, use its reasonable best efforts to cause such post-effective amendment to be declared effective under the Securities Act as promptly as is reasonably practicable, but in any event by the date (the “Amendment Effectiveness Deadline Date”) that is forty-five (45) days after the date such post-effective amendment is required by this clause to be filed; (ii) provide such Holder a reasonable number of copies of any documents filed pursuant to Section 2(d)(i); and (iii) notify such Holder as promptly as reasonably practicable after the effectiveness under the Securities Act of any post-effective amendment filed pursuant to Section 2(d) (i); provided that if such Notice and Questionnaire is delivered during a Suspension Period, or a Suspension Period is put into effect within ten (10) Business Days after such delivery date, the Company shall so inform the Holder delivering such Notice and Questionnaire and shall take the actions set forth in clauses (i), (ii) and (iii) above within ten (10) Business Days after expiration of the Suspension Period in accordance with Section 3(i); provided further that if under applicable law, the Company has more than one option as to the type or manner of making any such filing involving substantially similar expense to the Company, the Company shall make the required filing or filings in the manner or of a type that is reasonably expected to result in the earliest availability of the Prospectus for effecting resales of Registrable Securities. Notwithstanding anything contained herein to the contrary, the Company shall be under no obligation to name or take any action to name any Holder that is not a Notice Holder as a selling securityholder in any Shelf Registration Statement or related Prospectus; provided, however, that any Holder that becomes a Notice Holder pursuant to the provisions of this Section 2(d)

(whether or not such Holder was a Notice Holder at the time the Shelf Registration Statement was declared effective) shall be named as a selling securityholder in the Shelf Registration Statement or related Prospectus in accordance with the requirements of this Section 2(d). In addition to the information required to be provided in the Notice and Questionnaire, the Company may require Holders to furnish to the Company additional information regarding such Holder and such Holder's intended method of disposition of Securities and Common Stock issuable upon conversion thereof as may be required in order to comply with the Act or as may be reasonably required to respond to the staff of the SEC. Each Holder agrees to notify the Company as promptly as reasonably practicable of any inaccuracy or change in information previously furnished by such Holder to the Company or of the occurrence of any event in either case as a result of which any Prospectus relating to the Shelf Registration Statement contains or would contain an untrue statement of a material fact regarding such Holder or such Holder's intended method of disposition or omits to state any material fact regarding such Holder or such Holder's intended method of disposition required to be stated therein or necessary to make the statement therein not misleading in light of the circumstances then existing. Each Holder further agrees not to sell any Securities or Common Stock issuable upon conversion thereof pursuant to the Shelf Registration Statement without delivering, or causing to be delivered, a Prospectus to the purchaser thereof and, following expiration of the Effectiveness Period, to notify the Company, within ten Business Days of a request by the Company, of the number of Debentures or Common Stock issuable upon conversion thereof sold pursuant to the Shelf Registration Statement and, in absence of a response, the Company may assume that all of Holder's Debentures and Common Stock issuable upon conversion thereof were so sold.

(e) The parties hereto agree that the Holders of Registrable Securities will suffer damages, and that it would not be feasible to ascertain the extent of such damages with precision, if (i) the Initial Shelf Registration Statement has not been filed on or prior to the Filing Deadline Date, (ii) the Initial Shelf Registration Statement has not been declared effective under the Securities Act on or prior to the Effectiveness Deadline Date or (iii) the Initial Shelf Registration Statement is filed and declared effective but shall thereafter cease to be effective (without being succeeded immediately by an additional registration statement filed and declared effective) or usable for the offer and sale of Registrable Securities for a period of time (including any Suspension Period) which shall exceed forty-five (45) days in the aggregate in any three (3) month period or ninety (90) days in the aggregate in any twelve (12) month period (each of the events of a type described in any of the foregoing clauses (i) through (iii) are individually referred to herein as an "Event," and the Filing Deadline Date in the case of clause (i), the Effectiveness Deadline Date in the case of clause (ii), the date on which the duration of the ineffectiveness or unusability of the Initial Shelf Registration Statement in any period exceeds the number of days permitted by clause (iii) hereof in the case of clause (iii), being referred to herein as an "Event Date").

Events shall be deemed to continue until the following dates with respect to the respective types of Events: the date the Initial Shelf Registration Statement is filed in the case of an Event of the type described in clause (i), the date the Initial Shelf Registration Statement is declared effective under the Securities Act in the case of an Event of the type described in clause (ii), and the date the Initial Shelf Registration Statement becomes effective or usable again in the case of an Event of the type described in clause (iii).

Accordingly, commencing on (and including) any Event Date and ending on (but excluding) the next date on which there are no Events that have occurred and are continuing (a “Damages Accrual Period”), the Company agrees to pay, as liquidated damages and not as a penalty, an amount (the “Liquidated Damages Amount”) at the rate described below, payable periodically on each Damages Payment Date to Notice Holders of Debentures that are Registrable Securities and of shares of Underlying Common Stock issued upon conversion of Debentures that are Registrable Securities, as the case may be, to the extent of, for each such Damages Payment Date, accrued and unpaid Liquidated Damages Amount up to (but excluding) such Damages Payment Date (or, if the Damages Accrual Period shall have ended prior to such Damages Payment Date, the date of the end of the Damages Accrual Period); provided that any Liquidated Damages Amount accrued with respect to any Debenture or portion thereof called for redemption on a redemption date or converted into Underlying Common Stock on a conversion date prior to the Damages Payment Date, shall, in any such event, be paid instead to the Notice Holder who submitted such Debenture or portion thereof for redemption or conversion on the applicable redemption date or conversion date, as the case may be, on such date (or promptly following the conversion date, in the case of conversion). The Liquidated Damages Amount shall accrue at a rate per annum equal to (1) one-quarter of one percent (0.25%) for the first 90 day period from the Event Date and (2) one-half of one percent (0.50%) thereafter of (i) the principal amount of such Debentures or, without duplication, (ii) in the case of Debentures that have been converted into Underlying Common Stock, the Applicable Conversion Price of such shares of Underlying Common Stock, as the case may be, in each case determined as of the Business Day immediately preceding the next Damages Payment Date. Notwithstanding the foregoing or anything to the contrary contained herein, no Liquidated Damages Amounts shall accrue as to any Registrable Security from and after the earlier of (x) the date such security is no longer a Registrable Security and (y) expiration of the Effectiveness Period. The rate of accrual of the Liquidated Damages Amount with respect to any period shall not exceed the rate provided for in this paragraph notwithstanding the occurrence of multiple concurrent Events. Following the cure of all Events requiring the payment by the Company of Liquidated Damages Amounts to the Notice Holders of Registrable Securities pursuant to this Section, the accrual of Liquidated Damages Amounts shall cease (without in any way limiting the effect of any subsequent Event requiring the payment of Liquidated Damages Amount by the Company).

The Trustee shall be entitled, on behalf of Holders of Debentures, to seek any available remedy for the enforcement of this Agreement, including for the payment of any Liquidated Damages Amount. Notwithstanding the foregoing or anything to the contrary contained herein, the parties agree that the sole damages payable for a violation of the terms of this Agreement with respect to which liquidated damages are expressly provided shall be such liquidated damages.

All of the Company's obligations set forth in this Section 2(e) that are outstanding with respect to any Registrable Security at the time such security ceases to be a Registrable Security shall survive until such time as all such obligations with respect to such security have been satisfied in full (notwithstanding termination of this Agreement pursuant to Section 8(k)).

The parties hereto agree that the liquidated damages provided for in this Section 2(e) constitute a reasonable estimate of the damages that may be incurred by Holders of Registrable Securities by reason of the failure of the Shelf Registration Statement to be filed or declared effective or available for effecting resales of Registrable Securities in accordance with the provisions hereof.

Section 3. *Registration Procedures.* In connection with the registration obligations of the Company under Section 2 hereof, the Company shall:

(a) Prepare and file with the SEC a Shelf Registration Statement or Shelf Registration Statements on Form S-1 or S-3 or any other appropriate form under the Securities Act available for the sale of the Registrable Securities by the Holders thereof in accordance with the intended method or methods of distribution thereof, and use its reasonable best efforts to cause each such Shelf Registration Statement to become effective and remain effective as provided herein; provided that before filing any Shelf Registration Statement or Prospectus or any amendments or supplements thereto with the SEC, the Company shall furnish to the Initial Purchaser and counsel for the Holders and for the Initial Purchaser (or, if applicable, separate counsel for the Holders) copies of all such documents proposed to be filed and use its reasonable best efforts to reflect in each such document when so filed with the SEC such comments as the such counsel reasonably shall propose within three (3) Business Days of the delivery of such copies to the Initial Purchaser and such counsel.

(b) Use its reasonable best efforts to prepare and file with the SEC such amendments and post-effective amendments to each Shelf Registration Statement as may be necessary to keep such Shelf Registration Statement continuously effective until the expiration of the Effectiveness Period; use its reasonable best efforts to cause the related Prospectus to be supplemented by any required Prospectus supplement, and as so supplemented to be filed pursuant to Rule 424 (or any similar provisions then in force) under the Securities Act; and use its reasonable best efforts to comply with the provisions of the Securities Act applicable to it with respect to the disposition of all securities covered by such

Shelf Registration Statement during the Effectiveness Period in accordance with the intended methods of disposition by the sellers thereof set forth in such Shelf Registration Statement as so amended or such Prospectus as so supplemented.

(c) As promptly as reasonably practicable give notice to the Holders that have delivered a Notice and Questionnaire to the Company in accordance with this Agreement (the “Notice Holders”), the Initial Purchaser and counsel for the Holders and for the Initial Purchaser (or, if applicable, separate counsel for the Holders) (i) when any Prospectus, Prospectus supplement, Shelf Registration Statement or post-effective amendment to a Shelf Registration Statement has been filed with the SEC and, with respect to a Shelf Registration Statement or any post-effective amendment, when the same has been declared effective, (ii) of any request, following the effectiveness of the Initial Shelf Registration Statement under the Securities Act, by the SEC or any other federal or state governmental authority for amendments or supplements to any Shelf Registration Statement or related Prospectus or for additional information, (iii) of the issuance by the SEC or any other federal or state governmental authority of any stop order suspending the effectiveness of any Shelf Registration Statement or the initiation or threatening of any proceedings for that purpose, (iv) of the receipt by the Company of any notification with respect to the suspension of the qualification or exemption from qualification of any of the Registrable Securities for sale in any jurisdiction or the initiation or threatening of any proceeding for such purpose and (v) of the determination by the Company that a post-effective amendment to a Shelf Registration Statement will be filed with the SEC, which notice may, at the discretion of the Company (or as required pursuant to Section 3(i)), state that it constitutes a Suspension Notice, in which event the provisions of Section 3(i) shall apply.

(d) Use its reasonable best efforts to prevent the issuance of, and, if issued, to obtain the withdrawal of any order suspending the effectiveness of a Shelf Registration Statement or the lifting of any suspension of the qualification (or exemption from qualification) of any of the Registrable Securities for sale in any jurisdiction in which they have been qualified for sale, in either case at the earliest possible moment, and provide prompt notice to each Notice Holder and the Initial Purchaser of the withdrawal of any such order.

(e) If requested by the Initial Purchaser or any Notice Holder, as promptly as reasonably practicable incorporate in a Prospectus supplement or post-effective amendment to a Shelf Registration Statement such information as the Initial Purchaser, such Notice Holder or counsel for the Holders and for the Initial Purchaser (or, if applicable, separate counsel for the Holders) shall determine to be required to be included therein by applicable law and make any required filings of such Prospectus supplement or such post-effective amendment; provided that the Company shall not be required to take any actions under this Section 3(e) that, in the opinion of counsel for the Company, are not in compliance with applicable law.

(f) Upon request, as promptly as reasonably practicable furnish to each Notice Holder, counsel for the Holders and for the Initial Purchaser (or, if applicable, separate counsel for the Holders) and the Initial Purchaser, without charge, at least one (1) conformed copy of the Shelf Registration Statement and any amendment thereto, including financial statements but excluding schedules, all documents incorporated or deemed to be incorporated therein by reference and all exhibits (unless specifically requested in writing to the Company by such Notice Holder, such counsel or the Initial Purchaser).

(g) During the Effectiveness Period, deliver to each Notice Holder, counsel for the Holders and for the Initial Purchaser (or, if applicable, separate counsel for the Holders) and the Initial Purchaser, in connection with any sale of Registrable Securities pursuant to a Shelf Registration Statement, without charge, as many copies of the Prospectus or Prospectuses relating to such Registrable Securities (including each preliminary prospectus) and any amendment or supplement thereto as such Notice Holder and the Initial Purchaser may reasonably request; and the Company hereby consents (except during such periods that a Suspension Notice is outstanding and has not been revoked) to the use of such Prospectus or each amendment or supplement thereto by each Notice Holder, solely in connection with any offering and sale of the Registrable Securities covered by such Prospectus or any amendment or supplement thereto in the manner set forth therein.

(h) Prior to any public offering of the Registrable Securities pursuant to the Shelf Registration Statement, use its reasonable best efforts to register or qualify or cooperate with the Notice Holders in connection with the registration or qualification (or exemption from such registration or qualification) of such Registrable Securities for offer and sale under the securities or Blue Sky laws of such jurisdictions within the United States as any Notice Holder reasonably requests in writing (which request may be included in the Notice and Questionnaire); prior to any public offering of the Registrable Securities pursuant to the Shelf Registration Statement, use its reasonable best efforts to keep each such registration or qualification (or exemption therefrom) effective during the Effectiveness Period in connection with such Notice Holder's offer and sale of Registrable Securities pursuant to such registration or qualification (or exemption therefrom) and do any and all other acts or things reasonably necessary or advisable to enable the disposition in such jurisdictions of such Registrable Securities in the manner set forth in the relevant Shelf Registration Statement and the related Prospectus; provided that the Company will not be required to (i) qualify as a foreign corporation or as a dealer in securities in any jurisdiction where it would not otherwise be required to qualify but for this Agreement or (ii) take any action that would subject it to general service of process in suits or to taxation in any such jurisdiction where it is not then so subject.

(i) Upon (A) the issuance by the SEC of a stop order suspending the effectiveness of the Shelf Registration Statement or the initiation of proceedings

with respect to the Shelf Registration Statement under Section 8(d) or 8(e) of the Securities Act, (B) the occurrence of any event or the existence of any fact as a result of which any Shelf Registration Statement shall contain any untrue statement of a material fact or omit to state any material fact required to be stated therein or necessary to make the statements therein not misleading, or any Prospectus shall contain any untrue statement of a material fact or omit to state any material fact necessary in order to make the statements therein, in the light of the circumstances under which they were made, not misleading, or (C) the occurrence or existence of any pending corporate development or other event (a “Material Event”) that, in the sole, but reasonable discretion of the Company, makes it appropriate to suspend the availability of the Shelf Registration Statement and the related Prospectus, (i) in the case of clause (B) or (C) above, subject to the next sentence, as promptly as reasonably practicable, prepare and file, if necessary pursuant to applicable law, a post-effective amendment to such Shelf Registration Statement or a supplement to the related Prospectus or any document incorporated therein by reference or file any other required document that would be incorporated by reference into such Shelf Registration Statement and Prospectus so that such Shelf Registration Statement does not contain any untrue statement of a material fact or omit to state any material fact required to be stated therein or necessary to make the statements therein not misleading, and such Prospectus does not contain any untrue statement of a material fact or omit to state any material fact necessary in order to make the statements therein, in the light of the circumstances under which they were made, not misleading (it being understood that the Company may rely on information provided by each Notice Holder with respect to such Notice Holder), as thereafter delivered to the purchasers of the Registrable Securities being sold thereunder, and, in the case of a post-effective amendment to a Shelf Registration Statement, subject to the next sentence, use its reasonable best efforts to cause it to be declared effective as promptly as is reasonably practicable, and (ii) give notice to the Notice Holders and counsel for the Holders and for the Initial Purchaser (or, if applicable, separate counsel for the Holders) that the availability of the Shelf Registration Statement is suspended (a “Suspension Notice”) and, upon receipt of any Suspension Notice, each Notice Holder agrees to treat the receipt and existence of any Suspension Notice as confidential and not to sell any Registrable Securities pursuant to such Shelf Registration Statement until such Notice Holder’s receipt of copies of the supplemented or amended Prospectus provided for in clause (i) above, or until it is advised in writing by the Company that the Prospectus may be used, and has received copies of any additional or supplemental filings that are incorporated or deemed incorporated by reference in such Prospectus. The Company will use its reasonable best efforts to ensure that the use of the Prospectus may be resumed (x) in the case of clause (A) above, as promptly as is reasonably practicable, (y) in the case of clause (B) above, as soon as, in the reasonable judgment of the Company, the Shelf Registration Statement does not contain any untrue statement of a material fact or omits to state any material fact required to be stated therein or necessary to make the statements therein not misleading and the Prospectus does not contain any untrue statement of a material

fact or omits to state any material fact necessary in order to make the statements therein, in the light of the circumstances under which they were made, not misleading, and (z) in the case of clause (C) above, as soon as, in the reasonable discretion of the Company, such suspension is no longer appropriate. The period during which the availability of the Shelf Registration Statement and any Prospectus may be suspended (the “Suspension Period”) without the Company incurring any obligation to pay liquidated damages pursuant to Section 2(e) shall not exceed forty-five (45) days in any three (3) month period and ninety (90) days in any twelve (12) month period. The Effectiveness Period shall be extended by the number of days from and including the date of the giving of the Suspension Notice to and including the date on which the Notice Holder received copies of the supplemented or amended Prospectus provided in clause (i) above, or the date on which it is advised in writing by the Company that the Prospectus may be used, and has received copies of any additional or supplemental filings that are incorporated or deemed incorporated by reference in such Prospectus. The Company need not specify the nature of the event giving rise to a suspension in any Suspension Notice or other notice to Holders and the holders agree to treat and keep such suspension confidential.

(j) Comply with all applicable rules and regulations of the SEC and make generally available to its securityholders earning statements (which need not be audited) satisfying the provisions of Section 11(a) of the Securities Act and Rule 158 thereunder (or any similar rule promulgated under the Securities Act) no later than 45 days after the end of any 12-month period (or 90 days after the end of any 12-month period if such period is a fiscal year) commencing on the first day of the first fiscal quarter of the Company commencing after the effective date of a Shelf Registration Statement as defined in Rule 158(c) under the Securities Act, which statements shall cover said 12-month periods.

(k) Cooperate with each Notice Holder to facilitate the timely preparation and delivery of certificates representing Registrable Securities sold pursuant to a Shelf Registration Statement, which certificates shall not bear any restrictive legends, and cause such Registrable Securities to be in such denominations as are permitted by the Indenture and registered in such names as such Notice Holder may request in writing at least five (5) Business Days prior to any sale of such Registrable Securities.

(l) Provide a CUSIP number for all Registrable Securities covered by each Shelf Registration Statement not later than the effective date of such Shelf Registration Statement and provide the Trustee and the transfer agent for the Common Stock with certificates for the Registrable Securities that are in a form eligible for deposit with The Depository Trust Company.

(m) Cooperate and assist in any filings required to be made with the National Association of Securities Dealers, Inc.

(n) Upon (i) the filing of the Initial Registration Statement and (ii) the effectiveness of the Initial Registration Statement, announce the same, in each case by release to Reuters Economic Services and Bloomberg Business News.

(o) Enter into such customary agreements and take all such other necessary actions in connection therewith (including those requested by the holders of a majority of the Registrable Securities being sold) in order to expedite or facilitate disposition of such Registrable Securities.

(p) Cause the Indenture to be qualified under the TIA not later than the effective date of any Shelf Registration Statement; and in connection therewith, cooperate with the Trustee to effect such changes to the Indenture as may be required for the Indenture to be so qualified in accordance with the terms of the TIA and execute, and use its reasonable best efforts to cause the Trustee to execute, all documents as may be required to effect such changes, and all other forms and documents required to be filed with the SEC to enable the Indenture to be so qualified in a timely manner.

Section 4. *Holder's Obligations.* Each Holder agrees, by acquisition of the Registrable Securities, that no Holder of Registrable Securities shall be entitled to sell any of such Registrable Securities pursuant to a Shelf Registration Statement or to receive a Prospectus relating thereto or to the payment of liquidated damages, unless such Holder has furnished the Company with a Notice and Questionnaire as required pursuant to Section 2(d) hereof (including the information required to be included in such Notice and Questionnaire) and the information set forth in the next sentence. Each Notice Holder agrees promptly to furnish to the Company all information required to be disclosed in order to make the information previously furnished to the Company by such Notice Holder not misleading and any other information regarding such Notice Holder and the distribution of such Registrable Securities as the Company may from time to time reasonably request. Any sale of any Registrable Securities by any Holder shall constitute a representation and warranty by such Holder that the information relating to such Holder and its plan of distribution is as set forth in the Prospectus delivered by such Holder in connection with such disposition, that such Prospectus does not as of the time of such sale contain any untrue statement of a material fact relating to or provided by such Holder or its plan of distribution, that such Prospectus does not as of the time of such sale omit to state any material fact relating to or provided by such Holder or its plan of distribution necessary in order to make the statements in such Prospectus, in the light of the circumstances under which they were made, not misleading and that such Holder has complied with its obligations under Section 2(d) of this Agreement in connection with such sale.

Section 5. *Registration Expenses.* The Company shall bear all fees and expenses incurred in connection with the performance by the Company of its obligations under Section 2 and 3 of this Agreement whether or not any of the

Shelf Registration Statements are declared effective. Such fees and expenses (“Registration Expenses”) shall include, without limitation, (i) all registration and filing fees (including, without limitation, fees and expenses (x) with respect to filings required to be made with the National Association of Securities Dealers, Inc. and (y) of compliance with federal and state securities or Blue Sky laws (including, without limitation, reasonable fees and disbursements of counsel for the Holders in connection with Blue Sky qualifications of the Registrable Securities under the laws of such jurisdictions as the Notice Holders of a majority of the Registrable Securities being sold pursuant to a Shelf Registration Statement may designate), (ii) printing expenses (including, without limitation, expenses of printing certificates for Registrable Securities in a form eligible for deposit with The Depository Trust Company), (iii) duplication and mailing expenses relating to copies of any Shelf Registration Statement or Prospectus delivered to any Holders hereunder, (iv) fees and disbursements of counsel for the Company and the fees and disbursements of one counsel for the Holders in connection (designated by the Initial Purchaser) with the Shelf Registration Statement, (v) fees and disbursements of the Trustee and its counsel and of the registrar and transfer agent for the Common Stock and (vi) Securities Act liability insurance obtained by the Company in its sole discretion. In addition, the Company shall pay the internal expenses of the Company (including, without limitation, all salaries and expenses of officers and employees performing legal or accounting duties), the expense of any annual audit, the fees and expenses incurred in connection with the listing by the Company of the Registrable Securities on any securities exchange on which similar securities of the Company are then listed and the fees and expenses of any person, including special experts, retained by the Company. Notwithstanding the provisions of this Section 5 or anything to the contrary herein, each Holder shall bear the expenses of any broker commission, agency fee, underwriter discount or commission or transfer taxes.

Section 6. Indemnification; Contribution.

(a) The Company agrees to indemnify, defend and hold harmless each Holder and each person who controls any Holder within the meaning of Section 15 of the Securities Act or Section 20 of the Exchange Act (each, a “Holder Indemnified Party”), from and against any loss, damage, expense, liability or claim (including the reasonable cost of investigation) which such Holder Indemnified Party may incur under the Securities Act, the Exchange Act or otherwise, insofar as such loss, damage, expense, liability or claim arises out of or is based upon any untrue statement or alleged untrue statement of a material fact contained in any Shelf Registration Statement or Prospectus or in any amendment or supplement thereto or in any preliminary prospectus, or arises out of or is based upon any omission or alleged omission to state a material fact required to be stated in any Shelf Registration Statement or in any amendment or supplement thereto or necessary to make the statements therein not misleading, or arises out of or is based upon any omission or alleged omission to state a material fact necessary in order to make the statements made in any Prospectus or in any

amendment or supplement thereto or in any preliminary prospectus, in the light of the circumstances under which they were made, not misleading, except insofar as any such loss, damage, expense, liability or claim arises out of or is based upon any untrue statement or omission or alleged untrue statement or omission of a material fact contained in, or omitted from, and in conformity with information furnished in writing by or on behalf of any Holder to the Company expressly for use therein, provided that the foregoing indemnity shall not apply to any sales of Registrable Securities by a Holder if, in connection with such sale, such Holder fails to comply with the Prospectus delivery requirements under the Securities Act or initiates such sale during a Suspension Period.

(b) Each Holder, severally and not jointly, agrees to indemnify, defend and hold harmless the Company, its directors and officers and any person who controls the Company within the meaning of Section 15 of the Securities Act or Section 20 of the Exchange Act (each, a “Company Indemnified Party”) from and against any loss, damage, expense, liability or claim (including the reasonable cost of investigation) which such Company Indemnified Party may incur under the Securities Act, the Exchange Act or otherwise, insofar as such loss, damage, expense, liability or claim arises out of or is based upon any untrue statement or alleged untrue statement of a material fact contained in information furnished in writing by or on behalf of such Holder to the Company expressly for use in any Shelf Registration Statement or Prospectus or in any amendment or supplement thereto or in any preliminary prospectus, or arises out of or is based upon any omission or alleged omission to state a material fact required to be stated in any Shelf Registration Statement or in any amendment or supplement thereto or necessary to make the statements therein not misleading, or arises out of or is based upon any omission or alleged omission to state a material fact necessary in order to make the statements in any Prospectus or in any amendment or supplement thereto or in any preliminary prospectus, in the light of the circumstances under which they were made, not misleading, in connection with such information. In no event shall the liability of any selling Holder of Registrable Securities hereunder be greater in amount than the dollar amount of the proceeds received by such Holder upon the sale of the Registrable Securities pursuant to the Shelf Registration Statement giving rise to such indemnification obligation.

(c) If any action, suit or proceeding (each, a “Proceeding”) is brought against any person in respect of which indemnity may be sought pursuant to either subsection (a) or (b) of this Section 6, such person (the “Indemnified Party”) shall promptly notify the person against whom such indemnity may be sought (the “Indemnifying Party”) in writing of the institution of such Proceeding and the Indemnifying Party shall assume the defense of such Proceeding; provided, however, that the omission to notify such Indemnifying Party shall not relieve such Indemnifying Party from any liability which it may have to such Indemnified Party or otherwise unless, and only to the extent that, the Indemnifying Party is materially prejudiced thereby. Such Indemnified Party shall have the right to

employ its own counsel in any such case, but the fees and expenses of such counsel shall be at the expense of such Indemnified Party unless the employment of such counsel shall have been authorized in writing by such Indemnifying Party in connection with the defense of such Proceeding or such Indemnifying Party shall not have employed counsel to have charge of the defense of such Proceeding within 30 days of the receipt of notice thereof or such Indemnified Party shall have reasonably concluded upon the written advice of counsel that there may be one or more defenses available to it that are different from, additional to or in conflict with those available to such Indemnifying Party (in which case such Indemnifying Party shall not have the right to direct that portion of the defense of such Proceeding on behalf of the Indemnified Party, but such Indemnifying Party may employ counsel and participate in the defense thereof but the reasonable fees and expenses of such counsel shall be at the expense of such Indemnifying Party), in any of which events such reasonable fees and expenses shall be borne by such Indemnifying Party and paid as incurred (it being understood, however, that such Indemnifying Party shall not be liable for the expenses of more than one separate counsel in any one Proceeding or series of related Proceedings together with reasonably necessary local counsel representing the Indemnified Parties who are parties to such action). An Indemnifying Party shall not be liable for any settlement of such Proceeding effected without the written consent of such Indemnifying Party, but if settled with the written consent of such Indemnifying Party, such Indemnifying Party agrees to indemnify and hold harmless an Indemnified Party from and against any loss or liability by reason of such settlement.

Notwithstanding the foregoing sentence, if at any time an Indemnified Party shall have requested an Indemnifying Party to reimburse such Indemnified Party for reasonable fees and expenses of counsel as contemplated by the second sentence of this paragraph, then such Indemnifying Party agrees that it shall be liable for any settlement of any Proceeding effected without its written consent if (i) such settlement is entered into more than 90 Business Days after receipt by such Indemnifying Party of the aforesaid request, (ii) such Indemnifying Party shall not have reimbursed such Indemnified Party in accordance with such request prior to the date of such settlement and (iii) such Indemnified Party shall have given such Indemnifying Party at least 30 days' prior notice of its intention to settle. No Indemnifying Party shall, without the prior written consent of any Indemnified Party, effect any settlement of any pending or threatened Proceeding in respect of which such Indemnified Party is or could have been a party and indemnity could have been sought hereunder by such Indemnified Party, unless such settlement includes an unconditional release of such Indemnified Party from all liability on claims that are the subject matter of such Proceeding and does not include an admission of fault, culpability or a failure to act, by or on behalf of such Indemnified Party.

(d) If the indemnification provided for in this Section 6 is unavailable to an Indemnified Party under subsections (a) and (b) of this Section 6 in respect of any losses, damages, expenses, liabilities or claims referred to therein, then each applicable Indemnifying Party, in lieu of indemnifying such Indemnified Party,

shall contribute to the amount paid or payable by such Indemnified Party as a result of such losses, damages, expenses, liabilities or claims (i) in such proportion as is appropriate to reflect the relative benefits received by the Company on the one hand and the Holders on the other hand from the offering of the Registrable Securities or (ii) if the allocation provided by clause (i) above is not permitted by applicable law, in such proportion as is appropriate to reflect not only the relative benefits referred to in clause (i) above but also the relative fault of the Company on the one hand and of the Holders on the other in connection with the statements or omissions which resulted in such losses, damages, expenses, liabilities or claims, as well as any other relevant equitable considerations. The relative fault of the Company on the one hand and of the Holders on the other shall be determined by reference to, among other things, whether the untrue statement or alleged untrue statement of a material fact or omission or alleged omission relates to information supplied by the Company or by the Holders and the parties' relative intent, knowledge, access to information and opportunity to correct or prevent such statement or omission. The amount paid or payable by a party as a result of the losses, damages, expenses, liabilities and claims referred to above shall be deemed to include any reasonable legal or other fees or expenses reasonably incurred by such party in connection with investigating or defending any Proceeding.

(e) The Company and the Holders agree that it would not be just and equitable if contribution pursuant to this Section 6 were determined by pro rata allocation or by any other method of allocation which does not take account of the equitable considerations referred to in subsection (d) above. Notwithstanding the provisions of this Section 6, no Holder shall be required to contribute any amount in excess of the amount by which the total price at which the Registrable Securities sold by it were offered to the public exceeds the amount of any damages which it has otherwise been required to pay by reason of such untrue or alleged untrue statement or omission or alleged omission. No person guilty of fraudulent misrepresentation (within the meaning of Section 11(f) of the Securities Act) shall be entitled to contribution from any person who was not guilty of such fraudulent misrepresentation. The Holders' respective obligations to contribute pursuant to this Section 6 are several in proportion to the respective amount of Registrable Securities they have sold pursuant to a Shelf Registration Statement, and not joint. The remedies provided for in this Section 6 are not exclusive and shall not limit any rights or remedies which may otherwise be available to any indemnified party at law or in equity.

(f) The indemnity and contribution provisions contained in this Section 6 shall remain operative and in full force and effect regardless of (i) any termination of this Agreement, (ii) any investigation made by or on behalf of any Holder or any person controlling any Holder, or the Company, or the Company's officers or directors or any person controlling the Company and (iii) the sale of any Registrable Security by any Holder.

Section 7. *Information Requirements.* (a) The Company covenants that, if at any time before the end of the Effectiveness Period it is not subject to the reporting requirements of the Exchange Act, it will cooperate with any Holder of Registrable Securities and take such further action as any Holder of Registrable Securities may reasonably request in writing (including, without limitation, making such representations as any such Holder may reasonably request), all to the extent required from time to time to enable such Holder to sell Registrable Securities without registration under the Securities Act within the limitation of the exemptions provided by Rule 144, Rule 144A, Regulation S and Regulation D under the Securities Act and customarily taken in connection with sales pursuant to such exemptions. Upon the written request of any Holder of Registrable Securities, the Company shall deliver to such Holder a written statement as to whether it has complied with such filing requirements, unless such a statement has been included in the Company's most recent report filed with the SEC pursuant to Section 13 or Section 15(d) of Exchange Act. Notwithstanding the foregoing, nothing in this Section 7 shall be deemed to require the Company to register any of its securities (other than the Common Stock) under any section of the Exchange Act.

(b) The Company shall file the reports required to be filed by it under the Exchange Act and shall comply with all other requirements set forth in the instructions to Form S-1 or Form S-3, as the case may be, in order to allow the Company to be eligible to file registration statements on Form S-1 or Form S-3.

Section 8. *Miscellaneous.*

(a) *No Conflicting Agreements.* The Company is not, as of the date hereof, a party to, nor shall it, on or after the date of this Agreement, enter into, any agreement with respect to its securities that conflicts with the rights granted to the Holders of Registrable Securities in this Agreement. The Company represents and warrants that the rights granted to the Holders of Registrable Securities hereunder do not in any way conflict with the rights granted to the holders of the Company's securities under any other agreements.

(b) *Amendments and Waivers.* The provisions of this Agreement, including the provisions of this sentence, may not be amended, modified or supplemented, and waivers or consents to departures from the provisions hereof may not be given, unless the Company has obtained the written consent of Holders of a majority of the then outstanding Underlying Common Stock constituting Registrable Securities (with Holders of Debentures deemed to be the Holders, for purposes of this Section, of the number of outstanding shares of Underlying Common Stock into which such Debentures are or would be convertible as of the date on which such consent is requested). Notwithstanding the foregoing, a waiver or consent to depart from the provisions hereof with respect to a matter that relates exclusively to the rights of Holders of Registrable Securities whose securities are being sold pursuant to a Shelf Registration

Statement and that does not directly or indirectly affect the rights of other Holders of Registrable Securities may be given by Holders of at least a majority of the Registrable Securities being sold by such Holders pursuant to such Shelf Registration Statement; provided that the provisions of this sentence may not be amended, modified, or supplemented except in accordance with the provisions of the immediately preceding sentence. Each Holder of Registrable Securities outstanding at the time of any such amendment, modification, supplement, waiver or consent or thereafter shall be bound by any such amendment, modification, supplement, waiver or consent effected pursuant to this Section 8(b), whether or not any notice, writing or marking indicating such amendment, modification, supplement, waiver or consent appears on the Registrable Securities or is delivered to such Holder.

(c) *Notices.* All notices and other communications provided for or permitted hereunder shall be made in writing by hand delivery, by telecopier, by courier guaranteeing overnight delivery or by first-class mail, return receipt requested, and shall be deemed given (i) when made, if made by hand delivery, (ii) upon confirmation, if made by telecopier, (iii) one (1) Business Day after being deposited with such courier, if made by overnight courier or (iv) on the date indicated on the notice of receipt, if made by first-class mail, to the parties as follows:

(x) if to a Holder of Registrable Securities, at the most current address given by such Holder to the Company in a Notice and Questionnaire or any amendment thereto;

(y) if to the Company, to:

Red Hat, Inc.
1801 Varsity Drive
Raleigh, North Carolina 27606
Attention: General Counsel
Telecopy No.: (919) 754-3704

(z) if to the Initial Purchaser, to:

c/o UBS Securities LLC
299 Park Avenue
New York, New York 10171
Attention: Syndicate Department
Telecopy No.: (212) 821-4998

with a copy to (for informational purposes only):

c/o UBS Securities LLC
677 Washington Boulevard
Stamford, Connecticut 06901
Attention: Legal Department
Telecopy No.: (203) 719-0683

or to such other address as such person may have furnished to the other persons identified in this Section 8(c) in writing in accordance herewith.

(d) *Approval of Holders.* Whenever the consent or approval of Holders of a specified percentage of Registrable Securities is required hereunder, Registrable Securities held by the Company or its affiliates (as such term is defined in Rule 405 under the Securities Act) (other than the Initial Purchaser or subsequent Holders of Registrable Securities if such subsequent Holders are deemed to be such affiliates solely by reason of their holdings of such Registrable Securities) shall not be counted in determining whether such consent or approval was given by the Holders of such required percentage.

(e) *Successors and Assigns.* Any person who purchases any Registrable Securities from the Initial Purchaser or any Holder shall be deemed, for purposes of this Agreement, to be an assignee of the Initial Purchaser or such Holder, as the case may be. This Agreement shall inure to the benefit of and be binding upon the successors and assigns of each of the parties and shall inure to the benefit of and be binding upon each Holder of any Registrable Securities.

(f) *Counterparts.* This Agreement may be executed in any number of counterparts and by the parties hereto in separate counterparts, each of which when so executed shall be deemed to be original and all of which taken together shall constitute one and the same agreement.

(g) *Headings.* The headings in this Agreement are for convenience of reference only and shall not limit or otherwise affect the meaning hereof.

(h) *Governing Law.* THIS AGREEMENT SHALL BE GOVERNED BY, AND CONSTRUED IN ACCORDANCE WITH, THE LAWS OF THE STATE OF NEW YORK, WITHOUT REGARD TO CONFLICTS OF LAWS PRINCIPLES THEREOF.

(i) *Severability.* If any term, provision, covenant or restriction of this Agreement is held to be invalid, illegal, void or unenforceable, the remainder of the terms, provisions, covenants and restrictions set forth herein shall remain in full force and effect and shall in no way be affected, impaired or invalidated thereby, and the parties hereto shall use its reasonable best efforts to find and employ an alternative means to achieve the same or substantially the same result as that contemplated by such term, provision, covenant or restriction, it being intended that all of the rights and privileges of the parties shall be enforceable to the fullest extent permitted by law.

(j) *Entire Agreement.* This Agreement is intended by the parties as a final expression of their agreement and is intended to be a complete and exclusive statement of the agreement and understanding of the parties hereto in respect of the subject matter contained herein and the registration rights granted by the Company with respect to the Registrable Securities. Except as provided in the Purchase Agreement, there are no restrictions, promises, warranties or undertakings, other than those set forth or referred to herein, with respect to the registration rights granted by the Company with respect to the Registrable Securities. This Agreement supersedes all prior agreements and undertakings among the parties with respect to such registration rights. No party hereto shall have any rights, duties or obligations other than those specifically set forth in this Agreement.

(k) *Termination.* This Agreement and the obligations of the parties hereunder shall terminate upon the end of the Effectiveness Period, except for any liabilities or obligations under Section 4, 5 or 6 hereof and the obligations to make payments of and provide for liquidated damages under Section 2(e) hereof to the extent such damages accrue prior to the end of the Effectiveness Period, each of which shall remain in effect in accordance with its terms.

IN WITNESS WHEREOF, the parties have executed this Agreement as of the date first written above.

RED HAT, INC.

By: /s/ Kevin B. Thompson

Name: Kevin B. Thompson

Title: Executive Vice President
and Chief Financial Officer

Confirmed and accepted as of the date first above written:

UBS SECURITIES LLC

By: /s/ Tony Trouset

Name: Tony Trouset

Title: Executive Director

By: /s/ Scott Jacobsen

Name: Scott Jacobsen

Title: Director

RED HAT, INC.

as Issuer

U.S. BANK TRUST NATIONAL ASSOCIATION,

as Trustee

Up to \$600,000,000 Aggregate Principal Amount of

0.50% Convertible Senior Debentures due 2024

INDENTURE

Dated as of January 12, 2004

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EXHIBIT A Form of Security

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INDENTURE dated as of January 12, 2004 between RED HAT, INC., a Delaware corporation (the “**Company**”), and U.S. BANK TRUST NATIONAL ASSOCIATION, a national banking association duly organized and existing under the laws of the United States as trustee (the “**Trustee**”).

Each party agrees as follows for the benefit of the other party and for the equal and ratable benefit of the Holders of the Company’s 0.50% Convertible Senior Debentures due 2024:

ARTICLE I

DEFINITIONS AND INCORPORATION BY REFERENCE

Section 1.1. Definitions.

“**Affiliate**” of any specified person means any other person directly or indirectly controlling or controlled by or under direct or indirect common control with such specified person. For the purposes of this definition, “control” when used with respect to any specified person means the power to direct or cause the direction of the management and policies of such person, directly or indirectly, whether through the ownership of voting securities, by contract or otherwise; and the terms “controlling” and “controlled” have meanings correlative to the foregoing.

“**Agent Members**” has the meaning set forth in Section 2.1(b).

“**Applicable Procedures**” means, with respect to any transfer or transaction involving a Global Security or beneficial interest therein, the rules and procedures of the Depositary for such Security, in each case to the extent applicable to such transaction and as in effect from time to time.

“**Applicable Stock**” means the shares of Common Stock; *provided, that*, in the event of a Repurchase Event in which the Company is not the surviving Person, the term “**Applicable Stock**” shall mean the Capital Stock or ordinary shares or American Depositary Shares (or similar securities) of such surviving Person or its direct or indirect parent.

“**Bankruptcy Law**” means Title 11 of the United States Code, or any similar federal or State law for the relief of debtors.

“**Bid Solicitation Agent**” has the meaning set forth in Section 2.3.

“**Board of Directors**” means either the board of directors of the Company or any duly authorized committee of such board.

“**Board Resolution**” means a resolution of the Board of Directors.

“**Business Day**” means each day of the year other than a Saturday or a Sunday or other day on which banking institutions in The City of New York are required or authorized by law or regulation to close.

“Capital Stock” of any Person means any and all shares, interests, rights to purchase, warrants, options, participations or other equivalents of or interests in (however designated) equity issued by that Person.

“Cash” means such coin or currency of the United States as at any time of payment is legal tender for the payment of public and private debts.

“Certificated Securities” means Securities that are in substantially the form attached hereto as Exhibit A and that do not include the information called for by footnotes 1 and 3 thereof.

“Code” means the Internal Revenue Code of 1986, as amended.

“Common Stock” means the common stock, \$0.0001 par value per share, of the Company as that stock exists on the date of this Indenture or any other shares of Capital Stock of the Company into which such Common Stock shall be reclassified or changed.

“Company” means the party named as the “Company” in the first paragraph of this Indenture until a successor replaces it pursuant to the applicable provisions of this Indenture and, thereafter, shall mean such successor. The foregoing sentence shall likewise apply to any such subsequent successor or successors.

“Company Request” or **“Company Order”** means a written request or order signed in the name of the Company by any two Officers, at least one of whom is the Chief Executive Officer, the President, the Chief Financial Officer, an Executive Vice President or a Senior Vice President.

“Conversion Agent” has the meaning set forth in Section 2.3.

“Conversion Date” has the meaning set forth in Section 12.2(c).

“Conversion Notice” has the meaning set forth in Section 12.2(b).

“Conversion Price” means, at any time, \$1,000 divided by the Conversion Rate in effect at such time rounded to two decimal places (rounded up if the third decimal place thereof is 5 or more and otherwise rounded down).

“Conversion Rate” means initially 39.0753 shares per \$1,000 principal amount of Securities, subject to adjustment as set forth herein.

“Conversion Value” means, at any time, the amount equal to the product of the Sale Price at such time multiplied by the then current Conversion Rate.

“Corporate Trust Office” means the principal office of the Trustee at which at any time its corporate trust business shall be administered which office at the date of the execution of this Indenture is located at 100 Wall Street, Suite 1600, New York, NY 10005, or such other address as the Trustee may designate from time to time by notice to the Holders and the Company, or the principal corporate trust office of any successor Trustee (or such other

address as a successor Trustee may designate from time to time by notice to the Holders and the Company).

“Current Market Price” has the meaning set forth in Section 12.3(f).

“Custodian” means any receiver, trustee, assignee, liquidator, custodian or similar official under any Bankruptcy Law.

“Debenture Measurement Period” has the meaning set forth in Section 12.1(a).

“Default” means, when used with respect to the Securities, any event which is, or after notice or passage of time or both would be, an Event of Default.

“Depository” means, with respect to any Global Securities, a clearing agency that is registered as such under the Exchange Act and is designated by the Company to act as Depository for such Global Securities (or any successor securities clearing agency so registered), which shall initially be DTC.

“Director” means a member of the Board of Directors.

“distributed assets” has the meaning set forth in Section 12.3(d).

“DTC” means The Depository Trust Company, a New York corporation.

“Event of Default” has the meaning set forth in Section 8.1.

“Excess Amount Per Share” has the meaning set forth in Section 12.3(e).

“Exchange Act” means the United States Securities Exchange Act of 1934, as amended.

“Ex-Dividend Date” means, with respect to any issuance or distribution on shares of Common Stock, the first Trading Day on which the shares of Common Stock trade regular way on the principal securities market on which the shares of Common Stock are then traded without the right to receive such issuance or distribution.

“Fair Market Value” has the meaning set forth in Section 12.3(f).

“Global Securities” means Securities that are in substantially the form attached hereto as Exhibit A and that include the information called for by footnotes 1 and 3 thereof and that are deposited with the Depository or its custodian and registered in the name of, the Depository or its nominee.

“Holder” or **“Securityholder”** means a person in whose name a Security is registered on the Registrar’s books.

“Indebtedness” has the meaning set forth in Section 2.14.

“Indenture” means this Indenture, as amended or supplemented from time to time in accordance with the terms hereof, including the provisions of the TIA that are explicitly incorporated in this Indenture by reference to the TIA.

“Initial Purchaser” means UBS Investment Bank.

“Interest Payment Date” has the meaning set forth in the Securities.

“Issue Date” of any Security means the date on which such Security was originally issued or deemed issued as set forth on the face of the Security.

“Legal Holiday” means any day other than a Business Day.

“Liquidated Damages Amount” has the meaning set forth in the Registration Rights Agreement. All references herein or in the Securities to interest accrued or payable as of any date shall include any Liquidated Damages Amount accrued or payable as of such date as provided in the Registration Rights Agreement.

“Market Price” means, with respect to Securities, as of any date of determination, the average of the secondary market bid quotations per \$1,000 principal amount of Securities obtained by the Bid Solicitation Agent (which shall initially be the Trustee) for \$1,000,000 principal amount of Securities at approximately 3:30 p.m., New York City time, on such date of determination from three securities dealers (none of which shall be an Affiliate of the Company) selected by the Company, which may include the Initial Purchaser, *provided*, that if at least three such bids cannot be reasonably obtained by the Bid Solicitation Agent, but two bids are obtained, then the average of the two bids shall be used, and if only one such bid can be reasonably obtained by the Bid Solicitation Agent, this one bid will be used; *provided, however*, if (a) the Bid Solicitation Agent, through the exercise of reasonable efforts, is unable to obtain at least one bid from a securities dealer, or (b) in the Company’s reasonable judgment, the bid quotations are not indicative of the secondary market value of the Securities as of such date of determination, then the Market Price of a Security for such date of determination shall be deemed to be less than 97% of the Conversion Value on that date of determination;

“Measurement Period” means the last 30 consecutive Trading Days in a fiscal quarter, beginning with the fiscal quarter ending May 31, 2004.

“Non-Electing Share” has the meaning set forth Section 12.4.

“Non-Recourse Indebtedness” means indebtedness the terms of which provide that the lender’s claim for repayment of such indebtedness is limited solely to a claim against the property which secures such indebtedness.

“Notice of Default” has the meaning set forth in Section 8.1.

“NYSE” means The New York Stock Exchange, Inc.

“Officer” means the Chairman of the Board, the Chief Executive Officer, the President, the Chief Financial Officer, any Vice President, the Treasurer, the Controller, the Secretary, any Assistant Treasurer or Assistant Secretary of the Company.

“Officers’ Certificate” means a written certificate containing the information specified in Sections 14.4 and 14.5, signed in the name of the Company by any two Officers, at least one of whom is the Chief Executive Officer, the President, the Chief Financial Officer, an Executive Vice President or a Senior Vice President and delivered to the Trustee. An Officers’ Certificate given pursuant to Section 6.3 shall be signed by the principal financial or accounting Officer of the Company and one other Officer.

“Opinion of Counsel” means a written opinion containing the information specified in Sections 14.4 and 14.5, from legal counsel. The counsel may be an employee of, or counsel to, the Company.

“Ordinary Cash Dividends” means any cash dividend paid by the Company in accordance with the Company’s stated dividend policy as in effect from time to time.

“Paying Agent” has the meaning set forth in Section 2.3.

“Person” or “person” means any individual, corporation, limited liability company, partnership, joint venture, association, joint-stock company, trust, unincorporated organization, or government or any agency or political subdivision thereof.

“Purchase Agreement” means the Purchase Agreement dated as of January 6, 2004, among the Company and the Initial Purchaser.

“QIB” means a “qualified institutional buyer” as defined in Rule 144A.

“Record Date” has the meaning set forth in Section 12.3(f).

“Redemption Date” means, when used with respect to any Security to be redeemed, the date fixed for redemption pursuant to this Indenture.

“Redemption Price” has the meaning set forth in Section 3.1.

“Reference Period” has the meaning set forth in Section 12.3(d).

“Registrar” has the meaning set forth in Section 2.3.

“Registration Rights Agreement” means the Registration Rights Agreement, dated as of January 12, 2004, between the Company and the Initial Purchaser.

“Regular Record Date” has the meaning set forth in the Securities.

“Repurchase Date” has the meaning set forth in Section 4.1(a).

“Repurchase Event” has the meaning set forth in Section 5.1(a).

“Repurchase Event Company Notice” has the meaning set forth in Section 5.1(b).

“Repurchase Event Repurchase Date” has the meaning set forth in Section 5.1(a).

“Repurchase Event Repurchase Notice” has the meaning set forth in Section 5.1(c).

“Repurchase Event Repurchase Price” has the meaning set forth in Section 5.1(a).

“Repurchase Notice” has the meaning set forth in Section 4.1(c).

“Repurchase Price” has the meaning set forth in Section 4.1(a).

“Responsible Officer” means, when used with respect to the Trustee, any officer within the corporate trust department of the Trustee, including any vice president, assistant vice president or assistant treasurer or any other officer of the Trustee who customarily performs functions similar to those performed by the persons who at the time shall be such officers, respectively, or to whom any corporate trust matter is referred because of such person’s knowledge of and familiarity with the particular subject and who shall have direct responsibility for the administration of this Indenture.

“Restricted Certificated Security” means a Certificated Security which is a Transfer Restricted Security.

“Restricted Global Security” means a Global Security that is a Transfer Restricted Security.

“Restricted Security” means a Restricted Certificated Security or a Restricted Global Security.

“Rule 144A” means Rule 144A under the Securities Act (or any successor provision), as it may be amended from time to time.

“Sale Price” of one share of Common Stock or one share of Applicable Stock on any date means the closing per share sale price of such Common Stock or Applicable Stock, as applicable (or, if no closing sale price is reported, the average of the bid and ask prices or, if there is more than one bid or ask price, the average of the average bid and the average ask prices) on such date as reported in composite transactions on the Nasdaq National Market or the Nasdaq SmallCap Market or, if the shares of Applicable Stock are not quoted on the Nasdaq National Market or Nasdaq SmallCap Market, as reported on a U.S. national or regional securities exchange, or if not listed on a U.S. national or regional securities exchange, as reported by the National Association of Securities Dealers Automated Quotation System or by the National Quotation Bureau Incorporated. In the absence of such a quotation, the Board of Directors of the Company shall be entitled to make a good faith determination of the sale price on the basis it considers appropriate, which shall be conclusive.

“SEC” means the United States Securities and Exchange Commission.

“Securities Act” means the United States Securities Act of 1933, as amended.

“Security” or “Securities” means any of the Company’s 0.50% Convertible Senior Debentures due 2024, as amended or supplemented from time to time, issued under this Indenture.

“Significant Subsidiary” has the meaning set forth in Rule 1-02(w) of Regulation S-X (17 C.F.R. 210).

“Special Record Date” has the meaning set forth in the Securities.

“Spin-Off” has the meaning set forth in Section 12.3(d).

“Stated Maturity”, when used with respect to any Security, means January 15, 2024.

“Subsidiary” means any Person of which at least a majority of the outstanding voting stock shall at the time directly or indirectly be owned by the Company or by one or more Subsidiaries thereof or by the Company and one or more Subsidiaries.

“TIA” means the United States Trust Indenture Act of 1939 as in effect on the date of this Indenture, provided, however, that in the event the TIA is amended after such date, TIA means, to the extent required by any such amendment, the TIA as so amended.

“Trading Day” means:

(a) if the applicable security is quoted on the Nasdaq National Market, Nasdaq SmallCap Market or any similar United States system of automated dissemination of quotations of securities prices, a day on which trades may be made thereon;

(b) if the applicable security is listed or admitted for trading on the quoted on the NYSE or other national or regional securities exchange, a day on which such exchange is open for business; or

(c) if the applicable security is not so listed or admitted for trading and not so quoted, any day other than a Saturday or Sunday or a day on which banking institutions in the State of New York are authorized or obligated by law or executive order to close.

“Transfer Certificate” has the meaning set forth in Section 2.12(f).

“Transfer Restricted Security” has the meaning set forth in Section 2.12(f).

“Trigger Distribution” has the meaning set forth in Section 12.3(e).

“Trigger Event” has the meaning set forth in Section 12.3(d).

“Trustee” means the party named as the “Trustee” in the first paragraph of this Indenture until a successor replaces it pursuant to the applicable provisions of this Indenture and, thereafter, shall mean such successor. The foregoing sentence shall likewise apply to any subsequent such successor or successors.

“Unrestricted Certificated Security” means a Certificated Security that is not a Transfer Restricted Security.

“Unrestricted Global Security” means a Global Security that is not a Transfer Restricted Security.

Section 1.2. Incorporation by Reference of Trust Indenture Act.

Whenever this Indenture refers to a provision of the TIA, the provision is incorporated by reference in and made a part of this Indenture. The following TIA terms used in this Indenture have the following meanings:

“Commission” means the SEC.

“indenture securities” means the Securities.

“indenture security holder” means a Securityholder.

“indenture to be qualified” means this Indenture.

“indenture trustee” or **“institutional trustee”** means the Trustee.

“obligor” on the indenture securities means the Company.

All other TIA terms used but not defined in this Indenture that are defined by the TIA, defined by TIA reference to another statute or defined by SEC rule have the meanings assigned to them by such definitions.

Section 1.3. Rules of Construction.

Unless the context otherwise requires:

(a) a term has the meaning assigned to it;

(b) an accounting term not otherwise defined has the meaning assigned to it in accordance with accounting principles generally accepted in the United States as in effect from time to time;

(c) “or” is not exclusive;

(d) “including” means including, without limitation; and

(e) words in the singular include the plural, and words in the plural include the singular.

Section 1.4. Acts of Holders.

(a) Any request, demand, authorization, direction, notice, consent, waiver or other action provided by this Indenture to be given or taken by Holders may be embodied in and evidenced by one or more instruments of substantially similar tenor signed by such Holders in person or by an agent duly appointed in writing; and, except as herein otherwise expressly provided, such action shall become effective when such instrument or instruments are delivered to the Trustee and, where it is hereby expressly required, to the Company, as described in Section 14.2. Such instrument or instruments (and the action embodied therein and evidenced thereby) are herein sometimes referred to as the “Act” of Holders signing such instrument or instruments. Proof of execution of any such instrument or of a writing appointing any such agent shall be sufficient for any purpose of this Indenture and conclusive in favor of the Trustee and the Company, if made in the manner provided in this Section.

(b) The fact and date of the execution by any person of any such instrument or writing may be proved by the affidavit of a witness of such execution or by a certificate of a notary public or other officer authorized by law to take acknowledgments of deeds, certifying that the individual signing such instrument or writing acknowledged to such officer the execution thereof. Where such execution is by a signer acting in a capacity other than such signer’s individual capacity, such certificate or affidavit shall also constitute sufficient proof of such signer’s authority, if it so states. The fact and date of the execution of any such instrument or writing, or the authority of the person executing the same, may also be proved in any other manner which the Trustee deems sufficient.

(c) The principal amount and serial number of any Security and the ownership of Securities shall be proved by the register maintained by the Registrar for the Securities.

(d) Any request, demand, authorization, direction, notice, consent, waiver or other Act of the Holder of any Security shall bind every future Holder of the same Security and the Holder of every Security issued upon the registration of transfer thereof or in exchange therefor or in lieu thereof in respect of anything done, omitted or suffered to be done by the Trustee or the Company in reliance thereon, whether or not notation of such action is made upon such Security.

(e) If the Company shall solicit from the Holders any request, demand, authorization, direction, notice, consent, waiver or other Act, the Company may, at its option, by or pursuant to a Board Resolution, fix in advance a record date for the determination of Holders entitled to give such request, demand, authorization, direction, notice, consent, waiver or other Act, but the Company shall have no obligation to do so. If such a record date is fixed, such request, demand, authorization, direction, notice, consent, waiver or other Act may be given before or after such record date, but only the Holders of record at the close of business on such record date shall be deemed to be Holders for the purposes of determining whether Holders of the requisite proportion of Outstanding Securities have authorized or agreed or consented to such request, demand, authorization, direction, notice, consent, waiver or other Act, and for that

purpose the Outstanding Securities shall be computed as of such record date; provided that no such authorization, agreement or consent by the Holders on such record date shall be deemed effective unless it shall become effective pursuant to the provisions of this Indenture not later than six months after the record date.

ARTICLE II

THE SECURITIES

Section 2.1. Form and Dating.

The Securities and the Trustee's certificate of authentication shall be substantially in the form of Exhibit A attached hereto, which is a part of this Indenture. The Securities may have notations, legends or endorsements required by law, stock exchange rule or usage (provided that any such notation, legend or endorsement required by usage is in a form acceptable to the Company). The Company shall provide any such notations, legends or endorsements to the Trustee in writing. Each Security shall be dated the date of its authentication.

(a) Restricted Global Securities. All of the Securities are being offered and sold to QIBs in reliance on Rule 144A and shall be issued initially in the form of one or more Restricted Global Securities, which shall be deposited with the Trustee at its Corporate Trust Office, as custodian for the Depositary and registered in the name of DTC or the nominee thereof, duly executed by the Company and authenticated by the Trustee as hereinafter provided. The aggregate principal amount of the Restricted Global Securities may from time to time be increased or decreased by adjustments made on the records of the Trustee and the Depositary as hereinafter provided.

(b) Global Securities in General. Each Global Security shall represent such of the outstanding Securities as shall be specified therein and each shall provide that it shall initially represent the aggregate amount of outstanding Securities stated thereon, but that the aggregate amount of outstanding Securities represented thereby may from time to time be reduced or increased, as appropriate, to reflect exchanges, redemptions, repurchases and conversions of such Securities.

Any adjustment of the aggregate principal amount of a Global Security to reflect the amount of any increase or decrease in the amount of outstanding Securities represented thereby shall be made by the Trustee in accordance with instructions given by the Holder thereof as required by Section 2.12 and shall be made on the records of the Trustee and the Depositary.

Neither any members of, or participants in, the Depositary (collectively, the "**Agent Members**") nor any other persons on whose behalf Agent Members may act shall have any rights under this Indenture with respect to any Global Security registered in the name of the Depositary or any nominee thereof, or under any such Global Security, and the Depositary or such nominee, as the case may be, may be treated by the Company, the Trustee and any agent of the Company or the Trustee as the absolute owner and Holder of such Global Security for all purposes whatsoever. Notwithstanding the foregoing, nothing contained herein shall (A) prevent the Company, the Trustee or any agent of the Company or the Trustee from giving effect to any

written certification, proxy or other authorization furnished by the Depositary or such nominee, as the case may be, or (B) impair, as between the Depositary, its Agent Members and any other person on whose behalf an Agent Member may act, the operation of customary practices of such Persons governing the exercise of the rights of a Holder of any Security.

(c) Certificated Securities. Certificated Securities will be issued only under the limited circumstances provided in Section 2.12(a)(i).

Section 2.2. Execution and Authentication.

The Securities shall be executed on behalf of the Company by any Officer. The signature of the Officer on the Securities may be manual or facsimile.

A Security bearing the manual or facsimile signature of an individual who was at the time of the execution of the Security an Officer shall bind the Company, notwithstanding that such individual has ceased to hold such office(s) prior to the authentication and delivery of such Securities or did not hold such office(s) at the date of authentication of such Securities.

No Security shall be entitled to any benefit under this Indenture or be valid or obligatory for any purpose unless there appears on such Security a certificate of authentication substantially in the form provided for herein duly executed by the Trustee by manual signature of an authorized signatory, and such certificate upon any Security shall be conclusive evidence, and the only evidence, that such Security has been duly authenticated and delivered hereunder.

The Trustee shall authenticate and deliver the Securities for original issue in an aggregate principal amount of up to \$600,000,000 (which amount includes Securities issued upon exercise of the Initial Purchaser's option provided for in the Purchase Agreement) upon one or more Company Orders without any further action by the Company (other than as contemplated in Section 14.4 and Section 14.5). Subject to the preceding sentence, at any time and from time to time after the execution and delivery of this Indenture, the Company may deliver Securities executed by the Company to the Trustee for authentication. Except as otherwise provided in this Article Two, the Trustee shall thereupon authenticate and make available for delivery said Securities to or upon Company Order. The aggregate principal amount of the Securities due at the Stated Maturity thereof outstanding at any time may not exceed the amount set forth in this paragraph except as provided in Section 2.7. In authenticating such Securities, and accepting the additional responsibilities under this Indenture in relation to such Securities, the Trustee shall receive and shall be fully protected in relying upon:

(a) a copy of the Board Resolution in or pursuant to which the terms and form of the Securities were established, the issuance and sale of the Securities was authorized, this Indenture was authorized and specified Officers were authorized to establish the form and determine the terms of the Securities and the form of this Indenture, to execute the Securities and this Indenture on behalf of the Company and to take any other necessary actions relating thereto and evidence of any actions taken by authorized Officers pursuant to that Board Resolution, each certified by the Secretary or an Assistant Secretary of the Company to have been duly adopted by

the Board of Directors or taken by any authorized Officer and to be in full force and effect as of the date of such certificate;

(b) an Officers' Certificate delivered in accordance with Sections 14.4 and 14.5; and

(c) an Opinion of Counsel reasonably satisfactory to the Trustee.

The Trustee shall act as the initial authenticating agent. Thereafter, the Trustee may appoint an authenticating agent acceptable to the Company to authenticate Securities. An authenticating agent may authenticate Securities whenever the Trustee may do so. Each reference in this Indenture to authentication by the Trustee includes authentication by such agent.

The Securities shall be issued only in registered form without coupons and only in denominations of \$1,000 of principal amount and any multiple of \$1,000.

Section 2.3. Registrar, Paying Agent, Conversion Agent and Bid Solicitation Agent.

The Company shall maintain an office or agency where Securities may be presented for registration of transfer or for exchange ("**Registrar**"), an office or agency where Securities may be presented for redemption, repurchase or payment ("**Paying Agent**"), an office or agency where Securities may be presented for conversion ("**Conversion Agent**") and an office or agency where notices and demands to or upon the Company in respect of the Securities and this Indenture may be served. The Company shall also appoint a bid solicitation agent ("**Bid Solicitation Agent**") to act as set forth in Section 3 of the Securities. Pursuant to Section 6.5, the Company will at all times maintain a Registrar, Paying Agent, Conversion Agent, and Bid Solicitation Agent and an office or agency where notices and demands to or upon the Company in respect of the Securities and this Indenture may be served in the Borough of Manhattan, New York City. The Registrar shall keep a register of the Securities and of their transfer and exchange.

The Company may have one or more co-registrars, one or more additional paying agents, one or more additional conversion agents and one or more additional Bid Solicitation Agents. The term Paying Agent includes any additional paying agent, including any named pursuant to Section 6.5. The term Conversion Agent includes any additional conversion agent, including any named pursuant to Section 6.5.

The Company shall enter into an appropriate limited agency agreement with any Registrar, Paying Agent, Conversion Agent, Bid Solicitation Agent or co-registrar (in each case, if such Person is a Person other than the Trustee). The agreement shall implement the provisions of this Indenture that relate to such agent. The Company shall notify the Trustee of the name and address of any such agent. If the Company fails to maintain a Registrar, Paying Agent, Conversion Agent or Bid Solicitation Agent, the Trustee shall act as such and shall be entitled to appropriate compensation therefor pursuant to Section 9.7. The Company or any Subsidiary or an Affiliate of either of them may act as Paying Agent, Registrar, Conversion Agent or

co-registrar. None of the Company or any Subsidiary or any Affiliate of any of them may act as Bid Solicitation Agent.

The Company hereby initially appoints the Trustee as Registrar, Paying Agent, Conversion Agent and Bid Solicitation Agent in connection with the Securities.

Section 2.4. Paying Agent to Hold Cash and Securities in Trust.

Except as otherwise provided herein, prior to 10:00 a.m., New York City time, on each due date of payments in respect of, or delivery of Common Stock or Applicable Stock upon conversion of, any Security, the Company shall deposit with the Paying Agent Cash (in immediately available funds if deposited on the due date) or with the Conversion Agent such number of shares of Common Stock and/or Applicable Stock sufficient to make such payments or deliveries when so becoming due. The Company shall require each Paying Agent or Conversion Agent, as applicable (other than the Trustee), to agree in writing that such Agent shall hold in trust for the benefit of Securityholders or the Trustee all Cash, Common Stock and Applicable Stock, as applicable, held by such Agent for the making of payments or deliveries in respect of the Securities and shall notify the Trustee of any default by the Company in making any such payment or delivery. If the Company, a Subsidiary or an Affiliate of any of them acts as Paying Agent or Conversion Agent, as applicable, it shall segregate the money, Common Stock and Applicable Stock, as applicable, held by it as Paying Agent or Conversion Agent, as applicable and hold it as a separate trust fund.

The Company at any time may require a Paying Agent or Conversion Agent, as applicable to pay all Cash, Common Stock and Applicable Stock, as applicable, held by it to the Trustee, and to account for any funds and Common Stock or Applicable Stock, as applicable, disbursed by it, and the Trustee may at any time during the continuance of any default, upon the written request to the Paying Agent or Conversion Agent, as applicable, require such Paying Agent or Conversion Agent, as applicable to forthwith pay to the Trustee all Cash, Common Stock and Applicable Stock, as applicable, so held in trust. Upon doing so, the Paying Agent or Conversion Agent, as applicable shall have no further liability for such Cash, Common Stock or Applicable Stock, as applicable.

Section 2.5. Securityholder Lists.

The Trustee shall preserve in as current a form as is reasonably practicable the most recent list available to it of the names and addresses of Securityholders. If the Trustee is not the Registrar, the Company shall cause to be furnished to the Trustee on or before each semiannual interest payment date and at such other times as the Trustee may request in writing a list in such form and as of such date as the Trustee may reasonably require of the names and addresses of Securityholders.

Section 2.6. Transfer and Exchange.

(a) Subject to compliance with any applicable additional requirements contained in Section 2.12, when a Security is presented to the Registrar with a request to register a transfer thereof or to exchange such Security for an equal principal amount of Securities of

other authorized denominations, the Registrar shall register the transfer or make the exchange as requested; *provided, however*, that every Security presented or surrendered for registration of transfer or exchange shall be duly endorsed or accompanied by an assignment form and, if applicable, a transfer certificate, each in the form included in Exhibit A attached hereto and in form satisfactory to the Registrar and each duly executed by the Holder thereof or its attorney duly authorized in writing. To permit registration of transfers and exchanges, upon surrender of any Security for registration of transfer or exchange at an office or agency maintained for such purpose pursuant to Section 2.3, the Company shall execute, and the Trustee shall authenticate Securities of a like aggregate principal amount at the Registrar's request. Any transfer or exchange shall be without charge, except that the Company or the Registrar may require payment of a sum sufficient to pay all taxes, assessments or other governmental charges that may be imposed in connection with the transfer or exchange of the Securities from the Securityholder requesting such transfer or exchange.

Neither the Company, the Registrar nor the Trustee shall be required to exchange or register a transfer of (i) any Securities selected for redemption (except, in the case of Securities to be redeemed in part, the portion thereof not to be redeemed), (ii) any Securities in respect of which a Repurchase Notice or a Repurchase Event Repurchase Notice has been given and not withdrawn by the Holder thereof in accordance with the terms of this Indenture (except, in the case of Securities to be repurchased in part, the portion thereof not to be repurchased) or (iii) any Securities for a period of 15 days before the mailing of a notice of redemption of Securities to be redeemed.

All Securities issued upon any transfer or exchange of Securities shall be valid obligations of the Company, evidencing the same debt and entitled to the same benefits under this Indenture, as the Securities surrendered upon such transfer or exchange.

(b) Any Registrar appointed pursuant to Section 2.3 shall provide to the Trustee such information as the Trustee may reasonably require in connection with the delivery by such Registrar of Securities upon transfer or exchange of Securities.

(c) Each Holder of a Security agrees to indemnify the Company, the Registrar and the Trustee against any liability that may result from the transfer, exchange or assignment of such Holder's Security in violation of any provision of this Indenture and/or applicable United States federal or state securities law.

The Trustee shall have no obligation or duty to monitor, determine or inquire as to compliance with any restrictions on transfer imposed under this Indenture or under applicable law with respect to any transfer of any interest in any Security (including any transfers between or among Agent Members or other beneficial owners of interests in any Global Security) other than to require delivery of such certificates and other documentation or evidence as are expressly required by, and to do so if and when expressly required by the terms of, this Indenture, and to examine the same to determine substantial compliance as to form with the express requirements hereof.

Section 2.7. Replacement Securities.

If (a) any mutilated Security is surrendered to the Company, the Registrar or the Trustee, or (b) the Company, the Registrar and the Trustee receive evidence to their satisfaction of the destruction, loss or theft of any Security, and there is delivered to the Company, the Registrar and the Trustee such security or indemnity as may be required by them to save each of them harmless, then, in the absence of notice to the Company, the Registrar or the Trustee that such Security has been acquired by a bona fide or protected purchaser, the Company shall execute and upon its written request the Trustee shall authenticate and deliver, in exchange for any such mutilated Security or in lieu of any such destroyed, lost or stolen Security, a new Security of like tenor and principal amount, bearing a certificate number not contemporaneously outstanding.

In case any such mutilated, destroyed, lost or stolen Security has become or is about to become due and payable, or is about to be redeemed by the Company pursuant to Article III or repurchased by the Company pursuant to Article IV or V, the Company in its discretion may, instead of issuing a new Security, pay, redeem or repurchase such Security, as the case may be to the Holder of record.

Upon the issuance of any new Securities under this Section 2.7, the Company may require the payment of a sum sufficient to cover any tax, assessment or other governmental charge that may be imposed in relation thereto and any other expenses (including the fees and expenses of the Trustee or the Registrar) connected therewith.

Every new Security issued pursuant to this Section 2.7 in lieu of any mutilated, destroyed, lost or stolen Security shall constitute an original additional contractual obligation of the Company, whether or not the destroyed, lost or stolen Security shall be at any time enforceable by anyone, and shall be entitled to all benefits of this Indenture equally and proportionately with any and all other Securities duly issued hereunder.

The provisions of this Section 2.7 are exclusive and shall preclude (to the extent lawful) all other rights and remedies with respect to the replacement or payment of mutilated, destroyed, lost or stolen Securities.

Section 2.8. Outstanding Securities; Determinations of Holders' Action.

Securities outstanding at any time are all the Securities authenticated by the Trustee, except for those cancelled by it, those paid, redeemed or repurchased pursuant to Section 2.7, those delivered to it for cancellation and those described in this Section 2.8 as not outstanding.

A Security does not cease to be outstanding because the Company or an Affiliate thereof holds the Security; *provided, however*, that in determining whether the Holders of the requisite principal amount of Securities have given or concurred in any request, demand, authorization, direction, notice, consent, waiver, or other Act hereunder, Securities owned by the Company or any other obligor upon the Securities or any Affiliate of the Company or such other obligor shall be disregarded and deemed not to be outstanding, except that, in determining

whether the Trustee shall be protected in relying upon any such request, demand, authorization, direction, notice, consent, waiver or other Act, only Securities which a Responsible Officer of the Trustee actually knows to be so owned shall be so disregarded. Subject to the foregoing, only Securities outstanding at the time of such determination shall be considered in any such determination.

If a Security is replaced pursuant to Section 2.7, the replaced Security ceases to be outstanding unless the Trustee receives proof satisfactory to it that the replaced Security is held by a bona fide or protected purchaser unaware that such Security has been replaced.

If the Paying Agent holds, in accordance with the terms of this Indenture, prior to 10:00 a.m., New York City time, on the Stated Maturity or a Redemption Date or on the Business Day immediately following a Repurchase Date or a Repurchase Event Repurchase Date, as the case may be, Cash or securities, if permitted hereunder, sufficient to pay Securities payable, then immediately after such Stated Maturity, Redemption Date, Repurchase Date or Repurchase Event Repurchase Date, as the case may be, such Securities shall cease to be outstanding and interest and Liquidated Damages Amount, if any, on such Securities shall cease to accrue.

If a Security is converted in accordance with Article XII, then from and after the time of conversion on the date of conversion, such Security shall cease to be outstanding and interest and Liquidated Damages Amount, if any, on such Security shall cease to accrue.

Section 2.9. Temporary Securities.

Pending the preparation of definitive Securities, the Company may execute, and upon Company Order the Trustee shall authenticate and deliver, temporary Securities which are printed, lithographed, typewritten, mimeographed or otherwise produced, in any authorized denomination, substantially of the tenor of the definitive Securities in lieu of which they are issued and with such appropriate insertions, omissions, substitutions and other variations as the officers executing such Securities may determine, as conclusively evidenced by their execution of such Securities.

If temporary Securities are issued, the Company will cause definitive Securities to be prepared without unreasonable delay. After the preparation of definitive Securities, the temporary Securities shall be exchangeable for definitive Securities upon surrender of the temporary Securities at the office or agency of the Company designated for such purpose pursuant to Section 2.3, without charge to the Holder. Upon surrender for cancellation of any one or more temporary Securities the Company shall execute and the Trustee shall authenticate and deliver in exchange therefor a like principal amount of definitive Securities of authorized denominations. Until so exchanged the temporary Securities shall in all respects be entitled to the same benefits under this Indenture as definitive Securities.

Section 2.10. Cancellation.

All Securities surrendered for payment, repurchase by the Company pursuant to Articles IV or V, conversion, redemption or registration of transfer or exchange shall, if

surrendered to any person other than the Trustee, be delivered to the Trustee and shall be promptly cancelled by it. The Company may at any time deliver to the Trustee for cancellation any Securities previously authenticated and delivered hereunder which the Company may have acquired in any manner whatsoever, and all Securities so delivered shall be promptly cancelled by the Trustee. The Company may not issue new Securities to replace Securities it has paid or delivered to the Trustee for cancellation or that any Holder has converted pursuant to Article XII. No Securities shall be authenticated in lieu of or in exchange for any Securities cancelled as provided in this Section, except as expressly permitted by this Indenture. All cancelled Securities held by the Trustee shall be disposed of by the Trustee in accordance with the Trustee's customary procedure.

Section 2.11. Persons Deemed Owners.

Prior to due presentment of a Security for registration of transfer, the Company, the Trustee and any agent of the Company or the Trustee may treat the person in whose name such Security is registered as the owner of such Security for the purpose of receiving payment (whether in Cash, Common Stock or Applicable Stock) of principal of, Redemption Price, Repurchase Price or Repurchase Event Repurchase Price, and interest and Liquidated Damages Amount, if any, on, the Security, for the purpose of receiving Cash, Common Stock or Applicable Stock upon conversion and for all other purposes whatsoever, whether or not such Security is overdue, and neither the Company, the Trustee nor any agent of the Company or the Trustee shall be affected by notice to the contrary.

Section 2.12. Additional Transfer and Exchange Requirements.

(a) Transfer and Exchange of Global Securities.

(i) Certificated Securities shall be issued in exchange for interests in the Global Securities only if (x) the Depositary notifies the Company that it is unwilling or unable to continue as Depositary for the Global Securities or if it at any time ceases to be a "clearing agency" registered under the Exchange Act, if so required by applicable law or regulation and a successor Depositary is not appointed by the Company within 90 days, (y) the Company decides to discontinue use of the system of book-entry transfer through DTC (or any successor depositary) or (z) an Event of Default has occurred and is continuing. In any such case, the Company shall execute, and the Trustee shall, upon receipt of a Company Order (which the Company agrees to deliver promptly), authenticate and deliver Certificated Securities in an aggregate principal amount equal to the principal amount of such Global Securities in exchange therefor. Only Restricted Certificated Securities shall be issued in exchange for beneficial interests in Restricted Global Securities, and only Unrestricted Certificated Securities shall be issued in exchange for beneficial interests in Unrestricted Global Securities. Certificated Securities issued in exchange for beneficial interests in Global Securities shall be registered in such names and shall be in such authorized denominations as the Depositary, pursuant to instructions from its direct or indirect participants or otherwise, shall instruct the Trustee. The Trustee shall deliver or cause to be delivered such Certificated Securities to the Persons in whose name such Securities are so registered. Such exchange shall be effected in accordance with the Applicable Procedures.

(ii) Notwithstanding any other provisions of this Indenture other than the provisions set forth in Section 2.12(a)(i), a Global Security may not be transferred except as a whole by the Depositary to a nominee of the Depositary or by a nominee of the Depositary to the Depositary or another nominee of the Depositary or by the Depositary or any such nominee to a successor Depositary or a nominee of such successor Depositary.

(b) Transfer and Exchange of Certificated Securities. In the event that Certificated Securities are issued in exchange for beneficial interests in Global Securities in accordance with Section 2.12(a)(i), and, on or after such event, Certificated Securities are presented by a Holder to the Registrar with a request:

(x) to register the transfer of the Certificated Securities to a person who will take delivery thereof in the form of Certificated Securities only; or

(y) to exchange such Certificated Securities for an equal principal amount of Certificated Securities of other authorized denominations,

such Registrar shall register the transfer or make the exchange as requested; *provided, however*, that the Certificated Securities presented or surrendered for register of transfer or exchange:

(i) shall be duly endorsed or accompanied by a written instrument of transfer in accordance with the proviso to the first paragraph of Section 2.6; and

(ii) in the case of a Restricted Certificated Security, such request shall be accompanied by the following additional information and documents, as applicable:

(A) if such Restricted Certificated Security is being delivered to the Registrar by a Holder for registration in the name of such Holder, without transfer, or such Restricted Certificated Security is being transferred to the Company or a Subsidiary of the Company, a certification to that effect from such Holder (in substantially the form set forth in the Transfer Certificate);

(B) if such Restricted Certificated Security is being transferred to a person the Holder reasonably believes is a QIB in accordance with Rule 144A, or pursuant to an effective registration statement under the Securities Act or in compliance with Rule 904 under the Securities Act, a certification to that effect from such Holder (in substantially the form set forth in the Transfer Certificate);

(C) if such Restricted Certificated Security is being issued to an institutional “accredited investor” (as defined in Rule 501(a)(1), (2), (3) or (7) under the Securities Act), a certificate to that effect from the Holder (in substantially the form set forth in the Transfer Certificate) and a signed letter containing certain representations and agreements relating to the restrictions on transfer of the Securities in the form obtained from the Trustee;

(D) if such Restricted Certificated Security is being transferred pursuant to an exemption from the registration requirements of the Securities Act in accordance with Rule 144 pursuant to and in compliance with an exemption from the registration requirements under the Securities Act, a certification to that effect from the Holder (in substantially the form set forth in the Transfer Certificate) and if the Company or the Registrar so requests, a customary Opinion of Counsel, certificates and other information reasonably acceptable to the Company and the Registrar to the effect that such transfer does not require registration under the Securities Act.

(c) Transfer of a Beneficial Interest in a Restricted Global Security for a Beneficial Interest in an Unrestricted Global Security.

Any person having a beneficial interest in a Restricted Global Security may upon request, subject to the Applicable Procedures, transfer such beneficial interest to a person who is required or permitted to take delivery thereof in the form of an Unrestricted Global Security. Upon receipt by the Trustee of written instructions, or such other form of instructions as is customary for the Depositary, from the Depositary or its nominee on behalf of any person having a beneficial interest in a Restricted Global Security and the following additional information and documents in such form as is customary for the Depositary from the Depositary or its nominee on behalf of the person having such beneficial interest in the Restricted Global Security (all of which may be submitted by facsimile or electronically):

(i) if such beneficial interest is being transferred pursuant to an effective registration statement under the Securities Act, a certification to that effect from the Holder (in substantially the form set forth in the Transfer Certificate); or

(ii) if such beneficial interest is being transferred pursuant to an exemption from the registration requirements of the Securities Act in accordance with Rule 144, a certification to that effect from the Holder (in substantially the form set forth in the Transfer Certificate) and, if the Company or the Trustee so requests, a customary Opinion of Counsel, certificates and other information reasonably acceptable to the Company and the Register to the effect that such transfer does not require registration under the Securities Act,

the Registrar shall reduce or cause to be reduced the aggregate principal amount of the Restricted Global Security by the appropriate principal amount and shall increase or cause to be increased the aggregate principal amount of the Unrestricted Global Security by a like principal amount. Such transfer shall otherwise be effected in accordance with the Applicable Procedures. If no Unrestricted Global Security is then outstanding, the Company shall execute and the Trustee shall, upon receipt of a Company Order (which the Company agrees to deliver promptly), authenticate and deliver an Unrestricted Global Security.

(d) Transfer of a Beneficial Interest in an Unrestricted Global Security for a Beneficial Interest in a Restricted Global Security.

Any person having a beneficial interest in an Unrestricted Global Security may upon request, subject to the Applicable Procedures, transfer such beneficial interest to a person who is required or permitted to take delivery thereof in the form of a Restricted Global Security. Upon receipt by the Trustee of written instructions, or such

other form of instructions as is customary for the Depositary, from the Depositary or its nominee on behalf of any person having a beneficial interest in an Unrestricted Global Security and the following additional information and documents in such form as is customary for the Depositary, from the Depositary or its nominee on behalf of the person having such beneficial interest in the Unrestricted Global Security (all of which may be submitted by facsimile or electronically):

(i) a certification from the Holder (in substantially the form set forth in the Transfer Certificate) to the effect that such beneficial interest is being transferred to a person that the transferor reasonably believes is a QIB in accordance with Rule 144A; or

(ii) a certification from the Holder (in substantially the form set forth in the Transfer Certificate) to the effect that such beneficial interest is being transferred in compliance with Rule 904 under the Act; or

(iii) a certification from the Holder (in substantially the form set forth in the Transfer Certificate) to the effect that such beneficial interest is being transferred to an institutional “accredited investor” (as defined in Rule 501(a)(1), (2), (3) or (7) under the Securities Act) and a signed letter containing certain representations and agreements relating to the restrictions on transfer of the Securities in the form obtained from the Trustee.

The Registrar shall reduce or cause to be reduced the aggregate principal amount of the Unrestricted Global Security by the appropriate principal amount and shall increase or cause to be increased the aggregate principal amount of the Restricted Global Security by a like principal amount. Such transfer shall otherwise be effected in accordance with the Applicable Procedures. If no Restricted Global Security is then outstanding, the Company shall execute and the Trustee shall, upon receipt of a Company Order (which the Company agrees to deliver promptly), authenticate and deliver a Restricted Global Security.

(e) Transfers of Certificated Securities for Beneficial Interest in Global Securities. In the event that Certificated Securities are issued in exchange for beneficial interests in Global Securities and, thereafter, the events or conditions specified in Section 2.12(a)(i) which required such exchange shall cease to exist, the Company shall mail notice to the Trustee and to the Holders stating that Holders may exchange Certificated Securities or interests in Global Securities by complying with the procedures set forth in this Indenture and briefly describing such procedures and the events or circumstances requiring that such notice be given. Thereafter, if Certificated Securities are presented by a Holder to a Registrar with a request:

(x) to register the transfer of such Certificated Securities to a person who will take delivery thereof in the form of a beneficial interest in a Global Security, which request shall specify whether such Global Security will be a Restricted Global Security or an Unrestricted Global Security, or

(y) to exchange such Certificated Securities for an equal principal amount of beneficial interests in a Global Security, which beneficial interests will be owned by the Holder transferring such Certificated Securities (provided that in the case of such an

exchange, Restricted Certificated Securities may be exchanged only for Restricted Global Securities and Unrestricted Certificated Securities may be exchanged only for Unrestricted Global Securities), the Registrar shall register the transfer or make the exchange as requested by canceling such Certificated Security and causing the aggregate principal amount of the applicable Global Security to be increased accordingly and, if no such Global Security is then outstanding, the Company shall issue and the Trustee shall, upon receipt of a Company Order (which the Company agrees to deliver promptly) authenticate and deliver a new Global Security;

provided, however, that the Certificated Securities presented or surrendered for registration of transfer or exchange:

(i) shall be duly endorsed or accompanied by a written instrument of transfer in accordance with the proviso to Section 2.6(a);

(ii) in the case of a Restricted Certificated Security to be transferred for a beneficial interest in an Unrestricted Global Security, such request shall be accompanied by the following additional information and documents, as applicable:

(A) if such Restricted Certificated Security is being transferred pursuant to an effective registration statement under the Securities Act, a certification to that effect from such Holder (in substantially the form set forth in the Transfer Certificate); or

(B) if such Restricted Certificated Security is being transferred pursuant to an exemption from the registration requirements of the Securities Act in accordance with Rule 144, a certification to that effect from such Holder (in substantially the form set forth in the Transfer Certificate) and, if the Company or the Registrar so requests, a customary Opinion of Counsel, certificates and other information reasonably acceptable to the Company and the Trustee to the effect that such transfer does not require registration under of the Securities Act;

(iii) in the case of a Restricted Certificated Security to be transferred or exchanged for a beneficial interest in a Restricted Global Security, such request shall be accompanied by the following information and documents, as applicable:

(A) if such Restricted Certificated Security is being transferred to a person the Holder reasonably believes is a QIB (which, in the case of an exchange, shall be such Holder) in accordance with Rule 144A, a certification to that effect from such Holder (in substantially the form set forth in the Transfer Certificate); or

(B) if such Restricted Certificated Security is being transferred in compliance with Rule 904 under the Act, certification to that effect from such Holder (in substantially the form set forth in the Transfer Certificate); or

(C) if such Restricted Certificated Security is being transferred to an institutional “accredited investor” (as defined in Rule 501(a)(1), (2), (3) or (7) under the Securities Act), certification to that effect from such Holder (in substantially the form set forth in the Transfer Certificate) and a signed letter containing certain representations and agreements relating to the restrictions on transfer of the Securities in the form obtained from the Trustee;

(iv) in the case of an Unrestricted Certificated Security to be transferred or exchanged for a beneficial interest in an Unrestricted Global Security, such request need not be accompanied by any additional information or documents; and

(v) in the case of an Unrestricted Certificated Security to be transferred or exchanged for a beneficial interest in a Restricted Global Security, such request shall be accompanied by the following additional information and documents, as applicable:

(A) if such Unrestricted Certificated Security is being transferred to a person the Holder reasonably believes is a QIB (which, in the case of an exchange, shall be such Holder) in accordance with Rule 144A, a certification to that effect from such Holder (in substantially the form set forth in the Transfer Certificate); or

(B) if such Unrestricted Certificated Security is being transferred in compliance with Rule 904 under the Act, certification to that effect from such Holder (in substantially the form set forth in the Transfer Certificate); or

(C) if such Unrestricted Certificated Security is being transferred to an institutional “accredited investor” (as defined in Rule 501(a)(1), (2), (3) or (7) under the Securities Act), certification to that effect from such Holder (in substantially the form set forth in the Transfer Certificate) and a signed letter containing certain representations and agreements relating to the restrictions on transfer of the Securities in the form obtained from the Trustee;

(f) Legends.

(i) Except as permitted by the following paragraphs (ii), (iii) and (iv), each Global Security and Certificated Security (and all Securities issued in exchange therefor or upon registration of transfer or replacement thereof) shall bear a legend in substantially the form called for by footnote 2 to Exhibit A attached hereto (each a “**Transfer Restricted Security**”), for so long as it is required by this Indenture to bear such legend. Each Transfer Restricted Security shall have attached thereto a certificate (a “**Transfer Certificate**”) in substantially the form called for by footnote 5 to Exhibit A attached hereto.

(ii) Upon any sale or transfer of a Transfer Restricted Security (x) after the expiration of the holding period applicable to sales of the Securities under Rule

144(k) of the Securities Act, (y) pursuant to Rule 144 or (z) pursuant to an effective registration statement under the Securities Act:

(A) in the case of any Restricted Certificated Security, any Registrar shall permit the Holder thereof to exchange such Restricted Certificated Security for an Unrestricted Certificated Security, or (under the circumstances described in Section 2.12(e)) to transfer such Restricted Certificated Security to a transferee who shall take such Security in the form of a beneficial interest in an Unrestricted Global Security, and in each case shall rescind any restriction on the transfer of such Security; *provided, however*, that the Holder of such Restricted Certificated Security shall, in connection with such exchange or transfer, comply with the other applicable provisions of this Section 2.12; and

(B) in the case of any beneficial interest in a Restricted Global Security, the Trustee shall permit the beneficial owner thereof to transfer such beneficial interest to a transferee who shall take such interest in the form of a beneficial interest in an Unrestricted Global Security and shall rescind any restriction on transfer of such beneficial interest; *provided, however*, that such Unrestricted Global Security shall continue to be subject to the provisions of Section 2.12(a)(ii); and *provided, further*, that the owner of such beneficial interest shall, in connection with such transfer, comply with the other applicable provisions of this Section 2.12.

(iii) Upon the exchange, registration of transfer or replacement of Securities not bearing the legend described in paragraph (1) above, the Company shall execute, and the Trustee shall authenticate and deliver, Securities that do not bear such legend and that do not have a Transfer Certificate attached thereto.

(iv) After the expiration of the holding period pursuant to Rule 144(k) of the Securities Act, the Company may with the consent of the Holder of a Restricted Global Security or a Restricted Certificated Security, remove any restriction of transfer on such Security, and the Company shall execute, and the Trustee shall authenticate and deliver, Securities that do not bear such legend and that do not have a Transfer Certificate attached thereto.

(v) Until the expiration of the holding period applicable to sales of the Securities under Rule 144(k) of the Securities Act or a transfer pursuant to Rule 144 or pursuant to an effective registration statement under the Securities Act, the shares of Common Stock issued upon conversion of the Securities shall bear the legend in substantially the form called for by Exhibit B attached hereto.

(g) Transfers to the Company. Nothing contained in this Indenture or in the Securities shall prohibit the sale or other transfer of any Securities (including beneficial interests in Global Securities) to the Company or any of its Subsidiaries, which Securities shall thereupon be cancelled in accordance with Section 2.10.

Section 2.13. CUSIP Numbers.

The Company may issue the Securities with one or more “CUSIP” numbers (if then generally in use), and, if so, the Trustee shall use “CUSIP” numbers in notices of redemption as a convenience to Holders; *provided, however*, that any such notice may state that no representation is made as to the correctness of such numbers either as printed on the Securities or as contained in any notice of a redemption and that reliance may be placed only on the other identification numbers printed on the Securities, and any such redemption shall not be affected by any defect in or omission of such numbers. The Company will promptly notify the Trustee of any change in the CUSIP numbers.

Section 2.14. Ranking.

The indebtedness of the Company arising under or in connection with this Indenture and every outstanding Security issued under this Indenture from time to time constitutes and will constitute a senior unsecured general obligation of the Company, and ranking equally with existing and future senior unsecured Indebtedness of the Company and ranking senior in right of payment to any future Indebtedness of the Company that is expressly made subordinate to the Securities by the terms of such Indebtedness.

For purposes of this Section 2.14 only, “**Indebtedness**” means, without duplication, the principal or face amount of:

- (a) all obligations for borrowed money;
- (b) all obligations evidenced by bonds, debentures, notes or other similar instruments;
- (c) all obligations in respect of letters of credit or bankers acceptances or similar instruments (or reimbursement obligations with respect thereto);
- (d) all obligations to pay the deferred purchase price of property or services, except trade accounts payable arising in the ordinary course of business;
- (e) all obligations as lessee which are capitalized in accordance with generally accepted accounting principles; and
- (f) all Indebtedness of others guaranteed by the Company or any of its Subsidiaries or for which the Company or any of its Subsidiaries is legally responsible or liable (whether by agreement to purchase indebtedness of, or to supply funds or to invest in, others).

ARTICLE III REDEMPTION

Section 3.1. The Company’s Right to Redeem; Notice to Trustee.

Prior to January 15, 2009, the Securities will not be redeemable at the Company’s option. Beginning on January 15, 2009, the Company, at its option, may redeem the Securities

in accordance with this Article III for Cash at any time as a whole, or from time to time in part, at a redemption price equal to 100% of the principal amount of Securities to be redeemed plus any accrued and unpaid interest and Liquidated Damages Amount, if any, on those Securities to, but not including, the Redemption Date (the “**Redemption Price**”).

In the event that the Company elects to redeem the Securities on a date that is on or after any Regular Record Date but on or before the corresponding Interest Payment Date, the Company shall be required to pay any accrued and unpaid interest and Liquidated Damages Amount, if any, to the same Holder to whom the Company pays the principal of such Security regardless of whether such Holder was the registered Holder on the Regular Record Date immediately preceding such Redemption Date and, if the Holder to whom the Company pays the principal, interest and Liquidation Damages Amount, if any, was not the registered Holder on the Regular Record Date, such payment shall be in lieu of payment to the registered Holder on such Regular Record Date.

If the Company elects to redeem Securities, it shall notify the Trustee in writing of the Redemption Date, the principal amount of Securities to be redeemed and the Redemption Price. The Company shall give this notice to the Trustee by a Company Order at least 35 days before the Redemption Date (unless a shorter notice shall be satisfactory to the Trustee).

Section 3.2. Selection of Securities to Be Redeemed.

If fewer than all of the outstanding Securities are to be redeemed, unless the procedures of the Depositary provide otherwise, the Trustee shall select the Securities to be redeemed by lot, on a pro rata basis or by any other method the Trustee considers fair and appropriate. The Trustee shall make the selection within five Business Days after it receives the notice provided for in Section 3.1 from outstanding Securities not previously called for redemption.

Securities and portions of Securities that the Trustee selects shall be in principal amounts of \$1,000 or a multiple of \$1,000. Provisions of this Indenture that apply to Securities called for redemption also apply to portions of Securities called for redemption. The Trustee shall notify the Company promptly of the Securities or portions of the Securities to be redeemed.

Securities and portions of Securities that are to be redeemed are convertible by the Holder until 5:00 p.m., New York City time, on the Business Day immediately preceding the Redemption Date. If any Security selected for partial redemption is converted in part before termination of the conversion right with respect to the portion of the Security so selected, the converted portion of such Security shall be deemed (so far as may be) to be the portion selected for redemption. Securities which have been converted during a selection of Securities to be redeemed may be treated by the Trustee as outstanding for the purpose of such selection.

Section 3.3. Notice of Redemption.

At least 30 days but not more than 60 days before a Redemption Date, the Company shall mail a notice of redemption by first-class mail, postage prepaid, to each Holder of Securities to be redeemed.

The notice of redemption shall identify the Securities to be redeemed and shall state:

(a) the Redemption Date;

(b) the Redemption Price;

(c) the Conversion Rate;

(d) the name and address of the Paying Agent and Conversion Agent;

(e) that Securities called for redemption may be converted at any time prior to 5:00 p.m., New York City time, on the Business Day preceding the Redemption Date;

(f) that Holders who want to convert their Securities must satisfy the requirements set forth in Article XII;

(g) that Securities called for redemption must be surrendered to the Paying Agent to collect the Redemption Price;

(h) in the case of any Security redeemed in part, that the Holder of such Security will receive a new Security or Securities, of authorized denominations for the principal amount thereof remaining unredeemed;

(i) if fewer than all of the outstanding Securities are to be redeemed, the certificate numbers, if any, and principal amounts of the particular Securities to be redeemed;

(j) that, unless the Company defaults in making payment of such Redemption Price, interest and Liquidated Damages Amount, if any, on Securities called for redemption will cease to accrue on and after the Redemption Date;

(k) the CUSIP number(s) of the Securities to be redeemed; and

(l) any other information the Company at the discretion of the Company.

At the Company's request, the Trustee shall give the notice of redemption in the Company's name and at the Company's expense; *provided, however*, that the Company makes such request at least five Business Days (unless a shorter period shall be satisfactory to the Trustee) prior to the date by which such notice of redemption must be given to Holders in accordance with this Section 3.3; *provided, further*, that the text of the notice of redemption shall be prepared by the Company.

Section 3.4. Effect of Notice of Redemption.

Once notice of redemption is given, Securities called for redemption become due and payable on the Redemption Date and at the Redemption Price, except for Securities which are converted in accordance with the terms of this Indenture. Upon surrender to the Paying Agent, such Securities shall be paid at the Redemption Price.

Section 3.5. Deposit of Redemption Price.

Prior to 10:00 a.m., New York City time, on the applicable Redemption Date, the Company shall deposit with the Paying Agent (or if the Company or a Subsidiary or an Affiliate of any of them is acting as the Paying Agent, shall segregate and hold in trust as provided in Section 2.4) an amount of Cash (in immediately available funds if deposited on the Redemption Date) sufficient to pay the aggregate Redemption Price of all Securities or portions thereof which are to be redeemed as of such Redemption Date other than Securities or portions of Securities called for redemption which on or prior thereto have been delivered by the Company to the Trustee for cancellation or have been converted.

If the Paying Agent holds, in accordance with the terms hereof, at 10:00 a.m., New York City time, on the applicable Redemption Date, Cash sufficient to pay the Redemption Price of any Securities for which notice of redemption is given, then, on such Redemption Date, such Securities will cease to be outstanding and interest and Liquidated Damages Amount, if any, on such Securities will cease to accrue, whether or not such Securities are delivered to the Paying Agent, and the rights of the Holders in respect thereof shall terminate (other than the right to receive the Redemption Price upon delivery of such Securities).

Section 3.6. Securities Redeemed in Part.

Any Certificated Security which is to be redeemed only in part shall be surrendered at the office of the Paying Agent and the Company shall execute and the Trustee shall authenticate and deliver to the Holder of such Security, without charge, a new Security or Securities, of any authorized denomination as requested by such Holder in aggregate principal amount equal to the unredeemed portion of the Security surrendered.

Section 3.7. Repayment to the Company.

To the extent that the aggregate amount of Cash deposited by the Company pursuant to Section 3.5 exceeds the aggregate Redemption Price of the Securities or portions thereof which the Company is redeeming as of the Redemption Date, then, promptly after the Redemption Date, the Paying Agent shall return any such excess to the Company.

ARTICLE IV

REPURCHASE OF SECURITIES AT THE OPTION OF HOLDERS ON SPECIFIC DATES

Section 4.1. Optional Put.

(a) Securities shall be repurchased by the Company, at the option of the Holder thereof, on January 15, 2009, January 15, 2014 and January 15, 2019 (each, a “**Repurchase Date**”), at a repurchase price equal to 100% of the principal amount of those Securities plus accrued and unpaid interest and Liquidated Damages Amount, if any, to, but not

including, such Repurchase Date (the “**Repurchase Price**”), subject to satisfaction by or on behalf of the Holder of the requirements set forth in Section 4.1(c).

(b) No later than 20 Business Days prior to each Repurchase Date, the Company shall mail a written notice of the repurchase right by first class mail to the Trustee and to each Holder (and to beneficial owners as required by applicable law). The notice shall include a form of Repurchase Notice to be completed by the Holder and shall briefly state, as applicable:

- (i) the date by which the Repurchase Notice must be delivered to the Paying Agent in order for a Holder to exercise the repurchase right;
- (ii) the Repurchase Date;
- (iii) the Repurchase Price;
- (iv) the name and address of the Paying Agent and the Conversion Agent;
- (v) the Conversion Rate and any adjustments thereto;
- (vi) that the Securities as to which a Repurchase Notice has been given may be converted if they are otherwise convertible pursuant to Article XII only if the Repurchase Notice has been withdrawn in accordance with the terms of this Indenture;
- (vii) that the Securities must be surrendered to the Paying Agent to collect payment;
- (viii) that the Repurchase Price for any Security as to which a Repurchase Notice has been duly given and not withdrawn will be paid promptly following the later of the Repurchase Date and the time of surrender of such Security;
- (ix) the procedures the Holder must follow to exercise its put right under this Section 4.1;
- (x) the conversion rights, if any, of the Securities;
- (xi) the procedures for withdrawing a Repurchase Notice;
- (xii) that, unless the Company defaults in making payment of such Repurchase Price, interest and Liquidated Damages Amount, if any, on Securities surrendered for repurchase by the Company will cease to accrue on and after the Repurchase Date; and
- (xiii) the CUSIP number(s) of the Securities.

At the Company’s request, the Trustee shall give the notice of repurchase right in the Company’s name and at the Company’s expense; *provided, however*, that the Company makes such request at least three Business Days (unless a shorter period shall be satisfactory to

the Trustee) prior to the date by which such notice of repurchase right must be given to the Holder in accordance with this Section 4.1(b); *provided, further*, that the text of the notice of repurchase right shall be prepared by the Company.

(c) A Holder may exercise its right specified in Section 4.1(a) upon delivery of a written notice of repurchase (a “**Repurchase Notice**”), substantially in the form of Exhibit C hereto, to the Paying Agent at any time during the period beginning at 9:00 a.m., New York City time, on the date that is 20 Business Days immediately preceding the relevant Repurchase Date until 5:00 p.m., New York City time, on the Business Day immediately preceding such Repurchase Date, stating:

- (i) the certificate number of the Security which the Holder will deliver to be repurchased if Certificated Securities have been issued;
- (ii) the portion of the principal amount of the Security which the Holder will deliver to be repurchased, which portion must be in principal amounts of \$1,000 or a multiple of \$1,000; and
- (iii) that such Security shall be repurchased by the Company as of the Repurchase Date pursuant to the terms and conditions specified in the Securities and in this Indenture.

The delivery of such Security to the Paying Agent with, or at any time after delivery of, the Repurchase Notice (together with all necessary endorsements) at the offices of the Paying Agent shall be a condition to the receipt by the Holder of the Repurchase Price therefor; *provided, however*, that such Repurchase Price shall be so paid pursuant to this Section 4.1 only if the Security so delivered to the Paying Agent shall conform in all respects to the description thereof in the related Repurchase Notice.

The Company shall repurchase from the Holder thereof, pursuant to this Section 4.1, a portion of a Security, so long as the principal amount of such portion is \$1,000 or a multiple of \$1,000. Provisions of this Indenture that apply to the repurchase of all of a Security also apply to the repurchase of such portion of such Security.

Any repurchase by the Company contemplated pursuant to the provisions of this Section 4.1 shall be consummated by the delivery of the consideration to be received by the Holder promptly following the later of the Repurchase Date and the time of delivery of the Security.

Notwithstanding anything contained herein to the contrary, any Holder delivering to the Paying Agent the Repurchase Notice contemplated by this Section 4.1(c) shall have the right to withdraw such Repurchase Notice at any applicable time prior to 5:00 p.m., New York City time, on the Business Day immediately preceding the Repurchase Date by delivery of a written notice of withdrawal to the Paying Agent in accordance with Section 4.3.

The Paying Agent shall promptly notify the Company of the receipt by it of any Repurchase Notice or written notice of withdrawal thereof.

Section 4.2. Manner of Payment of Repurchase Price.

The Repurchase Price will be paid in cash.

Section 4.3. Effect of Repurchase Notice.

Upon receipt by the Paying Agent of the Repurchase Notice specified in Section 4.1(c), the Holder of the Security in respect of which such Repurchase Notice was given shall (unless such Repurchase Notice is withdrawn as specified in the following paragraph) thereafter be entitled to receive solely the Repurchase Price with respect to such Security. Securities in respect of which a Repurchase Notice has been given by the Holder thereof may not be converted pursuant to Article XII on or after the date of the delivery of such Repurchase Notice unless such Repurchase Notice has first been validly withdrawn as specified in the following paragraph.

A Repurchase Notice may be withdrawn by means of a written notice of withdrawal delivered to the office of the Paying Agent in accordance with the Repurchase Notice at any time prior to 5:00 p.m., New York City time, on the Business Day immediately preceding the Repurchase Date, specifying:

- (a) the certificate number, if any, of the Security in respect of which such notice of withdrawal is being submitted;
- (b) the principal amount of the Security with respect to which such notice of withdrawal is being submitted; and
- (c) the principal amount, if any, of such Security which remains subject to the original Repurchase Notice and which has been or will be delivered for repurchase by the Company.

Section 4.4. Deposit of Repurchase Price.

Prior to 10:00 a.m., New York City time, on the applicable Repurchase Date, the Company shall deposit with the Paying Agent (or if the Company or a Subsidiary or an Affiliate of any of them is acting as the Paying Agent, shall segregate and hold in trust as provided in Section 2.4) an amount of Cash (in immediately available funds if deposited on such Business Day) sufficient to pay the aggregate Repurchase Price of all the Securities or portions thereof which are to be repurchased on such Repurchase Date.

If the Paying Agent holds, in accordance with the terms hereof, at 10:00 a.m., New York City time, on the applicable Repurchase Date, Cash sufficient to pay the Repurchase Price of any Securities for which a Repurchase Notice has been tendered and not withdrawn pursuant to Section 4.3, then, immediately after such Repurchase Date, such Securities will cease to be outstanding and interest and Liquidated Damages Amount, if any, on such Securities will cease to accrue, whether or not such Securities are delivered to the Paying Agent, and the rights of the Holders in respect thereof shall terminate (other than the right to receive the Repurchase Price upon delivery of such Securities).

Section 4.5. Securities Repurchased in Part.

Any Certificated Security which is to be repurchased only in part shall be surrendered at the office of the Paying Agent (with, if the Company or the Trustee so requires, due endorsement by, or a written instrument of transfer in form satisfactory to the Company and the Trustee duly executed by, the Holder thereof or such Holder's attorney duly authorized in writing) and the Company shall execute and the Trustee shall authenticate and deliver to the Holder of such Security, without charge, a new Security or Securities, of any authorized denomination as requested by such Holder in aggregate principal amount equal to, and in exchange for, the portion of the principal amount of the Security so surrendered which is not repurchased.

Section 4.6. Covenant to Comply With Securities Laws Upon Repurchase of Securities.

When complying with the provisions of Section 4.1 hereof (provided that such offer or purchase constitutes an "issuer tender offer" for purposes of Rule 13e-4 (which term, as used herein, includes any successor provision thereto) under the Exchange Act at the time of such offer or purchase), and subject to any exemptions available under applicable law, the Company shall:

- (a) comply with Rule 13e-4 and Rule 14e-1 (or any successor provision) under the Exchange Act;
- (b) file the related Schedule TO (or any successor schedule, form or report) under the Exchange Act; and
- (c) otherwise comply with all federal and state securities laws so as to permit the rights and obligations under this Article IV to be exercised in the time and in the manner specified therein.

To the extent that the provisions of any securities laws or regulations conflict with the provisions of this Article IV, the Company's compliance with such laws and regulations shall not in and of itself cause a breach of its obligations under this Article IV.

Section 4.7. Repayment to the Company.

To the extent that the aggregate amount of Cash deposited by the Company pursuant to Section 4.4 exceeds the aggregate Repurchase Price of the Securities or portions thereof which the Company is obligated to repurchase on the Repurchase Date, then, promptly after the Repurchase Date, the Paying Agent shall return any such excess to the Company.

ARTICLE V

REPURCHASE AT THE OPTION OF HOLDERS UPON A REPURCHASE EVENT

Section 5.1. Repurchase Event Put.

(a) General. If a Repurchase Event occurs, any Securities not previously repurchased, redeemed or converted by the Company shall be repurchased by the Company at the option of the Holder thereof at a repurchase price equal to 100% of the principal amount of the Securities to be repurchased, plus accrued and unpaid interest and Liquidated Damages Amount, if any, on those notes to, but not including, the Repurchase Event Repurchase Date (the “**Repurchase Event Repurchase Price**”), subject to satisfaction by or on behalf of any Holder of the requirements set forth in Section 5.1(c). The repurchase event repurchase date must be within 30 days after the date of the mailing of the Repurchase Event Company Notice under Section 5.1 (b) (the “**Repurchase Event Repurchase Date**”).

A “**Repurchase Event**” shall be deemed to have occurred upon the occurrence of either a “change in control” or a “termination of trading” where:

(i) a “change in control” will be deemed to have occurred at such time as:

(A) any person or group is or becomes the beneficial owner, directly or indirectly, of 50% or more of the Company’s voting stock;

(B) the Company consolidates with, or merges with or into, another person or any person consolidates with, or merges with or into, the Company, in any such event other than pursuant to a transaction in which the persons that beneficially owned, directly or indirectly, the shares of voting stock immediately prior to such transaction beneficially own immediately after such transaction, directly or indirectly, shares of voting stock representing not less than a majority of the total voting power of all outstanding classes of voting stock of the continuing or surviving corporation in substantially the same proportion as such ownership prior to the transaction;

(C) a majority of the members of the Company’s board of directors are not continuing directors (as defined below);

(D) the sale, lease, transfer or other conveyance or disposition of all or substantially all of the Company’s assets or property to any person or group; or

(E) the Company is liquidated or dissolved, or its stockholders approve any plan or proposal for the liquidation or dissolution of the Company;

Provided, however,

(1) a “change in control” will not be deemed to have occurred if the last sale price of the Common Stock for any five Trading Days during the ten Trading Days immediately preceding the change in control is at least equal to or exceeds 120% of the conversion price in effect on such Trading Day; or

(2) a “change in control” will not be deemed to have occurred under Section 5.1.(a)(i)(A) or Section 5.1.(a)(i)(B), if in the case of a merger or consolidation, all of the consideration (excluding cash payments for fractional shares and cash payments pursuant to dissenters’ appraisal rights) in the merger or consolidation constituting the change in control consists of common stock traded on a United States national securities exchange or quoted on the Nasdaq National Market (or which will be so traded or quoted when issued or exchanged in connection with such change in control) and as a result of such transaction or transactions the debentures become convertible solely into such common stock; and

(3) a “change of control” under Section 5.1.(a)(i)(C) above shall not be deemed to have occurred if it is concurrent and in connection with a change of control transaction covered by items (1) or (2) immediately above, and from and after any such transactions, the term “date of this Indenture” as used in the definition of continuing director (as defined below) shall refer instead to the effective date of such transaction.

(ii) a “termination of trading” shall occur if the Company’s Applicable Stock is neither listed for trading on a United States national or regional securities exchange nor approved for trading on the NASDAQ National Market, NASDAQ SmallCap Market or any other established United States system of automated dissemination of quotations of securities prices.

For purposes of this section, a “continuing director” means, as of any date of determination, any member of the Company’s board of directors who:

(1) was a member of such board of directors on the date of this Indenture; or

(2) was nominated for election or elected to such board of directors with the approval of: (a) a majority of the continuing directors who were members of such board at the time of such nomination or election, or (b) a nominating committee, a majority of which committee shall be continuing directors as the time of such nomination or election.

For purposes of this section, the terms “person” or “group” shall have the meanings used for purposes of Sections 13(d) and 14(d) of the Exchange Act.

For purposes of this section, the terms “beneficial owner,” “beneficially owned” and similar terms shall have the meanings set forth in Rule 13d-3 under the Exchange Act.

For purposes of this section, the term “voting stock” shall mean the Company’s Capital Stock entitled to vote generally in the election of directors.

(b) Notice of Repurchase Event. No later than 20 days after the occurrence of a Repurchase Event, the Company shall mail a written notice of Repurchase Event (the “**Repurchase Event Company Notice**”) by first class mail to the Trustee and to each Holder (and to beneficial owners as required by applicable law). The notice shall include a form of Repurchase Event Repurchase Notice to be completed by the Holder and shall briefly state, as applicable:

- (i) the events causing a Repurchase Event and the date of such Repurchase Event;
- (ii) that the Holder has a right to require the Company to repurchase the Holder’s Securities;
- (iii) the date by which the Repurchase Event Repurchase Notice must be delivered to the Paying Agent in order for a Holder to exercise the Repurchase Event repurchase right;
- (iv) the Repurchase Event Repurchase Date;
- (v) the Repurchase Event Repurchase Price;
- (vi) the name and address of the Paying Agent and the Conversion Agent;
- (vii) the Conversion Rate applicable on the Repurchase Event Company Notice Date and any adjustments to the Conversion Rate that may result from the Repurchase Event;
- (viii) that the Securities as to which a Repurchase Event Repurchase Notice has been given may be converted if they are otherwise convertible pursuant to Article XII only if the Repurchase Event Repurchase Notice has been withdrawn in accordance with the terms of this Indenture;
- (ix) that the Securities must be surrendered to the Paying Agent to collect payment;
- (x) that the Repurchase Event Repurchase Price for any Security as to which a Repurchase Event Repurchase Notice has been duly given and not withdrawn will be paid promptly following the later of the Fundamental Repurchase Date and the time of surrender of such Security;
- (xi) the procedures the Holder must follow to exercise its Repurchase Event repurchase right under this Section 5.1;
- (xii) the conversion rights, if any, of the Securities;
- (xiii) the procedures for withdrawing a Repurchase Event Repurchase Notice;

(xiv) that, unless the Company defaults in making payment of such Repurchase Event Repurchase Price, interest and Liquidated Damages Amount, if any, on Securities surrendered for repurchase by the Company will cease to accrue on and after the Repurchase Event Repurchase Price; and

(xv) the CUSIP number(s) of the Securities.

At the Company's request, the Trustee shall give the Repurchase Event Company Notice in the Company's name and at the Company's expense; *provided, however*, the Company makes such request at least three Business Days (unless a shorter period shall be satisfactory to the Trustee) prior to the date by which such Repurchase Event Company Notice must be given to the Holders in accordance with this Section 5.1(b); *provided, further*, that the text of the Repurchase Event Company Notice shall be prepared by the Company.

(c) Repurchase Event Repurchase Notice. A Holder may exercise its right specified in Section 5.1(a) upon delivery of a written notice of repurchase (a "**Repurchase Event Repurchase Notice**"), substantially in the form of Exhibit D hereto, to the Paying Agent at any time prior to 5:00 p.m., New York City time, on the Business Day immediately preceding the Repurchase Event Repurchase Date, stating:

(i) the certificate number of the Security which the Holder will deliver to be repurchased if Certificated Securities have been issued;

(ii) the portion of the principal amount of the Security which the Holder will deliver to be repurchased, which portion must be \$1,000 or a multiple of \$1,000;

(iii) that such Security shall be repurchased on the Repurchase Event Repurchase Date pursuant to the terms and conditions specified in the Securities and in this Indenture; and

The delivery of such Security to the Paying Agent with, or at any time after delivery of, the Repurchase Event Repurchase Notice (together with all necessary endorsements) at the offices of the Paying Agent shall be a condition to the receipt by the Holder of the Repurchase Event Repurchase Price therefor; *provided, however*, that such Repurchase Event Repurchase Price shall be so paid pursuant to this Section 5.1 only if the Security so delivered to the Paying Agent shall conform in all respects to the description thereof set forth in the related Repurchase Event Repurchase Notice.

The Company shall repurchase from the Holder thereof, pursuant to this Section 5.1, a portion of a Security, so long as the principal amount of such portion is \$1,000 or a multiple of \$1,000. Provisions of this Indenture that apply to the repurchase of all of a Security also apply to the repurchase of such portion of such Security.

Any repurchase by the Company contemplated pursuant to the provisions of this Section 5.1 shall be consummated by the delivery of the consideration to be received by the

Holder promptly following the later of the Repurchase Event Repurchase Date and the time of delivery of the Security.

Notwithstanding anything contained herein to the contrary, any Holder delivering to the Paying Agent the Repurchase Event Repurchase Notice contemplated by this Section 5.1(c) shall have the right to withdraw such Repurchase Event Repurchase Notice at any time prior to 5:00 p.m., New York City time, on the Business Day immediately preceding the Repurchase Event Repurchase Date by delivery of a written notice of withdrawal to the Paying Agent in accordance with Section 5.3.

The Paying Agent shall promptly notify the Company of the receipt by it of any Repurchase Event Repurchase Notice or written notice of withdrawal thereof.

Section 5.2. Manner of Payment of Repurchase Event Repurchase Price.

The Securities to be repurchased with respect to any Repurchase Event Repurchase Date pursuant to 5.1(a) will be paid in cash.

Section 5.3. Effect of Repurchase Event Repurchase Notice.

Upon receipt by the Paying Agent of the Repurchase Event Repurchase Notice specified in Section 5.1(c), the Holder of the Security in respect of which such Repurchase Event Repurchase Notice was given shall (unless such Repurchase Event Repurchase Notice is withdrawn as specified in the following paragraph) thereafter be entitled to receive solely the Repurchase Event Repurchase Price with respect to such Security. Securities in respect of which a Repurchase Event Repurchase Notice has been given by the Holder thereof may not be converted pursuant to Article XII on or after the date of the delivery of such Repurchase Event Repurchase Notice unless such Repurchase Event Repurchase Notice has first been validly withdrawn as specified in the following paragraph.

A Repurchase Event Repurchase Notice may be withdrawn by means of a written notice of withdrawal delivered to the office of the Paying Agent in accordance with the Repurchase Event Repurchase Notice at any time prior to 5:00 p.m., New York City time, on the Business Day immediately preceding the Repurchase Event Repurchase Date, specifying:

- (a) the principal amount of the Security with respect to which such notice of withdrawal is being submitted;
- (b) the certificate number, if any, of the Security in respect of which such notice of withdrawal is being submitted; and
- (c) the principal amount, if any, of such Security which remains subject to the original Repurchase Event Repurchase Notice and which has been or will be delivered for repurchase by the Company.

Section 5.4. Deposit of Repurchase Event Repurchase Price.

Prior to 10:00 a.m., New York City time, on the applicable Repurchase Event Repurchase Date, the Company shall deposit with the Paying Agent (or if the Company or a Subsidiary or an Affiliate of any of them is acting as the Paying Agent, shall segregate and hold in trust as provided in Section 2.4) an amount of Cash (in immediately available funds if deposited on such Business Day), sufficient to pay the aggregate Repurchase Event Repurchase Price of all the Securities or portions thereof which are to be repurchased on such Repurchase Event Repurchase Date.

If the Paying Agent holds, in accordance with the terms hereof, at 10:00 a.m., New York City time, on the applicable Repurchase Event Repurchase Date, Cash sufficient to pay the Repurchase Event Repurchase Price of any Securities for which a Repurchase Event Repurchase Notice has been tendered and not withdrawn pursuant to Section 5.3, then, immediately after such Repurchase Event Repurchase Date, such Securities will cease to be outstanding and interest and Liquidated Damages Amount, if any, on such Securities will cease to accrue, whether or not such Securities are delivered to the Paying Agent, and the rights of the Holders in respect thereof shall terminate (other than the right to receive the Repurchase Event Repurchase Price upon delivery of such Securities).

Section 5.5. Securities Repurchased in Part.

Any Certificated Security which is to be repurchased only in part shall be surrendered at the office of the Paying Agent (with, if the Company or the Trustee so requires, due endorsement by, or a written instrument of transfer in form satisfactory to the Company and the Trustee duly executed by, the Holder thereof or such Holder's attorney duly authorized in writing) and the Company shall execute and the Trustee shall authenticate and deliver to the Holder of such Security, without charge, a new Security or Securities, of any authorized denomination as requested by such Holder in aggregate principal amount equal to, and in exchange for, the portion of the principal amount of the Security so surrendered which is not repurchased.

Section 5.6. Covenant to Comply With Securities Laws Upon Repurchase of Securities.

When complying with the provisions of Section 5.1 hereof (provided that such offer or purchase constitutes an "issuer tender offer" for purposes of Rule 13e-4 (which term, as used herein, includes any successor provision thereto) under the Exchange Act at the time of such offer or purchase), and subject to any exemptions available under applicable law, the Company shall:

- (a) comply with Rule 13e-4 and Rule 14e-1 (or any successor provision) under the Exchange Act;
- (b) file the related Schedule TO (or any successor schedule, form or report) under the Exchange Act; and

(c) otherwise comply with all federal and state securities laws so as to permit the rights and obligations under this Article V to be exercised in the time and in the manner specified therein.

To the extent that the provisions of any securities laws or regulations conflict with the provisions of this Article V, the Company's compliance with such laws and regulations shall not in and of itself cause a breach of its obligations under this Article V.

Section 5.7. Repayment to the Company.

To the extent that the aggregate amount of Cash deposited by the Company pursuant to Section 5.4 exceeds the aggregate Repurchase Event Repurchase Price of the Securities or portions thereof which the Company is obligated to repurchase as of the Repurchase Event Repurchase Date then, promptly after the Repurchase Event Repurchase Date, the Paying Agent shall return any such excess to the Company.

ARTICLE VI

COVENANTS

Section 6.1. Payment of Securities.

The Company shall promptly make all payments in respect of the Securities on the dates and in the manner provided in the Securities or pursuant to this Indenture. Principal amount, Redemption Price, Repurchase Price and Repurchase Event Repurchase Price and accrued and unpaid interest and Liquidated Damages Amount, if any, shall be considered paid on the applicable date due if by 10:00 a.m., New York City time, on such date the Paying Agent holds, in accordance with this Indenture, Cash or securities, if permitted hereunder, sufficient to pay all such amounts then due. The Company shall, to the fullest extent permitted by law, pay interest on overdue principal and overdue installments of interest and Liquidated Damages Amount, if any, at the rate borne by the Securities per annum. Except as otherwise specified, all references in this Indenture or the Securities to interest shall be deemed to include, without duplication, Liquidated Damages Amount, if any, payable pursuant to the Registration Rights Agreement.

Payment of the principal of and interest and Liquidated Damages Amount, if any, on the Securities shall be in Cash.

Except as provided in the immediately succeeding paragraph, the Company shall pay interest and Liquidated Damages Amount, if any, on the Securities to the Person in whose name the Securities are registered at the close of business on the Regular Record Date next preceding the corresponding Interest Payment Date. Any such interest and Liquidated Damages Amount, if any, not so punctually paid or duly provided for will forthwith cease to be payable to the Holder on such Regular Record Date and may be paid (a) to the Person in whose name the Securities are registered at the close of business on a Special Record Date for the payment of such defaulted interest and Liquidated Damages Amount, if any, to be fixed by the Trustee, notice whereof will be given to the Holders not less than 10 days prior to such Special Record

Date or (b) at any time in any other lawful manner not inconsistent with the requirements of any securities exchange on which the Securities may be listed, and upon such notice as may be required by such exchange.

If a Security is redeemed pursuant to Article III hereof or the Holder elects to require the Company to repurchase such Security pursuant to either Article IV or Article V hereof on a date that is after the Regular Record Date and prior to the corresponding Interest Payment Date, interest and Liquidated Damages Amount, if any, accrued and unpaid on such Security to, but not including, the applicable Redemption Date, Repurchase Date or Repurchase Event Repurchase Date will be paid to the same Holder to whom the Company pays the principal of such Security regardless of whether such Holder was the registered Holder on the Regular Record Date immediately preceding the applicable Redemption Date, Repurchase Date or Repurchase Event Repurchase Date.

Holders must surrender the Securities to the Paying Agent to collect payment of principal. Payment of interest and Liquidated Damages Amount, if any, on Certificated Securities will be made by (i) check mailed to the address of the Person entitled thereto as such address appears in the Register if such Securities have an aggregate principal amount of \$5 million or less or (ii) wire transfer of immediately available funds to an account designated by such Person if such Securities have an aggregate principal amount in excess of \$5 million. Notwithstanding the foregoing, so long as the Securities are registered in the name of a Depositary or its nominee, all payments with respect to the Securities shall be made by wire transfer of immediately available funds to the account of the Depositary or its nominee.

Section 6.2. SEC and Other Reports to the Trustee.

The Company shall ensure delivery to the Trustee within 15 days after it files such annual and quarterly reports, information, documents and other reports with the SEC, copies of its annual report and of the information, documents and other reports (or copies of such portions of any of the foregoing as the SEC may by rules and regulations prescribe) which the Company is required to file with the SEC pursuant to Section 13 or 15(d) of the Exchange Act in accordance with TIA Section 314(a); *provided, however*, that the Company shall not be required to deliver to the Trustee any material for which the Company has sought and received confidential treatment by the SEC. In the event the Company is at any time no longer subject to the reporting requirements of Section 13 or 15(d) of the Exchange Act, it shall continue to provide the Trustee with annual and quarterly reports containing substantially the same information as would have been required to be filed with the SEC had the Company continued to have been subject to such reporting requirements. In such event, such reports shall be provided at the times the Company would have been required to provide reports had it continued to have been subject to such reporting requirements. The Company also shall comply with the other provisions of TIA Section 314(a). Delivery of such reports, information and documents to the Trustee is for informational purposes only and the Trustee's receipt of such shall not constitute constructive notice of any information contained therein or determinable from information contained therein, including the Company's compliance with any of its covenants hereunder (as to which the Trustee is entitled to rely exclusively on Officers' Certificates).

Section 6.3. Compliance Certificate.

The Company shall deliver to the Trustee within 120 days after the end of each fiscal year of the Company (beginning with the fiscal year ending February 29, 2004) an Officers' Certificate, stating whether or not to the knowledge of the signers thereof, the Company is in Default in the performance and observance of any of the terms, provisions and conditions of this Indenture and if the Company shall be in Default, specifying all such Defaults and the nature and status thereof of which they may have knowledge.

Section 6.4. Further Instruments and Acts.

Upon reasonable request of the Trustee, or as otherwise necessary, the Company will execute and deliver such further instruments and do such further acts as may be reasonably necessary or proper to carry out more effectively the purposes of this Indenture.

Section 6.5. Maintenance of Office or Agency of the Trustee, Registrar, Paying Agent and Conversion Agent.

The Company will maintain in the Borough of Manhattan, The City of New York, an office or agency of the Trustee, Registrar, Paying Agent and Conversion Agent where Securities may be presented or surrendered for payment, where Securities may be surrendered for registration of transfer, exchange, redemption, repurchase or conversion and where notices and demands to or upon the Company in respect of the Securities and this Indenture may be served. An office of the Trustee shall initially be such office or agency for all of the aforesaid purposes. The Company shall give prompt written notice to the Trustee of the location, and of any change in the location, of any such office or agency (other than a change in the location of the office of the Trustee). If at any time the Company shall fail to maintain any such required office or agency or shall fail to furnish the Trustee with the address thereof, such presentations, surrenders, notices and demands may be made or served at the address of the Trustee set forth in Section 14.2.

The Company may also from time to time designate one or more other offices or agencies where the Securities may be presented or surrendered for any or all such purposes and may from time to time rescind such designations; *provided, however*, that no such designation or rescission shall in any manner relieve the Company of its obligation to maintain an office or agency in the Borough of Manhattan, The City of New York, for such purposes.

Section 6.6. Delivery of Information Required Under Rule 144A.

At any time when the Company is not subject to Section 13 or 15(d) of the Exchange Act, upon the request of a Holder or any beneficial owner of Securities or holder or beneficial owner of shares of Common Stock issued upon conversion thereof, the Company will make available the information required pursuant to Rule 144A(d)(4) under the Securities Act to such Holder or any beneficial owner of Securities or holder or beneficial owner of shares of Common Stock issued upon conversion thereof, or to a prospective purchaser of any such security designated by any such holder, as the case may be, to the extent required to permit compliance by such Holder or holder with Rule 144A under the Securities Act in connection

with the resale of any such security; *provided, however*, that the Company shall not be required to furnish such information in connection with any request made on or after the date which is two years from the later of the date such security was last acquired from the Company or an “affiliate” (as defined under Rule 144 under the Securities Act) of the Company. Whether a person is a beneficial owner shall be determined by the Company to the Company’s reasonable satisfaction.

Section 6.7. Waiver of Stay, Extension or Usury Laws.

The Company covenants (to the extent that it may lawfully do so) that it will not at any time insist upon, or plead, or in any manner whatsoever claim or take the benefit or advantage of, any stay or extension law or any usury or other law wherever enacted, now or at any time hereafter in force, which would prohibit or forgive the Company from paying all or any portion of the principal amount, Redemption Price, Repurchase Price or Repurchase Event Repurchase Price in respect of Securities, or any interest and Liquidated Damages Amount, if any, on such amounts, as contemplated herein, or which may affect the covenants or the performance of this Indenture; and the Company (to the extent that it may lawfully do so) hereby expressly waives all benefit or advantage of any such law, and covenants that it will not hinder, delay or impede the execution of any power herein granted to the Trustee, but will suffer and permit the execution of every such power as though no such law had been enacted.

Section 6.8. Statement by Officers as to Default.

The Company shall deliver to the Trustee, as soon as practicable and in any event within five Business Days after the Company becomes aware of the occurrence of any Default or Event of Default or, an Officers’ Certificate setting forth the details of such Default or Event of Default and the action which the Company proposes to take with respect thereto.

ARTICLE VII

SUCCESSOR CORPORATION

Section 7.1. When Company May Merge or Transfer Assets.

The Company shall not consolidate with, merge with or into, or sell, assign, convey, transfer or lease its properties and assets substantially in their entirety (computed on a consolidated basis) to any Person, unless:

(a) either (i) the Company is the surviving entity or (ii) the successor or transferee (the “successor corporation”) is a corporation organized and existing under the laws of the United States, any State thereof, or the District of Columbia and shall expressly assume, by an indenture supplemental hereto, executed and delivered to the Trustee, all of the obligations of the Company under the Securities and the Indenture;

(b) immediately after giving effect to such transaction, no Event of Default, and no event which, after notice or the passage of time, or both, would become an Event of Default under this Indenture shall exist; and

(c) the Company shall have delivered to the Trustee an Officers' Certificate and, if requested by the Trustee, an Opinion of Counsel, each stating that such consolidation, merger, conveyance, transfer, sale, lease or other disposition and, if a supplemental indenture is required in connection with such transaction, such supplemental indenture, comply with this Article VII and that all conditions precedent herein provided for relating to such transaction have been satisfied.

Section 7.2. Successor Corporation Substituted

Upon any consolidation with or merger into any corporation, or any conveyance, transfer or lease of the properties and assets of the Company substantially in their entirety in accordance with Section 7.1, the successor corporation formed by such consolidation or into which the Company is merged or to which such conveyance, transfer or lease is made shall succeed to, and be substituted for, and may exercise every right and power of, the Company under this Indenture with the same effect as if such successor corporation had been named as the Company herein, and in the case of a conveyance, transfer, or lease of the properties and assets of the Company substantially in their entirety, the Company shall be irrevocably released from its liabilities as obligor and maker of the Securities and from its obligations under this Indenture.

ARTICLE VIII

DEFAULTS AND REMEDIES

Section 8.1. Events of Default.

So long as any Securities are outstanding, each of the following shall be an “**Event of Default**”:

(a) the Company defaults in the payment of the principal amount, with respect to the Securities, when the same become due and payable;

(b) the Company defaults in the payment of any accrued and unpaid interest and Liquidated Damages Amount, if any, in each case, when due and payable, and continuance of such default for a period of 30 days;

(c) following the exercise by the Holder of the right to convert a Security pursuant to and in accordance with Article XII, the Company fails to deliver the Common Stock upon conversion pursuant to Section 12.2(d);

(d) the Company fails to provide the Repurchase Event Company Notice as required by this Indenture.

(e) the Company fails to comply with any of its agreements or covenants in the Securities or this Indenture (other than those referred to in clause (a) through (d) above) and such failure continues for 60 days after receipt by the Company of a Notice of Default (defined below);

(f) the Company fails or any Significant Subsidiary fails to make any payment at maturity on any Indebtedness, including any applicable grace periods, in an amount in excess of \$10,000,000 in the aggregate for all such Indebtedness and such amount has not been paid or discharged within 30 days after receipt by the Company of a Notice of Default;

(g) a default by the Company or any Significant Subsidiary that results in the acceleration of maturity of any Indebtedness of the Company or any Significant Subsidiary (other than Non-Recourse Indebtedness), at any one time, in an amount in excess of \$10,000,000 unless the acceleration is rescinded, stayed or annulled within 30 days after receipt by the Company of a Notice of Default;

(h) the Company or any Significant Subsidiary, pursuant to or under or within the meaning of any Bankruptcy Law:

(i) commences a voluntary case or proceeding;

(ii) consents to the entry of any order for relief against it in an involuntary case or proceeding or the commencement of any case against it;

(iii) consents to the appointment of a Custodian of it or for any substantial part of its property;

(iv) makes a general assignment for the benefit of its creditors;

(v) files a petition in bankruptcy or answer or consent seeking reorganization or relief; or

(vi) consents to the filing of such petition or the appointment of or taking possession by a Custodian; or

(i) a court of competent jurisdiction enters an order or decree under any Bankruptcy Law that:

(i) is for relief against the Company or any Significant Subsidiary, in an involuntary case or proceeding;

(ii) appoints a Custodian of the Company or any Significant Subsidiary, or for any substantial part of its property; or

(iii) orders the winding up or liquidation of the Company or any Significant Subsidiary,

and the order of decree remains unstayed and in effect for 60 days.

A Default under clause (e), (f) or (g) above is not an Event of Default until the Trustee notifies the Company, or the Holders of at least 25% in aggregate principal amount of the Securities at the time outstanding notify the Company and the Trustee, of the Default and the Company does not cure such Default (and such Default is not waived) within the time specified

in clause (e), (f) or (g) above after actual receipt of such notice. Any such notice must specify the Default, demand that it be remedied and state that such notice is a **“Notice of Default.”**

Section 8.2. Acceleration.

If an Event of Default (other than an Event of Default specified in Section 8.1(h) or (i)) occurs and is continuing, the Trustee by notice to the Company, or the Holders of at least 25% in aggregate principal amount of the Securities at the time outstanding by notice to the Company and the Trustee, may declare the principal amount plus accrued and unpaid interest and Liquidated Damages Amount, if any, on all the Securities to be immediately due and payable. Upon such a declaration, such accelerated amount shall be due and payable immediately.

If an Event of Default specified in Section 8.1(h) or (i) occurs and is continuing, the principal amount plus accrued and unpaid interest and Liquidated Damages Amount, if any, on all the Securities shall become and be immediately due and payable without any declaration or other act on the part of the Trustee or any Securityholders.

The Holders of not less than a majority in aggregate principal amount of the Securities at the time outstanding, by notice to the Trustee (and without notice to any other Securityholder) may rescind an acceleration and its consequences if the rescission would not conflict with any judgment or decree for payment of money under this Indenture or the Debentures and if all existing Events of Default have been cured or waived except nonpayment of the principal amount plus accrued and unpaid interest and Liquidated Damages Amount, if any, that have become due solely as a result of acceleration and if all amounts due to the Trustee under Section 9.7 have been paid. No such rescission shall affect any subsequent Default or impair any right consequent thereto.

Section 8.3. Other Remedies.

If an Event of Default occurs and is continuing, the Trustee may, but shall not be obligated to, pursue any available remedy to collect the payment of the principal amount plus accrued and unpaid interest and Liquidated Damages Amount, if any, on the Securities or to enforce the performance of any provision of the Securities or this Indenture.

The Trustee may maintain a proceeding even if the Trustee does not possess any of the Securities or does not produce any of the Securities in the proceeding. A delay or omission by the Trustee or any Securityholder in exercising any right or remedy accruing upon an Event of Default shall not impair the right or remedy or constitute a waiver of, or acquiescence in, the Event of Default. No remedy is exclusive of any other remedy. All available remedies are cumulative.

Section 8.4. Waiver of Past Defaults.

Subject to Sections 8.7 and 11.2, the Holders of not less than a majority in aggregate principal amount of the Securities at the time outstanding, by notice to the Trustee

(and without notice to any other Securityholder), may waive an existing Default (or Event of Default) and its consequences except:

(a) an Event of Default in the payment of the principal of, or any interest or Liquidated Damages Amount, if any, with respect to, any Security or the payment of any applicable Repurchase Price, Repurchase Event Repurchase Price or Redemption Price; or

(b) a Default in respect of any provision of this Indenture or the Securities, which, under Section 11.2, cannot be amended or modified without the consent of each Securityholder affected thereby.

When a Default is waived, it is deemed cured, but no such waiver shall extend to any subsequent or other Default or impair any consequent right. This Section 8.4 shall be in lieu of Section 316(a)1(B) of the TIA and such Section 316(a)1(B) is hereby expressly excluded from this Indenture, as permitted by the TIA.

Section 8.5. Control by Majority.

The Holders of a majority in aggregate principal amount of the Securities at the time outstanding may direct the time, method and place of conducting any proceeding for any remedy available to the Trustee or of exercising any trust or power conferred on the Trustee. However, the Trustee may refuse to follow any direction that conflicts with law or this Indenture or that the Trustee determines in good faith is prejudicial to the rights of other Securityholders or would involve the Trustee in personal liability unless the Trustee is offered indemnity or security satisfactory to it. This Section 8.5 shall be in lieu of Section 316(a)1(A) of the TIA and such Section 316(a)1(A) is hereby expressly excluded from this Indenture, as permitted by the TIA.

Section 8.6. Limitation on Suits.

A Securityholder may not pursue any remedy with respect to this Indenture or the Securities unless:

(a) the Holder gives to the Trustee written notice stating that an Event of Default is continuing;

(b) the Holders of at least 25% in aggregate principal amount of the Securities at the time outstanding make a written request to the Trustee to pursue the remedy;

(c) such Holder or Holders offer to the Trustee security or indemnity satisfactory to the Trustee against any loss, liability or expense;

(d) the Trustee does not comply with the request within 60 days after receipt of such notice, request and offer of security or indemnity; and

(e) the Holders of a majority in aggregate principal amount of the Securities at the time outstanding do not give the Trustee a direction inconsistent with the request during such 60-day period.

A Securityholder may not use this Indenture to prejudice the rights of any other Securityholder or to obtain a preference or priority over any other Securityholder.

Section 8.7. Rights of Holders to Receive Payment or to Convert.

Notwithstanding any other provision of this Indenture, the right of any Holder to receive payment of the principal amount, Redemption Price, Repurchase Price, Repurchase Event Repurchase Price or interest and Liquidated Damages Amount, if any, in respect of the Securities held by such Holder, on or after the respective due dates expressed in the Securities and in this Indenture, and to convert such Securities in accordance with Article XII, or to bring suit for the enforcement of any such payment on or after such respective dates or the right to convert, is absolute and unconditional and shall not be impaired or affected adversely without the consent of such Holder.

Section 8.8. Collection Suit by Trustee.

If an Event of Default described in Section 8.1(a) or (b), occurs and is continuing, the Trustee may recover judgment in its own name and as trustee of an express trust against the Company or another obligor on the Securities for the whole amount owing with respect to the Securities and the amounts provided for in Section 9.7.

Section 8.9. Trustee May File Proofs of Claim.

In case of the pendency of any receivership, insolvency, liquidation, bankruptcy, reorganization, arrangement, adjustment, composition or other judicial proceeding relative to the Company or any other obligor upon the Securities or the property of the Company or of such other obligor or their creditors, the Trustee (irrespective of whether the principal amount, Redemption Price, Repurchase Price, Repurchase Event Repurchase Price or interest and Liquidated Damages Amount, if any, in respect of the Securities shall then be due and payable as therein expressed or by declaration or otherwise and irrespective of whether the Trustee shall have made any demand on the Company for the payment of any such amount) shall be entitled and empowered, by intervention in such proceeding or otherwise:

(a) to file and prove a claim for the whole amount of the principal amount, Redemption Price, Repurchase Price, Repurchase Event Repurchase Price, or interest and Liquidated Damages Amount, if any, and to file such other papers or documents as may be necessary or advisable in order to have the claims of the Trustee (including any claim for the reasonable compensation, expenses, disbursements and advances of the Trustee, its agents and counsel or any other amounts due the Trustee under Section 9.7) and of the Holders allowed in such judicial proceeding, and

(b) to collect and receive any moneys or other property payable or deliverable on any such claims and to distribute the same;

and any custodian, receiver, assignee, trustee, liquidator, sequestrator or similar official in any such judicial proceeding is hereby authorized by each Holder to make such payments to the Trustee and, in the event that the Trustee shall consent to the making of such payments directly

to the Holders, to pay the Trustee any amount due it for the reasonable compensation, expenses, disbursements and advances of the Trustee, its agents and counsel, and any other amounts due the Trustee under Section 9.7.

Nothing contained herein shall be deemed to authorize the Trustee to authorize or consent to or accept or adopt on behalf of any Holder any plan of reorganization, arrangement, adjustment or composition affecting the Securities or the rights of any Holder thereof, or to authorize the Trustee to vote in respect of the claim of any Holder in any such proceeding.

Section 8.10. Priorities.

(a) If the Trustee collects any money pursuant to this Article VIII, it shall pay out the money in the following order:

FIRST: to the Trustee for amounts due under Section 9.7;

SECOND: to Securityholders for amounts due and unpaid on the Securities for the principal amount, Redemption Price, Repurchase Price, Repurchase Event Repurchase Price or interest and Liquidated Damages Amount, if any, as the case may be, ratably, without preference or priority of any kind, according to such amounts due and payable on the Securities; and

THIRD: the balance, if any, to the Company.

The Trustee may fix a record date and payment date for any payment to Securityholders pursuant to this Section 8.10. At least 15 days before such record date, the Trustee shall mail to each Securityholder and the Company a notice that states the record date, the payment date and the amount to be paid.

Section 8.11. Undertaking for Costs.

In any suit for the enforcement of any right or remedy under this Indenture or in any suit against the Trustee for any action taken or omitted by it as Trustee, a court in its discretion may require the filing by any party litigant (other than the Trustee) in the suit of an undertaking to pay the costs of the suit, and the court in its discretion may assess reasonable costs, including reasonable attorneys' fees and expenses, against any party litigant in the suit, having due regard to the merits and good faith of the claims or defenses made by the party litigant. This Section 8.11 does not apply to a suit by the Trustee, a suit by a Holder pursuant to Section 8.7 or a suit by Holders of more than 10% in aggregate principal amount of the Securities at the time outstanding. This Section 8.11 shall be in lieu of Section 315(e) of the TIA and such Section 315(e) is hereby expressly excluded from this Indenture, as permitted by the TIA.

Section 8.12. Restoration of Rights and Remedies.

If the Trustee or any Holder has instituted any proceedings to enforce any right or remedy under this Indenture and such proceeding has been discontinued or abandoned for any reason, or has been determined adversely to the Trustee or to such Holder, then and in every

case, subject to any determination in such proceeding, the Company, the Trustee and the Holders shall be restored severally and respectively to their former positions hereunder and thereafter all rights and remedies of the Trustee and the Holders shall continue as though no such proceeding had been instituted.

ARTICLE IX

TRUSTEE

Section 9.1. Duties of Trustee.

(a) If an Event of Default has occurred and is continuing, the Trustee shall exercise the rights and powers vested in it by this Indenture and use the same degree of care and skill in its exercise of those rights and powers as a prudent person would exercise or use under the circumstances in the conduct of such person's own affairs.

(b) Except during the continuance of an Event of Default:

(i) the Trustee undertakes to perform such duties and only such duties as are specifically set forth in this Indenture, and no implied covenants or obligations shall be read into this Indenture against the Trustee; and

(ii) in the absence of bad faith on its part, the Trustee may conclusively rely, as to the truth of the statements and the correctness of the opinions expressed therein, upon certificates or opinions furnished to the Trustee and conforming to the requirements of this Indenture, but in the case of any such certificates or opinions which by any provision hereof are specifically required to be furnished to the Trustee, the Trustee shall examine the certificates and opinions to determine whether or not they conform to the requirements of this Indenture, but need not confirm or investigate the accuracy of mathematical calculations or other facts stated therein.

This Section 9.1(b) shall be in lieu of Section 315(a) of the TIA and such Section 315(a) is hereby expressly excluded from this Indenture, as permitted by the TIA.

(c) The Trustee may not be relieved from liability for its own negligent action, its own negligent failure to act or its own willful misconduct, except that:

(i) this Section (c) does not limit the effect of Section (b) of this Section 9.1;

(ii) the Trustee shall not be liable for any error of judgment made in good faith by a Responsible Officer unless it is proved that the Trustee was negligent in ascertaining the pertinent facts; and

(iii) the Trustee shall not be liable with respect to any action it takes or omits to take in good faith in accordance with a direction received by it pursuant to Section 8.5.

Subparagraphs (c)(i), (ii) and (iii) shall be in lieu of Sections 315(d)(1), 315(d)(2) and 315(d)(3) of the TIA, respectively, and such Sections 315(d)(1), 315(d)(2) and 315(d)(3) are hereby expressly excluded from this Indenture, as permitted by the TIA.

(d) Every provision of this Indenture that in any way relates to the Trustee is subject to paragraphs (a), (b), (c) and (e) of this Section 9.1.

(e) The Trustee may refuse to perform any duty or exercise any right or power or extend or risk its own funds or otherwise incur any financial liability unless it receives indemnity or security satisfactory to it against any loss, liability or expense.

(f) Money held by the Trustee in trust hereunder need not be segregated from other funds except to the extent required by law. The Trustee (acting in any capacity hereunder) shall be under no liability for interest on any money received by it hereunder unless otherwise agreed in writing with the Company.

Section 9.2. Rights of Trustee.

Subject to its duties and responsibilities under Section 9.1 and under the TIA,

(a) the Trustee may conclusively rely and shall be protected in acting or refraining from acting upon any resolution, certificate, statement, instrument, opinion, report, notice, request, direction, consent, order, bond, debenture, note, other evidence of indebtedness or other paper or document believed by it to be genuine and to have been signed or presented by the proper party or parties;

(b) whenever in the administration of this Indenture the Trustee shall deem it desirable that a matter be proved or established prior to taking, suffering or omitting any action hereunder, the Trustee (unless other evidence be herein specifically prescribed) may, in the absence of bad faith on its part, conclusively rely upon an Officers' Certificate;

(c) the Trustee may execute any of the trusts or powers hereunder or perform any duties hereunder either directly or by or through agents or attorneys and the Trustee shall not be responsible for any misconduct or negligence on the part of any agent or attorney appointed with due care by it hereunder;

(d) the Trustee shall not be liable for any action taken, suffered, or omitted to be taken by it in good faith which it believes to be authorized or within its rights or powers conferred under this Indenture;

(e) the Trustee may consult with counsel selected by it and any advice or Opinion of Counsel shall be full and complete authorization and protection in respect of any action taken or suffered or omitted by it hereunder in good faith and in reliance on such advice or Opinion of Counsel;

(f) the Trustee shall be under no obligation to exercise any of the rights or powers vested in it by this Indenture at the request, order or direction of any of the Holders, pursuant to the provisions of this Indenture, unless such Holders shall have offered to the Trustee

security or indemnity satisfactory to it against the costs, expenses and liabilities which may be incurred therein or thereby;

(g) any request or direction of the Company mentioned herein shall be sufficiently evidenced by a Company Request or Company Order and any resolution of the Board of Directors may be sufficiently evidenced by a Board Resolution;

(h) the Trustee shall not be bound to make any investigation into the facts or matters stated in any resolution, certificate, statement, instrument, opinion, report, notice, request, direction, consent, order, bond, debenture, note, other evidence of indebtedness or other paper or document, but the Trustee, in its discretion, may make such further inquiry or investigation into such facts or matters as it may see fit, and, if the Trustee shall determine to make such further inquiry or investigation, it shall be entitled to examine the books, records and premises of the Company, personally or by agent or attorney at the sole cost of the Company and shall incur no liability or additional liability of any kind by reason of such inquiry or investigation;

(i) the Trustee shall not be deemed to have notice of any Default or Event of Default unless a Responsible Officer of the Trustee has actual knowledge thereof or unless written notice of any event which is in fact such a default is received by the Trustee at the Corporate Trust Office of the Trustee, and such notice references the Securities and this Indenture;

(j) the rights, privileges, protections, immunities and benefits given to the Trustee, including, without limitation, its right to be indemnified, are extended to, and shall be enforceable by, the Trustee in each of its capacities hereunder, and to each agent, custodian and other person employed to act hereunder; and

(k) the Trustee may request that the Company deliver an Officers' Certificate setting forth the names of individuals and/or titles of officers authorized at such time to take specified actions pursuant to this Indenture, which Officers' Certificate may be signed by any person authorized to sign an Officers' Certificate, including any person specified as so authorized in any such certificate previously delivered and not superseded.

Section 9.3. Individual Rights of Trustee.

The Trustee in its individual or any other capacity may become the owner or pledgee of Securities and may otherwise deal with the Company or its Affiliates with the same rights it would have if it were not Trustee. Any Paying Agent, Registrar, Conversion Agent or co-registrar may do the same with like rights. However, the Trustee must comply with Sections 9.10 and 9.11.

Section 9.4. Trustee's Disclaimer.

The Trustee makes no representation as to the validity or adequacy of this Indenture or the Securities, it shall not be accountable for the Company's use or application of the proceeds from the Securities, it shall not be responsible for any statement in any registration

statement for the Securities under the Securities Act or in any offering document for the Securities, this Indenture or the Securities (other than its certificate of authentication), or the determination as to which beneficial owners are entitled to receive any notices hereunder.

Section 9.5. Notice of Defaults.

If a Default occurs and if it is known to the Trustee, the Trustee shall give to each Securityholder notice of the Default within 90 days after it occurs or, if later, within 15 days after it is known to the Trustee, unless such Default shall have been cured or waived before the giving of such notice. Notwithstanding the preceding sentence, except in the case of a Default described in Section 8.1(a) or (b), the Trustee may withhold the notice if and so long as a committee of its Responsible Officers in good faith determines that withholding the notice is in the interest of the Securityholders. The preceding sentence shall be in lieu of the proviso to Section 315(b) of the TIA and such proviso is hereby expressly excluded from this Indenture, as permitted by the TIA.

Section 9.6. Reports by Trustee to Holders.

Within 60 days after each May 15 beginning with the May 15 following the date of this Indenture, the Trustee shall mail to each Securityholder a brief report dated as of such May 15 that complies with TIA Section 313(a), if required by such Section 313(a). The Trustee also shall comply with TIA Section 313(b). The Trustee will also transmit by mail all reports as required by TIA Section 313(c).

The Company agrees to notify the Trustee promptly whenever the Securities become listed on any securities exchange and of any delisting thereof.

Section 9.7. Compensation and Indemnity.

The Company agrees to:

(a) pay to the Trustee from time to time such compensation as the Company and the Trustee shall from time to time agree in writing for all services rendered by it hereunder (which compensation shall not be limited (to the extent permitted by law) by any provision of law in regard to the compensation of a trustee of an express trust);

(b) reimburse the Trustee upon its request for all reasonable expenses, disbursements and advances incurred or made by the Trustee in accordance with any provision of this Indenture (including the reasonable compensation and the expenses, advances and disbursements of its agents and counsel), except any such expense, disbursement or advance as may be attributable to its own negligence or willful misconduct or bad faith; and

(c) fully indemnify the Trustee, any predecessor Trustee and each of their directors and officers for, and to hold each of them harmless against, any and all loss, damage, claim, liability, cost or expense (including reasonable attorney's fees and expenses, and taxes (other than taxes based upon, measured by or determined by the income of the Trustee)) incurred without negligence or willful misconduct or bad faith on the part of the Person so indemnified,

arising out of or in connection with the acceptance or administration of this trust, including the reasonable costs and expenses of defending against any claim (whether asserted by the Company or any Holder or any other person) or liability in connection with the exercise or performance of any powers or duties hereunder, or in connection with enforcing the provisions of this Section 9.7.

The Trustee shall notify the Company promptly of any claim for which it may seek indemnity hereunder; *provided*, that a failure to notify shall not relieve the Company of its obligations hereunder except to the extent the Company is materially prejudiced by such failure. The Trustee shall have the right to employ one separate counsel in any such action or proceeding and participate in the investigation and defense thereof, and the Company shall pay the reasonable fees and expenses of such separate counsel; *provided, however*, that the Trustee may only employ such separate counsel at the expense of the Company if in the reasonable judgment of the outside counsel to the Trustee (i) a conflict of interest exists by reason of common representation or (ii) there are legal defenses available to the Trustee that are different from or are in addition to those available to the Company or if all parties commonly represented do not agree as to the action (or inaction) of counsel.

To secure the Company's payment obligations in this Section 9.7, the Trustee shall have a lien prior to the Securities on all money or property held or collected by the Trustee, except that held in trust to pay the principal amount, Redemption Price, Repurchase Price, Repurchase Event Repurchase Price or interest and Liquidated Damages Amount, if any, as the case may be, on particular Securities.

The Company's payment obligations pursuant to this Section 9.7 shall survive the discharge of this Indenture and the resignation or removal of the Trustee. When the Trustee incurs expenses after the occurrence of a Default specified in Section 8.1(h) or (i), the expenses including the reasonable charges and expenses of its counsel, are intended to constitute expenses of administration under any Bankruptcy Law.

Section 9.8. Replacement of Trustee.

The Trustee may resign by so notifying the Company; *provided, however*, that no such resignation shall be effective until a successor Trustee has accepted its appointment pursuant to this Section 9.8. The Holders of a majority in aggregate principal amount of the Securities at the time outstanding may remove the Trustee by so notifying the Trustee and the Company. The Company as soon as practicable shall remove the Trustee if:

- (a) the Company becomes aware that the Trustee fails to comply with Section 9.10;
- (b) the Trustee is adjudged bankrupt or insolvent or an order for relief is entered with respect to the Trustee under any Bankruptcy Law;
- (c) a receiver or public officer takes charge of the Trustee or its property; or
- (d) the Trustee otherwise becomes incapable of acting.

If the Trustee resigns or is removed or if a vacancy exists in the office of Trustee for any reason, the Company shall promptly appoint, by resolution of its Board of Directors, a successor Trustee.

A successor Trustee shall deliver a written acceptance of its appointment to the retiring Trustee and to the Company satisfactory in form and substance to the retiring Trustee and the Company. Thereupon the resignation or removal of the retiring Trustee shall become effective, and the successor Trustee shall have all the rights, powers and duties of the Trustee under this Indenture. The successor Trustee shall mail a notice of its succession to Securityholders. The retiring Trustee shall promptly transfer all property held by it as Trustee to the successor Trustee, subject to the lien provided for in Section 9.7.

If a successor Trustee does not take office within 30 days after the retiring Trustee resigns or is removed, the retiring Trustee, the Company or the Holders of a majority in aggregate principal amount of the Securities at the time outstanding may petition at the expense of the Company any court of competent jurisdiction at the expense of the Company for the appointment of a successor Trustee.

If the Trustee fails to comply with Section 9.10, any Securityholder may petition any court of competent jurisdiction for the removal of the Trustee and the appointment of a successor Trustee.

Section 9.9. Successor Trustee by Merger.

If the Trustee consolidates with, merges or converts into, or transfers all or substantially all its corporate trust business or assets to, another corporation or company, the resulting, surviving or transferee corporation without any further act shall be the successor Trustee.

Section 9.10. Eligibility; Disqualification.

The Trustee shall at all times satisfy the requirements of TIA Sections 310(a)(1) and 310(b). The Trustee (or its parent holding company) shall have a combined capital and surplus of at least \$100,000,000 as set forth in its most recent published annual report of condition. Nothing contained herein shall prevent the Trustee from filing with the Commission the application referred to in the penultimate paragraph of TIA Section 310(b).

Section 9.11. Preferential Collection of Claims Against Company.

The Trustee shall comply with TIA Section 311(a), excluding any creditor relationship listed in TIA Section 311(b). A Trustee who has resigned or been removed shall be subject to TIA Section 311 (a) to the extent indicated therein.

ARTICLE X

DISCHARGE OF INDENTURE

Section 10.1. Discharge of Liability on Securities.

When (a) the Company delivers to the Trustee all outstanding Securities (other than Securities replaced or repaid pursuant to Section 2.7) for cancellation or (b) all outstanding Securities have become due and payable (whether at the Stated Maturity or upon acceleration, or on any Redemption Date, or with respect to any Repurchase Date or Repurchase Event Repurchase Date, or upon conversion) and the Company deposits with the Paying Agent or Conversion Agent Cash, Common Stock or Applicable Stock, as applicable, sufficient to pay all amounts due and owing on all outstanding Securities (other than Securities replaced pursuant to Section 2.7), and if in either case the Company pays all other sums payable hereunder by the Company, then this Indenture shall, subject to Section 9.7, cease to be of further effect. The Trustee shall join in the execution of a document prepared by the Company acknowledging satisfaction and discharge of this Indenture on demand of the Company accompanied by an Officers' Certificate and Opinion of Counsel and at the cost and expense of the Company.

Section 10.2. Repayment to the Company.

The Trustee and the Paying Agent shall return to the Company upon written request any Cash or securities held by them for the payment of any amount with respect to the Securities that remains unclaimed for two years, subject to applicable unclaimed property law. After return to the Company, Holders entitled to the Cash or securities must look to the Company for payment as general creditors unless an applicable abandoned property law designates another person and the Trustee and the Paying Agent shall have no further liability to the Securityholders with respect to such Cash or securities for that period commencing after the return thereof.

ARTICLE XI

AMENDMENTS

Section 11.1. Without Consent of Holders.

The Company and the Trustee may amend this Indenture or the Securities without the consent of any Securityholder to:

- (a) add to the covenants of the Company for the benefit of the Holders of Securities;
- (b) surrender any right or power herein conferred upon the Company by the Indenture;

(c) provide for the assumption of the Company's obligations to the Holders of Securities in the case of a merger, consolidation, conveyance, transfer, sale, lease or other disposition pursuant to Article VII;

(d) increase the Conversion Rate or reduce the Conversion Price; *provided, however*, that such increase in the Conversion Rate or reduction in the Conversion Price, as the case may be, is in accordance with the terms of this Indenture or shall not adversely affect the interests of the Holders of Securities;

(e) provide for a successor Trustee with respect to the Securities;

(f) add any additional Events of Default with respect to all or any of the Securities;

(g) secure the Securities;

(h) supplement any of the provisions of the Indenture to such extent as shall be necessary to permit or facilitate the discharge of the Securities, provided that such change or modification does not adversely affect the interests of the Holders of the Securities;

(i) make any changes or modifications necessary in connection with the registration of the Securities under the Securities Act as contemplated in the Registration Rights Agreement; *provided, however*, that such action does not adversely affect the interests of the Holders of Securities in any material respect;

(j) cure any ambiguity, correct or supplement any provision herein which may be inconsistent with any other provision herein or which is otherwise defective, or to make any other provisions with respect to matters or questions arising under this Indenture which the Company may deem necessary or desirable and which shall not be inconsistent with the provisions of this Indenture; *provided, however*, that such action does not adversely affect the interests of the Holders of Securities;

(k) add or modify any other provisions herein with respect to matters or questions arising hereunder which the Company and the Trustee may deem necessary or desirable and which would not adversely affect the interests of the Holders of Securities;

(l) comply with the requirements of the SEC in order to effect or maintain the qualification of this Indenture under the TIA;

(m) provide for issuance of the Securities in coupon form; and

(n) make provision with respect to the conversion rights of Holders of the Securities in accordance with this Indenture in connection with a reclassification, consolidation, combination, merger or sale of all or substantially all of the Company's property and assets.

Section 11.2. With Consent of Holders.

Except as provided below in this Section 11.2, this Indenture or the Securities may be amended, modified or supplemented, and noncompliance in any particular instance with any provision of this Indenture or the Securities may be waived, in each case with the written consent or affirmative vote of the Holders of not less than a majority of the principal amount of the Securities at the time outstanding.

Without the written consent or the affirmative vote of each Holder of Securities affected thereby (in addition to the written consent or the affirmative vote of the Holders of at least a majority of the principal amount of the Securities at the time outstanding), an amendment or waiver under this Section 11.2 may not:

- (a) change the maturity of the principal amount of or the payment date of any installment of interest or Liquidated Damages Amount, if any, on, any Security;
- (b) reduce the principal amount of, or rate of interest or Liquidated Damages Amount, if any, on, or Redemption Price, Repurchase Price or Repurchase Event Repurchase Price of, any Security;
- (c) change the currency of payment of principal amount of, or interest or Liquidated Damages Amount, if any, on, or the Redemption Price, Repurchase Price or Repurchase Event Repurchase Price of, any Security from U.S. Dollars;
- (d) alter the manner of calculation or rate of accrual of interest or Liquidated Damages Amount, if any, on any Security;
- (e) impair the right of any Holder to institute suit for the enforcement of any repurchase of, payment on or with respect to, or conversion of, any Security, including any payment on or after the stated maturity of the Securities, in the case of redemption, on or after the Redemption Date, or in the case of repayment at the option of the Holder, on or after the Repurchase Date or Repurchase Event Repurchase Date;
- (f) modify the obligation of the Company to maintain an agency in The City of New York pursuant to Section 6.5;
- (g) adversely affect the right of Holders of the Securities to convert such Securities as provided in Article XII;
- (h) adversely affect the right of Holders of the Securities to require the Company to repurchase such Securities as provided in Articles IV and V;
- (i) modify the optional redemption provisions of Article III in a manner that adversely affects the Holders of the Securities;
- (j) reduce the percentage of the principal amount of the outstanding Securities the written consent or affirmative vote of whose Holders is required to take specific actions under the Indenture;

(k) reduce the percentage of the principal amount of the outstanding Securities the written consent or affirmative vote of whose Holders is required for any waiver of any past Default provided for in this Indenture; or

(l) modify any of (a)-(k) above.

It shall not be necessary for the consent of the Holders under this Section 11.2 to approve the particular form of any proposed amendment, but it shall be sufficient if such consent approves the substance thereof.

After an amendment under this Section 11.2 becomes effective, the Company shall mail to each Holder a notice briefly describing the amendment.

Nothing contained in this Section 11.2 shall impair the ability of the Company and the Trustee to amend this Indenture or the Securities without the consent of any Securityholder to provide for the assumption of the Company's obligations to the Holders of Securities in the case of a merger, consolidation, conveyance, transfer, sale, lease or other disposition pursuant to Article VII.

Section 11.3. Compliance with Trust Indenture Act.

Every supplemental indenture executed pursuant to this Article shall comply with the TIA.

Section 11.4. Revocation and Effect of Consents, Waivers and Actions.

Until an amendment, waiver or other action by Holders becomes effective, a consent thereto by a Holder of a Security hereunder is a continuing consent by the Holder and every subsequent Holder of that Security or portion of the Security that evidences the same obligation as the consenting Holder's Security, even if notation of the consent, waiver or action is not made on the Security. However, any such Holder or subsequent Holder may revoke the consent, waiver or action as to such Holder's Security or portion of the Security if the Trustee receives the notice of revocation before the date the amendment, waiver or action becomes effective. After an amendment, waiver or action becomes effective, it shall bind every Securityholder.

Section 11.5. Notation on or Exchange of Securities.

Securities authenticated and delivered after the execution of any supplemental indenture pursuant to this Article XI may, and shall if required by the Trustee, bear a notation in form approved by the Trustee as to any matter provided for in such supplemental indenture. If the Company shall so determine, new Securities so modified as to conform, in the opinion of the Trustee and the Board of Directors, to any such supplemental indenture may be prepared and executed by the Company and authenticated and delivered by the Trustee in exchange for outstanding Securities.

Section 11.6. Trustee to Sign Supplemental Indentures.

The Trustee shall sign any supplemental indenture authorized pursuant to this Article XI if the amendment contained therein does not affect the rights, duties, liabilities or immunities of the Trustee. If it does, the Trustee may, but need not, sign such supplemental indenture. In signing such supplemental indenture the Trustee shall receive, and (subject to the provisions of Section 9.1) shall be fully protected in relying upon, an Officers' Certificate and an Opinion of Counsel stating that such amendment is authorized or permitted by this Indenture.

Section 11.7. Effect of Supplemental Indentures.

Upon the execution of any supplemental indenture under this Article, this Indenture shall be modified in accordance therewith, and such supplemental indenture shall form a part of this Indenture for all purposes; and every Holder of Securities theretofore or thereafter authenticated and delivered hereunder shall be bound thereby.

ARTICLE XII

CONVERSION

Section 12.1. Conversion Privilege.

(a) Subject to and upon compliance with the provisions of this Article XII, a Holder of a Security shall have the right, at such Holder's option, to convert all or any portion (if the portion to be converted is \$1,000 or a multiple of \$1,000) of such Security into shares of Common Stock at the Conversion Rate in effect on the Conversion Date only as follows:

(i) during any fiscal quarter (beginning with the quarter ending May 31, 2004) if the Sale Price of the Common Stock for at least 20 consecutive Trading Days in the Measurement Period during the immediately preceding fiscal quarter exceeds 120% of the Conversion Price in effect on the last Trading Day of such Measurement Period (in the event that the Conversion Price on such last Trading Day of such Measurement Period is not the same as the Conversion Price in effect for each of the Trading Days in such Measurement Period, the Company shall make such adjustments as it, in its discretion, deems appropriate in determining whether the foregoing condition has been met);

(ii) during any five consecutive Trading Day period immediately following any five consecutive Trading Day period (the "**Debenture Measurement Period**") in which the average Market Price per \$1,000 principal amount of Securities during such Debenture Measurement Period was less than 97% of the average Conversion Value during such Debenture Measurement Period; *provided*, however, that a Holder shall not have the right to convert any Security pursuant to this Section 12.1(a)(ii) after January 15, 2019 if on any Trading Day during such Debenture Measurement Period the Sale Price was greater than the then-current Conversion Price but less than 120% of the then-current Conversion Price;

(iii) at any time prior to 5:00 p.m., New York City time, on the Business Day immediately preceding the Redemption Date, if such Security has been called for redemption pursuant to Article III hereof; or

(iv) as provided in Section 12.1(b).

The Company shall, determine at the end of each applicable period whether the Securities shall be convertible as a result of the occurrence of an event specified in clause (a) or (b) above and, if the Securities shall be so convertible, the Company shall promptly deliver to the Trustee written notice thereof. Whenever the Securities shall become convertible pursuant to this Section 12.1, the Company or, at the Company's request, the Trustee in the name and at the expense of the Company, shall notify the Holders in writing of the event triggering such convertibility in the manner provided in Section 14.2, and the Company shall also publicly announce such information and publish it on the Company's website. Any notice so given shall be conclusively presumed to have been duly given, whether or not the Holder receives such notice.

(b) In addition, in the event that:

(i)

(A) the Company distributes to all holders of Common Stock rights or warrants (other than pursuant to a stockholder rights plan) entitling them to purchase Common Stock at less than the Sale Price of the Common Stock at the time of the distribution of the rights or warrants; or

(B) the Company distributes to all holders of Common Stock cash or other assets, debt securities or certain rights to purchase the Company's securities, which distribution has a per share value as determined by the Board of Directors of the Company exceeding 15% of the Sale Price of the Common Stock on the Business Day immediately preceding the declaration for such distribution;

then, in each case, the Company must notify, in writing, Holders of Securities of the occurrence of such an event at least 20 days prior to the Ex-Dividend Date for any such distribution. Once the Company has given such notice, Holders may surrender their Securities for conversion at any time until the earlier of the close of business on the Business Day immediately preceding the Ex-Dividend Date or the date of announcement by the Company that the distribution will not take place. No Holder may convert its Securities pursuant to this Section 12.1(b) if such Holder may participate in the distribution without conversion.

(ii) the Company becomes party to a consolidation, merger or binding share exchange pursuant to which the Common Stock of the Company would be converted into cash, securities or other property, a Holder may surrender the Securities for conversion at any time from and after the date which is 15 days prior to the anticipated effective date of the transaction until 15 days after the actual date of the transaction. If the Company becomes party to a consolidation, merger or binding share

exchange pursuant to which the Common Stock of the Company would be converted into cash, securities or other property, then at the effective time of the transaction, the right to convert the Securities into Common Stock shall be changed into a right to convert such Securities into the kind and amount of cash, securities or other property which the Holder would have received if the Holder had converted such Securities immediately prior to the transaction. If the transaction constitutes a Repurchase Event, the Holder shall have the rights set forth in Article V above.

(iii) any “person” or “group” (as such terms are used for purposes of Sections 13(d) and 14(d) of the Exchange Act) becomes the “beneficial owner” (as such term is used in Rule 13-d-3 under the Exchange Act), directly or indirectly, of 50% or more of the total voting power of all classes of the Company’s capital stock entitled to vote generally in the election of directors, a holder may surrender the Securities for conversion at any time from and after the date that is 15 days prior to the anticipated effective date of the transaction or event until 15 days after the actual date of such transaction or event. If the transaction constitutes a Repurchase Event, the Holder shall have the rights set forth in Article V above.

Section 12.2. Conversion Procedure; Conversion Rate; Fractional Shares.

(a) Each Security shall be convertible at the office of the Conversion Agent into fully paid and nonassessable shares (calculated to the nearest 1/100th of a share) of Common Stock. The Security will be converted into shares of Common Stock at the Conversion Rate therefore.

No payment or adjustment shall be made in respect of dividends on the Common Stock or accrued interest (but not accrued and unpaid Liquidated Damages Amount, if any) on a converted Security, except as described in Section 12.9 hereof. In accordance with Section 2(e) of the Registration Rights Agreement, any accrued but unpaid Liquidated Damages Amount with respect to a Security delivered for conversion to but not including the Conversion Date shall be paid to the Notice Holder (as defined in the Registration Rights Agreement) who delivered such Security for conversion on or promptly following the Conversion Date.

The Company shall not issue any fraction of a share of Common Stock in connection with any conversion of Securities, but instead shall, subject to Section 12.3(g) hereof, make a Cash payment (calculated to the nearest cent) equal to such fraction multiplied by the Sale Price of the Common Stock on the last Trading Day prior to the date of conversion.

Notwithstanding the foregoing, a Security in respect of which a Holder has delivered a Repurchase Notice or Repurchase Event Repurchase Notice exercising such Holder’s option to require the Company to repurchase such Security may be converted only if such notice of exercise is withdrawn in accordance with Sections 4.3 or 5.3 hereof, as the case may be, prior to the close of business on the Business Day immediately preceding the applicable Repurchase Date or Repurchase Event Repurchase Date, as the case may be.

(b) Before any Holder of a Security shall be entitled to convert the same into Common Stock, such Holder shall, in the case of Securities issued in global form, comply with the procedures of the Depositary in effect at that time, and in the case of certificated Securities, surrender such Securities, duly endorsed to the Company or in blank, at the office of the Conversion Agent, and shall give written notice to the Company at said office or place in the form of the Conversion Notice attached to the Security (the “**Conversion Notice**”) that such Holder elects to convert the same and shall state in writing therein the principal amount of Security to be converted and the name or names (with addresses) in which such Holder wishes the certificate or certificates for Common Stock to be issued.

Before any such conversion, a Holder also shall pay all funds required, if any, relating to interest on the Securities, as provided in Section 12.9, and all taxes or duties, if any, as provided in Section 12.8.

If more than one Security shall be surrendered for conversion at one time by the same Holder, the number of full shares of Common Stock which shall be deliverable upon conversion shall be computed on the basis of the aggregate principal amount of the Security (or specified portions thereof to the extent permitted thereby) so surrendered.

If shares of Common Stock to be issued upon conversion of a Restricted Security are to be issued in the name of a Person other than the Holder of such Restricted Security, such Holder must deliver to the Conversion Agent a certification in substantially the form set forth in a Transfer Certificate dated the date of surrender of such Restricted Security and signed by such Holder, as to compliance with the restrictions on transfer applicable to such Restricted Security. The Company shall not be required to issue Common Stock upon conversion of any such Restricted Security to a Person other than the Holder if such Restricted Security is not so accompanied by a properly completed certification, and the Registrar shall not be required to register Common Stock upon conversion of any such Restricted Security in the name of a Person other than the Holder if such Restricted Security is not so accompanied by a properly completed certification.

(c) A Security shall be deemed to have been converted as of the close of business on the date of the surrender of such Security for conversion as provided above (such date, the “**Conversion Date**” for such Security), and the person or persons entitled to receive any Common Stock issuable upon such conversion shall be treated for all purposes as the record Holder or Holders of such Common Stock as of the close of business on such date. Upon conversion, all obligations under the Securities so converted will be deemed satisfied, including with respect to any accrued and unpaid interest, but not with respect to accrued and unpaid Liquidated Damages Amount, if any, which shall be paid upon conversion in accordance with this Section 12.2.

(d) Delivery of Common Stock and Cash in respect of accrued and unpaid Liquidated Damages Amount, if any, to a Holder of a Security upon conversion of such Security shall be accomplished by delivery to the Conversion Agent of certificates for the relevant number of shares, other than in the case of Holders of Common Stock in book-entry form with the Depositary, which shares will be delivered in accordance with the Depositary’s customary

practices and delivery of Cash in respect of Liquidated Damages Amount, if any, to the Conversion Agent or the Depository, as applicable, for payment to the Holder.

(e) In case any Certificated Security shall be surrendered for partial conversion, the Company shall execute and the Trustee shall authenticate and deliver to or upon the written order of the Holder of the Security so surrendered, without charge to such Holder (subject to the provisions of Section 12.8 hereof), a new Security or Securities in authorized denominations in an aggregate principal amount equal to the unconverted portion of the surrendered Certificated Securities.

(f) If a holder exercises its right to require the Company to repurchase the Securities as described in Article IV or Article V, such Holder may convert its Securities as provided above only if it withdraws its applicable Repurchase Notice or Repurchase Event Repurchase Notice and converts its Securities prior to the close of business on the business day immediately preceding the applicable Repurchase Date.

Section 12.3. Adjustment of Conversion Rate.

The Conversion Rate shall be adjusted from time to time as follows:

(a) In case the Company shall, at any time or from time to time while any of the Securities are outstanding, pay a dividend or make a distribution in shares of Common Stock to all holders of its outstanding shares of Common Stock, then the Conversion Rate in effect at the opening of business on the date next following the Record Date fixed for the determination of stockholders entitled to receive such dividend or other distribution shall be increased by multiplying such Conversion Rate by a fraction:

(i) the numerator of which shall be the sum of the number of shares of Common Stock outstanding at the close of business on such Record Date fixed for such determination and the total number of shares constituting such dividend or other distribution; and

(ii) the denominator of which shall be the number of shares of Common Stock outstanding at the close of business on such Record Date fixed for such determination.

Such increase shall become effective immediately after the opening of business on the day following the Record Date fixed for such determination.

If any dividend or distribution of the type described in this Section 12.3(a) is declared but not so paid or made, the Conversion Rate shall again be adjusted to the Conversion Rate which would then be in effect if such dividend or distribution had not been declared.

(b) In case the Company shall, at any time or from time to time while any of the Securities are outstanding, subdivide its outstanding shares of Common Stock into a greater number of shares of Common Stock, then the Conversion Rate in effect at the opening of business on the day following the day upon which such subdivision becomes effective shall be

proportionately increased, and conversely, in case the Company shall, at any time or from time to time while any of the Securities are outstanding, combine its outstanding shares of Common Stock into a smaller number of shares of Common Stock, then the Conversion Rate in effect at the opening of business on the day following the day upon which such combination becomes effective shall be proportionately decreased. In each such case, the Conversion Rate shall be adjusted by multiplying such Conversion Rate by a fraction, the numerator of which shall be the number of shares of Common Stock outstanding immediately after giving effect to such subdivision or combination and the denominator of which shall be the number of shares of Common Stock outstanding immediately prior to such subdivision or combination. Such increase or reduction, as the case may be, shall become effective immediately after the opening of business on the day following the day upon which such subdivision or combination becomes effective.

(c) In case the Company shall, at any time or from time to time while any of the Securities are outstanding, issue rights or warrants (other than pursuant to a shareholders rights plan) exercisable for a period less than or equal to 60 days (other than any rights or warrants referred to in Section 12.3(d)), to all holders of its shares of Common Stock entitling them to subscribe for or purchase shares of Common Stock (or securities convertible into or exchangeable or exercisable for shares of Common Stock), at a price per share (or having a conversion, exchange or exercise price per share) less than the Sale Price of the Common Stock on the Trading Day immediately preceding the date of the announcement of such issuance (treating the conversion, exchange or exercise price per share of the securities convertible into or exchangeable or exercisable for Common Stock as equal to the quotient of (x) the sum of (i) the price for a unit of the security convertible into or exchangeable or exercisable for Common Stock and (ii) any additional consideration initially payable upon the conversion, exchange or exercise of such security into Common Stock divided by (y) the number of shares of Common Stock initially underlying such convertible, exchangeable or exercisable security), then the Conversion Rate shall be adjusted so that the same shall equal the rate determined by multiplying the Conversion Rate in effect at the opening of business on the date after such date of announcement by a fraction:

(i) the numerator of which shall be the number of shares of Common Stock outstanding at the close of business on the date of announcement, plus the total number of additional shares of Common Stock so offered for subscription or purchase (or into which the convertible, exchangeable or exercisable securities so offered are convertible, exchangeable or exercisable); and

(ii) the denominator of which shall be the number of shares of Common Stock outstanding on the close of business on the date of announcement, plus the number of shares (or convertible, exchangeable or exercisable securities) which the aggregate offering price of the total number of shares (or convertible, exchangeable or exercisable securities) so offered for subscription or purchase (or the aggregate conversion, exchange or exercise price of the convertible securities so offered) would purchase at the Sale Price of the Common Stock on the Business Day immediately preceding the date of the announcement of such issuance (determined by multiplying

such total number of shares so offered by the exercise price of such rights or warrants and dividing the product so obtained by such Sale Price).

Such adjustment shall become effective immediately after the opening of business on the day following the date of announcement of such issuance.

To the extent that shares of Common Stock (or securities convertible into or exchangeable or exercisable for shares of Common Stock) are not delivered pursuant to such rights or warrants, upon the expiration or termination of such rights or warrants, the Conversion Rate shall be readjusted to the Conversion Rate which would then be in effect had the adjustments made upon the issuance of such rights or warrants been made on the basis of the delivery of only the number of shares of Common Stock (or securities convertible into or exchangeable or exercisable for shares of Common Stock) actually delivered. In the event that such rights or warrants are not so issued, the Conversion Rate shall again be adjusted to be the Conversion Rate which would then be in effect if the date fixed for the determination of stockholders entitled to receive such rights or warrants had not been fixed. In determining whether any rights or warrants entitle the holders to subscribe for or purchase shares of Common Stock at less than such Sale Price, and in determining the aggregate offering price of such shares of Common Stock, there shall be taken into account any consideration received for such rights or warrants and the value of such consideration if other than Cash, to be determined in good faith by the Board of Directors of the Company.

(d) (i) In case the Company shall, at any time or from time to time while any of the Securities are outstanding, by dividend or otherwise, distribute to all holders of its shares of Common Stock (including any such distribution made in connection with a consolidation or merger in which the Company is the continuing corporation and the Common Stock is not changed or exchanged), shares of its Capital Stock (other than any dividends or distributions to which Section 12.3(a) applies), evidences of its Indebtedness or other non-Cash assets, including securities, but excluding (x) any rights or warrants referred to in Section 12.3(c), (y) dividends or distributions of stock referred to in Section 12.3(a) and (z) dividends and distributions paid exclusively in Cash (such capital stock, evidence of its indebtedness, other non-Cash assets or securities being distributed hereinafter in this Section 12.3(d) called the “**distributed assets**”), then, in each such case, subject to the other provisions of this Section 12.3(d), the Conversion Rate shall be increased so that the same shall be equal to the rate determined by multiplying the Conversion Rate in effect immediately prior to the close of business on the Record Date with respect to such distribution by a fraction:

(A) the numerator of which shall be the Current Market Price; and

(B) the denominator of which shall be such Current Market Price, less the Fair Market Value on such date of the portion of the distributed assets so distributed applicable to one share of Common Stock (determined on the basis of the number of shares of Common Stock outstanding on the Record Date) (determined as provided in Section 12.3(f)).

Such increase shall become effective immediately prior to the opening of business on the day following the Record Date for such distribution. In the event that such dividend or distribution is not so paid or made, the Conversion Rate shall again be adjusted to be the Conversion Rate which would then be in effect if such dividend or distribution had not been declared.

(ii) If the Board of Directors determines the Fair Market Value of any distribution for purposes of this Section 12.3(d) by reference to the actual or when issued trading market for any distributed assets comprising all or part of such distribution, it must in doing so consider the prices in such market over the same period (the “**Reference Period**”) used in computing the Current Market Price pursuant to Section 12.3(f) to the extent possible, unless the Board of Directors determines in good faith that determining the Fair Market Value during the Reference Period would not be in the best interest of the Holders.

(iii) In the event any such distribution consists of shares of capital stock of, or similar equity interests in, one or more of the Company’s Subsidiaries (a “**Spin-Off**”), the Fair Market Value of the securities to be distributed shall equal the average of the closing sale prices of such securities on the principal securities market on which such securities are traded for the ten consecutive Trading Days commencing on and including the sixth Trading Day of those securities after the effectiveness of the Spin-Off, and the Current Market Price shall be measured for the same period. In the event, however, that an underwritten initial public offering of the securities in the Spin-Off occurs simultaneously with the Spin-Off, Fair Market Value of the securities distributed in the Spin-Off shall mean the initial public offering price of such securities and the Current Market Price shall mean the Sale Price for the Common Stock on the same Trading Day.

(iv) Rights or warrants distributed by the Company to all holders of its shares of Common Stock entitling them to subscribe for or purchase shares of the Company’s Capital Stock (either initially or under certain circumstances), which rights or warrants, until the occurrence of a specified event or events (“**Trigger Event**”), (x) are deemed to be transferred with such shares of Common Stock, (y) are not exercisable and (z) are also issued in respect of future issuances of shares of Common Stock shall be deemed not to have been distributed for purposes of this Section 12.3(d) (and no adjustment to the Conversion Rate under this Section 12.3(d) will be required) until the occurrence of the earliest Trigger Event. If such right or warrant is subject to subsequent events, upon the occurrence of which such right or warrant shall become exercisable to purchase different distributed assets, evidences of indebtedness or other assets, or entitle the holder to purchase a different number or amount of the foregoing or to purchase any of the foregoing at a different purchase price, then the occurrence of each such event shall be deemed to be the date of issuance and record date with respect to a new right or warrant (and a termination or expiration of the existing right or warrant without exercise by the holder thereof). Pursuant to rights issued under any Company shareholder’s rights plan, if holders of the Securities exercising the right of conversion after the date the rights separate from the underlying Common Stock are not entitled to receive the rights that would otherwise be attributable to the shares of Common Stock received upon

conversion, the Conversion Rate will be adjusted as though the rights were being distributed to holders of Common Stock on the date of such separation. If such an adjustment is made and the rights are later redeemed, invalidated or terminated, then a corresponding reversing adjustment will be made to the conversion rate on an equitable basis.

In addition, in the event of any distribution (or deemed distribution) of rights or warrants, or any Trigger Event or other event (of the type described in the preceding paragraph) with respect thereto, that resulted in an adjustment to the Conversion Rate under this Section 12.3(d):

(A) in the case of any such rights or warrants which shall all have been redeemed or repurchased without exercise by any holders thereof, the Conversion Rate shall be readjusted upon such final redemption or repurchase to give effect to such distribution or Trigger Event, as the case may be, as though it were a Cash distribution, equal to the per share redemption or repurchase price received by a holder of shares of Common Stock with respect to such rights or warrants (assuming such holder had retained such rights or warrants), made to all holders of shares of Common Stock as of the date of such redemption or repurchase; and

(B) in the case of such rights or warrants which shall have expired or been terminated without exercise, the Conversion Rate shall be readjusted as if such rights and warrants had never been issued.

(v) For purposes of this Section 12.3(d) and Sections 12.3(a), 12.3(b) and 12.3(c), any dividend or distribution to which this Section 12.3(d) is applicable that also includes (x) shares of Common Stock, (y) a subdivision or combination of shares of Common Stock to which Section 12.3(b) applies or (z) rights or warrants to subscribe for or purchase shares of Common Stock or securities convertible into or exercisable or exchangeable for Common Stock to which Section 12.3(c) applies (or any combination thereof), shall be deemed instead to be:

(A) a dividend or distribution of the evidences of indebtedness, assets, shares of capital stock, rights or warrants, other than such shares of Common Stock, such subdivision or combination or such rights or warrants or securities convertible into or exercisable or exchangeable for Common Stock to which Sections 12.3(a), 12.3(b) and 12.3(c) apply, respectively (and any Conversion Rate increase required by this Section 12.3(d) with respect to such dividend or distribution shall then be made), immediately followed by

(B) a dividend or distribution of such shares of Common Stock, such subdivision or combination or such rights or warrants or securities convertible into or exercisable or exchangeable for Common Stock (and any further Conversion Rate increase required by Sections 12.3(a), 12.3(b) and 12.3(c) with respect to such dividend or distribution shall then be made), except:

(1) the Record Date of such dividend or distribution shall be substituted as (x) “the date fixed for the determination of stockholders entitled to receive such dividend or other distribution,” “Record Date fixed for such determinations” and “Record Date” within the meaning of Section 12.3(a), (y) “the day upon which such subdivision becomes effective” and “the day upon which such combination becomes effective” within the meaning of Section 12.3(b), and (z) as “the date fixed for the determination of stockholders entitled to receive such rights or warrants,” “the Record Date fixed for the determination of the stockholders entitled to receive such rights or warrants” and such “Record Date” within the meaning of Section 12.3(c); and

(2) any shares of Common Stock included in such dividend or distribution shall not be deemed “outstanding at the close of business on the date fixed for such determination” within the meaning of Section 12.3(a) and any reduction or increase in the number of shares of Common Stock resulting from such subdivision or combination shall be disregarded in connection with such dividend or distribution.

(e) (i) In case the Company shall, by dividend or otherwise, at any time any Securities are outstanding distribute (a “**Triggering Distribution**”) to all or substantially all holders of its Common Stock Cash, the Conversion Rate shall be increased so that the same shall equal the rate determined by multiplying such Conversion Rate in effect on the Record Date for such Triggering Distribution by a fraction of which the numerator shall be the Current Market Price per share of the Common Stock on the Record Date, and the denominator shall be the Current Market Price per share of the Common Stock on the Record Date less the aggregate amount of cash so distributed applicable to one share of Common Stock (determined on the basis of the number of shares of Common Stock outstanding on the Record Date), such increase to become effective immediately prior to the opening of business on the day following the date on which the Triggering Distribution is paid. It is expressly understood that a stock buyback, repurchase or similar transaction or program shall in no event be considered a Triggering Distribution for purposes of this Section 12.3(e)(i).

(ii) In case the Company or any of its Subsidiaries shall, at any time or from time to time while any of the Securities are outstanding, make any tender offer or exchange offer for all or any portion of the shares of Common Stock for Cash or other consideration, to the extent that the aggregate amount of Cash and the Fair Market Value, as of the last date on which tenders or exchanges may be made pursuant to such tender offer or exchange offer, of any other consideration paid in respect of such tender offer or exchange offer (determined on a per share basis) exceeds the Closing Sale Price per share of Common Stock on the trading day next succeeding the last date on which tenders or exchange may be made pursuant to such tender or exchange offer then the Conversion Rate shall be adjusted such that immediately after the close of business on the date an Excess Amount Per Share is paid or distributed, the Conversion Rate shall be increased so that the same shall equal the rate determined by multiplying the Conversion Rate in effect immediately prior to the close of business on the Record Date for such payment by a fraction:

(A) the numerator of which shall be equal to the Current Market Price on the Record Date; and

(B) the denominator of which shall be equal to the Current Market Price on such date *minus* such Excess Amount Per Share.

(iii) In case someone other than the Company or one of its Subsidiaries makes a payment of Cash or other consideration in respect of a tender offer or exchange offer in which:

(A) as of the closing date of the offer, the Company's Board of Directors is not recommending rejection of the offer;

(B) the tender offer or exchange offer is for an amount that increases the offeror's ownership of the Company's Common Stock to more than 10% of the total shares of Common Stock outstanding; and

(C) the aggregate amount of such Cash and the Fair Market Value, as of the expiration of such tender offer or exchange offer, of any such other consideration paid in respect of such tender offer or exchange offer (determined on a per share basis) exceeds the closing Sale Price per share of the Common Stock on the trading day next succeeding the last date on which tenders or exchanges may be made pursuant to such tender or exchange offer;

the Conversion Rate shall be adjusted such that immediately after the close of business on the date an Excess Amount Per Share is paid or distributed, the Conversion Rate shall be increased so that the same shall equal the rate determined by multiplying the Conversion Rate in effect immediately prior to the close of business on the Record Date for such payment by a fraction:

(1) the numerator of which shall be equal to the Current Market Price on the Record Date; and

(2) the denominator of which shall be equal to the Current Market Price on such date minus such Excess Amount Per Share.

Provided, however, no adjustment will be made if as of the closing date of such offer, the offering documents disclose a plan or an intention to cause the Company to engage in a consolidation or merger or sale of substantially all of the Company's assets, the offeror accepts the tender of at least 50% of the outstanding Common Stock at the expiration of the offer, and such merger, consolidation or asset sale is completed within 120 days of the expiration of such tender offer or exchange offer, and provided that if the merger, consolidation or asset sale is not completed by such time, the conversion rate will be adjusted, retroactive to the date the tender offer or exchange offer expired.

(f) For purposes of this Article XII, the following terms shall have the meanings indicated:

(i) “**Current Market Price**” on any date means the average of the daily Sale Prices per share of Common Stock for the ten consecutive Trading Days immediately prior to such date; *provided, however*, that if the “ex” date (as hereinafter defined) for any event (other than the issuance or distribution requiring such computation) that requires an adjustment to the Conversion Rate pursuant to Section 12.3(a), (b), (c), (d) or (e) occurs during such ten consecutive Trading Days, “**Current Market Price**” shall be calculated for such period in a manner determined conclusively in good faith by the Board of Directors to reflect the impact of such event on the Closing Price of the Common Stock during such period.

For purposes of this paragraph, the term “ex” date, when used:

(x) with respect to any issuance or distribution, means the first date on which the shares of Common Stock trade regular way on the relevant exchange or in the relevant market from which the Sale Price was obtained without the right to receive such issuance or distribution;

(y) with respect to any subdivision or combination of shares of Common Stock, means the first date on which the shares of Common Stock trade regular way on such exchange or in such market after the time at which such subdivision or combination becomes effective; and

(z) with respect to any tender or exchange offer, means the first date on which the shares of Common Stock trade regular way on such exchange or in such market after the expiration of such offer.

Notwithstanding the foregoing, whenever successive adjustments to the Conversion Rate are called for pursuant to this Section 12.3, such adjustments shall be made to the Current Market Price as may be necessary or appropriate to effectuate the intent of this Section 12.3 and to avoid unjust or inequitable results as determined in good faith by the Board of Directors.

(ii) “**Excess Amount Per Share**” shall mean, with respect to Section 12.3(e)(ii) or (iii), the extent that the aggregate amount of Cash and the Fair Market Value, as of the expiration of any tender offer or exchange offer, of any other consideration paid in respect of such tender offer or exchange offer (determined on a per share basis) exceeds the Closing Sale Price per share of Common Stock on the trading day next succeeding the last date on which tenders or exchange may be made pursuant to such tender or exchange offer.

(iii) “**Fair Market Value**” shall mean the amount which a willing buyer would pay a willing seller in an arm’s length transaction (as determined in good faith by the Board of Directors, whose good faith determination shall be conclusive).

(iv) **“Record Date”** shall mean (except as expressly provided elsewhere in this Section 12.3):

(w) with respect to Section 12.3(a), the date fixed for determination of stockholders entitled to receive the Common Stock issued in such dividend or distribution;

(x) with respect to Section 12.3(d), the date fixed for determination of stockholders entitled to receive the distributed assets;

(y) with respect to Section 12.3(e)(i), the date fixed for determination of stockholders entitled to receive the Cash paid in such dividend or distribution; and

(z) with respect to Sections 12.3(e)(ii) and (iii), the last date on which tenders or exchanges may be made pursuant to such tender offer or exchange offer;

in each case, whether such date is fixed by the Board of Directors or by statute, contract or otherwise.

(g) The Company shall be entitled at its election to make such additional increases in the Conversion Rate, in addition to those required by Sections 12.3(a), (b), (c), (d) and (e), as shall be necessary in order that any dividend or distribution of Common Stock, any subdivision, reclassification or combination of shares of Common Stock or any issuance of rights or warrants referred to above shall not be taxable to the holders of Common Stock for United States federal income tax purposes.

(h) To the extent permitted by applicable law, the Company may, from time to time, increase the Conversion Rate by any amount for any period of time, if such period is at least 20 days, the Board of Directors determines that the increase in the Conversion Rate is in the best interest of the Company, and the increase is irrevocable during the period. Whenever the Conversion Rate is increased pursuant to the preceding sentence, the Company shall mail to the Trustee and each Holder at the address of such Holder as it appears in the register of the Securities maintained by the Registrar, at least 15 days prior to the date the increased Conversion Rate takes effect, a notice of the increase stating the increased Conversion Rate and the period during which it will be in effect.

(i) In any case in which this Section 12.3 shall require that any adjustment be made effective as of or retroactively immediately following a Record Date, the Company may elect to defer (but only for five Trading Days following the filing of the statement referred to in Section 12.5) issuing to the Holder of any Securities converted after such Record Date the shares of Common Stock issuable upon such conversion over and above the shares of Common Stock issuable upon such conversion on the basis of the Conversion Rate prior to adjustment; *provided, however*, that the Company shall deliver to such Holder a due bill or other appropriate instrument evidencing such Holder's right to receive such additional shares upon the occurrence of the event requiring such adjustment.

(j) All calculations under this Section 12.3 shall be made to the nearest cent or one-hundredth of a share, with one-half cent and 0.005 of a share, respectively, being rounded

upward. Notwithstanding any other provision of this Section 12.3, the Company shall not be required to make any adjustment of the Conversion Rate unless such adjustment would require an increase or decrease of at least 1% of such rate. Any lesser adjustment shall be carried forward and shall be made at the time of and together with the next subsequent adjustment which, together with any adjustment or adjustments so carried forward, shall amount to an increase or decrease of at least 1% in such rate. Any adjustments under this Section 12.3 shall be made successively whenever an event requiring such an adjustment occurs.

(k) In the event that at any time, as a result of an adjustment made pursuant to this Section 12.3, the Holder of any Securities thereafter surrendered for conversion shall become entitled to receive any shares of stock of the Company other than shares of Common Stock into which the Securities originally were convertible, the Conversion Rate of such other shares so receivable upon conversion of any such Security shall be subject to adjustment from time to time in a manner and on terms as nearly equivalent as practicable to the provisions with respect to Common Stock contained in subparagraphs (a) through (j) of this Section 12.3, and the provision of Sections 12.1, 12.2 and 12.4 through 12.9 with respect to the Common Stock shall apply on like or similar terms to any such other shares and the good faith determination of the Board of Directors as to any such adjustment shall be conclusive.

(l) No adjustment shall be made pursuant to this Section 12.3 if the Holders of the Securities may participate in the transaction that would otherwise give rise to an adjustment pursuant to this Section 12.3.

Section 12.4. Consolidation or Merger of the Company.

If any of the following events occurs, namely:

(a) any reclassification or change of the outstanding Common Stock (other than a change in par value, or from par value to no par value, or from no par value to par value, or as a result of a subdivision or combination) as a result of which all of the holders of Common Stock shall be entitled to receive stock, securities or other property or assets (including Cash or any combination thereof) with respect to or in exchange for all of their Common Stock;

(b) any merger, consolidation, statutory share exchange or combination of the Company with another corporation as a result of which all of the holders of Common Stock shall be entitled to receive stock, securities or other property or assets (including Cash or any combination thereof) with respect to or in exchange for all of their Common Stock; or

(c) any sale or conveyance of the properties and assets of the Company as, or substantially as, an entirety to any other person as a result of which all of the holders of Common Stock shall be entitled to receive stock, securities or other property or assets (including Cash or any combination thereof) with respect to or in exchange for all of their Common Stock;

the Company or the successor or purchasing person, as the case may be, shall execute with the Trustee a supplemental indenture (which shall comply with the Trust Indenture Act as in force at the date of execution of such supplemental indenture, if such supplemental indenture is then required to so comply) providing that the Holder's right to convert a Security into Common

Stock shall be changed to a right to convert a Security into the kind and amount of shares of stock and other securities or property or assets (including Cash) which such Holder would have been entitled to receive upon such reclassification, change, merger, consolidation, statutory share exchange, combination, sale or conveyance had such Securities been converted into Common Stock immediately prior to such reclassification, change, merger, consolidation, statutory share exchange, combination, sale or conveyance assuming such holder of Common Stock did not exercise its rights of election, if any, as to the kind or amount of securities, Cash or other property receivable upon such merger, consolidation, statutory share exchange, sale or conveyance (*provided*, that if the kind or amount of securities, Cash or other property receivable upon such merger, consolidation, statutory share exchange, sale or conveyance is not the same for each share of Common Stock in respect of which such rights of election shall not have been exercised (“**Non-Electing Share**”), then for the purposes of this Section 12.4, the kind and amount of securities, Cash or other property receivable upon such merger, consolidation, statutory share exchange, sale or conveyance for each Non-Electing Share shall be deemed to be the kind and amount so receivable per share by a plurality of the Non-Electing Shares). Such supplemental indenture shall provide for adjustments which shall be as nearly equivalent as may be practicable to the adjustments provided for in this Article XII. If, in the case of any such reclassification, change, merger, consolidation, statutory share exchange, combination, sale or conveyance, the stock or other securities and assets receivable thereupon by a holder of Common Stock includes shares of stock or other securities and assets of a corporation other than the successor or purchasing corporation, as the case may be, in such reclassification, change, merger, consolidation, statutory share exchange, combination, sale or conveyance, then such supplemental indenture shall also be executed by such other corporation and shall contain such additional provisions to protect the interests of the Holders of the Securities as the Board of Directors shall reasonably consider necessary by reason of the foregoing.

The Company shall cause notice of the execution of such supplemental indenture to be mailed to each Holder, at the address of such Holder as it appears on the register of the Securities maintained by the Registrar, within 20 days after execution thereof. Failure to deliver such notice shall not affect the legality or validity of such supplemental indenture.

The above provisions of this Section 12.4 shall similarly apply to successive reclassifications, changes, mergers, consolidations, statutory share exchanges, combinations, sales and conveyances.

If this Section 12.4 applies to any event or occurrence, Section 12.3 shall not apply.

Section 12.5. Notice of Adjustment.

Whenever an adjustment in the Conversion Rate with respect to the Securities is required:

(a) the Company shall forthwith place on file with the Trustee and any Conversion Agent for such securities a certificate of the Treasurer of the Company, stating the adjusted Conversion Rate determined as provided herein and setting forth in reasonable detail

such facts as shall be necessary to show the reason for and the manner of computing such adjustment; and

(b) a notice stating that the Conversion Rate has been adjusted and setting forth the adjusted Conversion Rate shall forthwith be given by the Company or, at the Company's request, by the Trustee in the name and at the expense of the Company, to each Holder in the manner provided in Section 14.2 hereof. Any notice so given shall be conclusively presumed to have been duly given, whether or not the Holder receives such notice.

Section 12.6. Notice in Certain Events.

In case:

(a) of a consolidation or merger to which the Company is a party and for which approval of any stockholders of the Company is required, or of the sale or conveyance to another Person or entity or group of Persons or entities acting in concert as a partnership, limited partnership, syndicate or other group (within the meaning of Rule 13d-3 under the Exchange Act) of all or substantially all of the property and assets of the Company; or

(b) of the voluntary or involuntary dissolution, liquidation or winding up of the Company; or

(c) of any action triggering an adjustment of the Conversion Rate referred to in clauses (y) or (z) below;

then, in each case, the Company shall cause to be filed with the Trustee and the Conversion Agent, and shall cause to be given, to the Holders of the Securities in the manner provided in Section 14.2 hereof, at least 15 days prior to the applicable date hereinafter specified, a notice stating:

(y) the date on which a record is to be taken for the purpose of any distribution or grant of rights or warrants or other securities triggering an adjustment to the Conversion Rate pursuant to this Article XII, or, if a record is not to be taken, the date as of which the holders of record of Common Stock entitled to such distribution, rights or warrants or other securities are to be determined, or

(z) the date on which any reclassification, consolidation, merger, sale, conveyance, dissolution, liquidation or winding up described under clauses (a), (b) and (c) of Section 12.4 that changes a Holder's right to convert its Common Stock to a right to convert into another kind and amount of securities or other property or assets is expected to become effective, and the date as of which it is expected that holders of Common Stock of record shall be entitled to exchange their Common Stock for securities or other property deliverable upon such reclassification, consolidation, merger sale, conveyance, dissolution, liquidation or winding up.

Failure to give such notice or any defect therein shall not affect the legality or validity of the proceedings described in clause (a), (b) or (c) of this Section 12.6.

Section 12.7. Company To Reserve Stock: Registration; Listing.

(a) The Company shall at all times reserve and keep available, free from preemptive rights, out of its authorized but unissued shares of Common Stock for the purpose of effecting the conversion of the Securities, such number of its duly authorized shares of Common Stock as shall from time to time be sufficient to effect the conversion of all Securities then outstanding into such Common Stock at any time (assuming that, at the time of the computation of such number of shares or securities, all such Securities would be held by a single Holder). The Company covenants that all shares of Common Stock which may be issued upon conversion of Securities will upon issue be fully paid and nonassessable and free from all liens and charges and, except as provided in Section 12.8, taxes with respect to the issue thereof.

(b) If any shares of Common Stock which would be issuable upon conversion of Securities hereunder require registration with or approval of any governmental authority before such shares or securities may be issued upon such conversion, the Company will use its commercially reasonable efforts to cause such shares or securities to be duly registered or approved, as the case may be. The Company further covenants that so long as the Common Stock shall be quoted on the Nasdaq National Market, the Company will use its commercially reasonable efforts, if permitted by the rules of the Nasdaq National Market, to quote and keep quoted all Common Stock issuable upon conversion of the Securities, and the Company will use its commercially reasonable efforts to list the shares of Common Stock required to be delivered upon conversion of the Securities prior to such delivery upon any other national securities exchange upon which the outstanding Common Stock is listed at the time of such delivery.

Section 12.8. Taxes on Conversion.

The issue of stock certificates on conversion of Securities shall be made without charge to the converting Holder for any documentary, stamp or similar issue or transfer taxes in respect of the issue thereof, and the Company shall pay any and all documentary, stamp or similar issue or transfer taxes that may be payable in respect of the issue or delivery of shares of Common Stock on conversion of Securities pursuant hereto. The Company shall not, however, be required to pay any such tax which may be payable in respect of any transfer involved in the issue or delivery of shares of Common Stock or the portion, if any, of the Securities which are not so converted in a name other than that in which the Securities so converted were registered, and no such issue or delivery shall be made unless and until the Person requesting such issue has paid to the Company the amount of such tax or has established to the satisfaction of the Company that such tax has been paid.

Section 12.9. Conversion After Record Date.

Except as provided in this Section 12.9, a converting Holder of Securities shall not be entitled to receive any accrued and unpaid interest (exclusive of accrued and unpaid Liquidated Damages Amount, if any, which in any event shall be paid upon conversion in accordance with Section 12.2) on any such Securities being converted. By delivery to the Holder of the number of shares of Common Stock or other consideration issuable or payable upon conversion in accordance with this Article XII, any accrued and unpaid interest on such Securities will be deemed to have been paid in full. If any Securities are surrendered for

conversion subsequent to the record date preceding an Interest Payment Date but prior to such Interest Payment Date, the Holder of such Securities at the close of business on such record date shall receive the interest payable (but not accrued and unpaid Liquidated Damages Amount, if any, with respect to such converted Security) on such Security on such Interest Payment Date notwithstanding the conversion thereof. Securities surrendered for conversion during the period from the close of business on any record date preceding any Interest Payment Date to the opening of business on such Interest Payment Date shall be accompanied by payment from converting Holders, for the account of the Company, in New York Clearing House funds, or other funds of an amount equal to the interest payable (but not accrued and unpaid Liquidated Damages Amount, if any, with respect to such converted Security) on such Interest Payment Date on the Securities being surrendered for conversion; *provided* that no such payment is required if (a) the Company has specified a Redemption Date during the period from the close of business on any record date preceding any Interest Payment Date through and including such Interest Payment Date or (b) any overdue interest exists at the time of the conversion with respect to the Securities converted, but only to the extent of the amount of such overdue interest.

Except as provided in this Section 12.9, no adjustments in respect of payments of interest on Securities surrendered for conversion or any dividends or distributions or interest on the Common Stock issued upon conversion shall be made upon the conversion of any Securities.

Section 12.10. Company Determination Final.

Any determination that the Company or the Board of Directors must make pursuant to this Article XII shall be conclusive if made in good faith and in accordance with the provisions of this Article, absent manifest error, and set forth in a Board Resolution.

Section 12.11. Responsibility of Trustee for Conversion Provisions.

The Trustee has no duty to determine when an adjustment under this Article XII should be made, how it should be made or what it should be. The Trustee makes no representation as to the validity or value of any securities or assets issued upon conversion of Securities. The Trustee shall not be responsible for any failure of the Company to comply with this Article XII. Each Conversion Agent other than the Company shall have the same protection under this Section 12.11 as the Trustee.

The rights, privileges, protections, immunities and benefits given to the Trustee under this Indenture including, without limitation, its rights to be indemnified, are extended to, and shall be enforceable by, the Trustee in each of its capacities hereunder, and each Paying Agent or Conversion Agent acting hereunder.

Section 12.12. Unconditional Right of Holders to Convert.

Notwithstanding any other provision in this Indenture, the Holder of any Security shall have the right, which is absolute and unconditional, to convert its Security in accordance with this Article XII and to bring an action for the enforcement of any such right to convert, and such rights shall not be impaired or affected without the consent of such Holder.

ARTICLE XIII

[RESERVED]

ARTICLE XIV

MISCELLANEOUS

Section 14.1. Trust Indenture Act Controls.

If any provision of this Indenture limits, qualifies, or conflicts with the duties imposed by TIA Section 318(c), such section of the TIA shall control. If any provision of this Indenture expressly modifies or excludes any provision of the TIA that may be so modified or excluded, the Indenture provision so modifying or excluding such provision of the TIA shall be deemed to apply.

Section 14.2. Notices.

Any request, demand, authorization, notice, waiver, consent or communication shall be in writing and delivered in person, mailed by first-class mail, postage prepaid, addressed as follows or transmitted by facsimile transmission (confirmed by guaranteed overnight courier) to the following facsimile numbers:

if to the Company:

Red Hat, Inc.
1801 Varsity Drive
Raleigh, North Carolina 27606
Attn: General Counsel
Facsimile No.: (919) 754-3704

if to the Trustee:

U.S. Bank Trust National Association
100 Wall Street Street
Suite 1600
New York, NY 10005
Attn: Adam Berman
Facsimile No.: (212) 509-3384

The Company or the Trustee by notice given to the other in the manner provided above may designate additional or different addresses for subsequent notices or communications.

Any notice or communication given to a Securityholder shall be mailed to the Securityholder, by first-class mail, postage prepaid, at the Securityholder's address as it appears on the registration books of the Registrar and shall be sufficiently given if so mailed within the time prescribed.

Failure to mail a notice or communication to a Securityholder or any defect in it shall not affect its sufficiency with respect to other Securityholders. If a notice or communication is mailed in the manner provided above, it is duly given, whether or not received by the addressee.

If the Company mails a notice or communication to the Securityholders, it shall mail a copy to the Trustee and each Registrar, Paying Agent, Conversion Agent or co-registrar.

Section 14.3. Communication by Holders with Other Holders.

Securityholders may communicate pursuant to TIA Section 312(b) with other Securityholders with respect to their rights under this Indenture or the Securities. The Company, the Trustee, the Registrar, the Paying Agent, the Conversion Agent and anyone else shall have the protection of TIA Section 312(c).

Section 14.4. Certificate and Opinion as to Conditions Precedent.

Upon any request or application by the Company to the Trustee to take any action under this Indenture, the Company shall furnish to the Trustee, if the Trustee so requests:

- (a) an Officers' Certificate stating that, in the opinion of the signers, all conditions precedent, if any, provided for in this Indenture relating to the proposed action have been complied with; and
- (b) an Opinion of Counsel stating that, in the opinion of such counsel, all such conditions precedent have been complied with.

Section 14.5. Statements Required in Certificate or Opinion.

Each Officers' Certificate or Opinion of Counsel with respect to compliance with a covenant or condition provided for in this Indenture shall include:

- (a) a statement that each person making such Officers' Certificate or Opinion of Counsel has read such covenant or condition;
- (b) a brief statement as to the nature and scope of the examination or investigation upon which the statements or opinions contained in such Officers' Certificate or Opinion of Counsel are based;
- (c) a statement that, in the opinion of each such person, he or she has made such examination or investigation as is necessary to enable such person to express an informed opinion as to whether or not such covenant or condition has been complied with; and

(d) a statement that, in the opinion of such person, such covenant or condition has been complied with.

Section 14.6. Separability Clause.

In case any provision in this Indenture or in the Securities shall be invalid, illegal or unenforceable, the validity, legality and enforceability of the remaining provisions shall not in any way be affected or impaired thereby.

Section 14.7. Rules by Trustee, Paying Agent, Conversion Agent and Registrar.

The Trustee may make reasonable rules for action by or a meeting of Securityholders. The Registrar, the Conversion Agent, the Bid Solicitation Agent and the Paying Agent may make reasonable rules for their functions.

Section 14.8. Legal Holidays.

If any specified date (including a date for giving notice) is a Legal Holiday, the action shall be taken on the next succeeding day that is not a Legal Holiday, and, if the action to be taken on such date is a payment in respect of the Securities, no interest, if any, shall accrue for the intervening period.

Section 14.9. Governing Law; Submission to Jurisdiction; Service of Process.

This Indenture and the Securities shall be governed by, and construed in accordance with, the laws of the State of New York.

The Company submits to the nonexclusive jurisdiction of the courts of the State of New York and the courts of the United States of America, in each case located in the Borough of Manhattan, The City of New York and State of New York over any suit, action or proceeding arising under or in connection with this Indenture or the transactions contemplated hereby or the Securities. The Company waives any objection that it may have to the venue of any suit, action or proceeding arising under or in connection with this Indenture or the transactions contemplated hereby or the Securities in the courts of the State of New York or the courts of the United States of America, in each case located in the Borough of Manhattan, City of New York and State of New York, or that such suit, action or proceeding brought in the courts of the State of New York or the courts of the United States of America, in each case located in the Borough of Manhattan, City of New York and State of New York, was brought in an inconvenient court and agrees not to plead or claim the same.

Section 14.10. No Recourse Against Others.

No recourse under or upon any obligation, covenant or agreement contained in this Indenture, or in any Security, or because of any indebtedness evidenced thereby, shall be had against any incorporator, as such, or against any past, present or future stockholder, officer or director, as such, of the Company or of any successor, either directly or through the Company or

any successor, under any rule of law, statute or constitutional provision or by the enforcement of any assessment or by any legal or equitable proceeding or otherwise, all such liability being expressly waived and released by the acceptance of the Securities by the Holders and as part of the consideration for the issue of the Securities.

Section 14.11. Successors.

All agreements of the Company in this Indenture and the Securities shall bind its successor. All agreements of the Trustee in this Indenture shall bind its successor.

Section 14.12. Multiple Originals.

The parties may sign any number of copies of this Indenture. Each signed copy shall be an original, but all of them together represent the same agreement. One signed copy is enough to prove this Indenture.

Section 14.13. Benefits of Indenture.

Nothing in this Indenture or in the Securities, express or implied, shall give to any person, other than the parties hereto and the Holders of the Securities, any benefit or any legal or equitable right, remedy or claim under this Indenture or the Securities.

IN WITNESS WHEREOF, the undersigned, being duly authorized, have executed this Indenture on behalf of the respective parties hereto as of the date first above written.

RED HAT, INC.

By: /s/ Kevin B. Thompson

Name: Kevin B. Thompson

Title: Executive Vice President and Chief Financial Officer

U.S. BANK TRUST NATIONAL ASSOCIATION,
As Trustee

By: /s/ Adam Berman

Name: Adam Berman

Title: Assistant Vice President

EXHIBIT A

[FORM OF FACE OF SECURITY]

[UNLESS THIS CERTIFICATE IS PRESENTED BY AN AUTHORIZED REPRESENTATIVE OF THE DEPOSITORY TRUST COMPANY TO THE COMPANY OR ITS AGENT FOR REGISTRATION OF TRANSFER, EXCHANGE OR PAYMENT, AND ANY CERTIFICATE ISSUED IS REGISTERED IN THE NAME OF CEDE & CO. OR IN SUCH OTHER NAME AS IS REQUESTED BY AN AUTHORIZED REPRESENTATIVE OF THE DEPOSITORY TRUST COMPANY (AND ANY PAYMENT HEREON IS MADE TO CEDE & CO. OR TO SUCH OTHER ENTITY AS IS REQUESTED BY AN AUTHORIZED REPRESENTATIVE OF THE DEPOSITORY TRUST COMPANY), ANY TRANSFER, PLEDGE OR OTHER USE HEREOF FOR VALUE OR OTHERWISE BY OR TO ANY PERSON IS WRONGFUL SINCE THE REGISTERED OWNER HEREOF, CEDE & CO., HAS AN INTEREST HEREIN. THIS SECURITY IS A GLOBAL SECURITY WITHIN THE MEANING OF THE INDENTURE HEREINAFTER REFERRED TO AND IS REGISTERED IN THE NAME OF A DEPOSITARY OR A NOMINEE THEREOF. THIS SECURITY IS EXCHANGEABLE FOR SECURITIES REGISTERED IN THE NAME OF A PERSON OTHER THAN THE DEPOSITARY OR ITS NOMINEE ONLY IN THE LIMITED CIRCUMSTANCES DESCRIBED IN THE INDENTURE AND, UNLESS AND UNTIL IT IS EXCHANGED IN WHOLE OR IN PART FOR SECURITIES IN DEFINITIVE FORM, THIS SECURITY MAY NOT BE TRANSFERRED EXCEPT AS A WHOLE BY THE DEPOSITARY TO A NOMINEE OF THE DEPOSITARY OR BY A NOMINEE OF THE DEPOSITARY TO THE DEPOSITARY OR ANOTHER NOMINEE OF THE DEPOSITARY OR BY THE DEPOSITARY OR ANY SUCH NOMINEE TO A SUCCESSOR DEPOSITARY OR A NOMINEE OF SUCH SUCCESSOR DEPOSITARY.]¹

[THIS DEBENTURE (OR ITS PREDECESSOR) WAS ORIGINALLY ISSUED IN A TRANSACTION EXEMPT FROM REGISTRATION UNDER THE UNITED STATES SECURITIES ACT OF 1933 (THE "SECURITIES ACT"), AND THIS DEBENTURE AND THE COMMON STOCK ISSUABLE UPON CONVERSION HEREOF MAY NOT BE OFFERED, SOLD OR OTHERWISE TRANSFERRED IN THE ABSENCE OF SUCH REGISTRATION OR AN APPLICABLE EXEMPTION THEREFROM. EACH PURCHASER OF THIS DEBENTURE IS HEREBY NOTIFIED THAT THE SELLER OF THIS DEBENTURE MAY BE RELYING ON THE EXEMPTION FROM THE PROVISIONS OF SECTION 5 OF THE SECURITIES ACT PROVIDED BY RULE 144A THEREUNDER. THE HOLDER OF THIS DEBENTURE AGREES FOR THE BENEFIT OF RED HAT, INC., THAT (A) THIS DEBENTURE AND THE COMMON STOCK ISSUABLE UPON CONVERSION HEREOF MAY BE OFFERED, RESOLD, PLEDGED OR OTHERWISE TRANSFERRED, ONLY (I) IN THE UNITED STATES TO A PERSON WHOM THE SELLER REASONABLY BELIEVES IS A QUALIFIED INSTITUTIONAL BUYER (AS DEFINED IN RULE 144A UNDER THE SECURITIES ACT) IN A TRANSACTION MEETING THE REQUIREMENTS OF RULE 144A, (II) INSIDE THE UNITED STATES TO AN INSTITUTIONAL ACCREDITED INVESTOR THAT, PRIOR TO SUCH TRANSFER, FURNISHES TO U.S. BANK TRUST NATIONAL ASSOCIATION, AS TRUSTEE (OR A SUCCESSOR TRUSTEE,

¹ This legend should be included only if the Security is a Global Security.

AS APPLICABLE), A SIGNED LETTER CONTAINING CERTAIN REPRESENTATIONS AND AGREEMENTS RELATING TO THE RESTRICTIONS ON TRANSFER OF THE DEBENTURES (THE FORM OF WHICH LETTER CAN BE OBTAINED FROM SUCH TRUSTEE OR SUCCESSOR TRUSTEE, AS APPLICABLE), (III) OUTSIDE THE UNITED STATES IN AN OFFSHORE TRANSACTION IN ACCORDANCE WITH RULE 904 UNDER THE SECURITIES ACT, (IV) PURSUANT TO AN EXEMPTION FROM REGISTRATION UNDER THE SECURITIES ACT PROVIDED BY RULE 144 THEREUNDER (IF AVAILABLE) OR (V) PURSUANT TO AN EFFECTIVE REGISTRATION STATEMENT UNDER THE SECURITIES ACT, IN EACH OF CASES (I) THROUGH (V) IN ACCORDANCE WITH ANY APPLICABLE SECURITIES LAWS OF ANY STATE OF THE UNITED STATES, AND (B) THE HOLDER WILL, AND EACH SUBSEQUENT HOLDER IS REQUIRED TO, NOTIFY ANY PURCHASER OF THIS DEBENTURE FROM IT OF THE RESALE RESTRICTIONS REFERRED TO IN (A) ABOVE. IN ANY CASE, THE HOLDER HEREOF WILL NOT, DIRECTLY OR INDIRECTLY, ENGAGE IN ANY HEDGING TRANSACTIONS WITH REGARD TO THE SECURITIES EXCEPT AS PERMITTED UNDER THE SECURITIES ACT^{2]}

[THE HOLDER OF THIS SECURITY IS ENTITLED TO THE BENEFITS OF A REGISTRATION RIGHTS AGREEMENT (AS SUCH TERM IS DEFINED IN THE INDENTURE REFERRED TO ON THE REVERSE HEREOF) AND, BY ITS ACCEPTANCE HEREOF, AGREES TO BE BOUND BY AND TO COMPLY WITH THE PROVISIONS OF SUCH REGISTRATION RIGHTS AGREEMENT.]²

² This legend should be included only if the Security is a Transfer Restricted Security.

RED HAT, INC.
0.50% Convertible Senior Debentures due 2024

No.

CUSIP: 756577 AA 0

RED HAT, INC., a Delaware corporation (the “**Company**”, which term shall include any successor corporation under the Indenture referred to on the reverse hereof), promises to pay to _____, or registered assigns, up to the principal amount of _____ Dollars (\$ _____) [, or such lesser amount as is indicated in the records of the Trustee and the Depositary,]³ on January 15, 2024, and to pay interest thereon from January 12, 2004 or from the most recent Interest Payment Date to which interest has been paid or duly provided for, on July 15 and January 15 in each year (each, an “**Interest Payment Date**”), commencing on July 15, 2004, at the rate of 0.50% per annum, until the principal hereof is paid or made available for payment at January 15, 2024 or upon acceleration, or until such date on which the Securities are converted, redeemed or repurchased as provided herein, and at the rate of 0.50% per annum on any overdue principal and on any overdue installment of interest and Liquidated Damages Amount, if any. The interest so payable, and punctually paid or duly provided for, on any Interest Payment Date will, as provided in the Indenture (as hereinafter defined), be paid to the Person in whose name this Security (or one or more predecessor Securities) is registered at the close of business on the regular record date for such interest, which will be the July 1 or January 1 (whether or not a Business Day), as the case may be, next preceding the corresponding Interest Payment Date (a “**Regular Record Date**”). Any such interest and Liquidated Damages Amount, if any, not so punctually paid or duly provided for will forthwith cease to be payable to the Holder on such Regular Record Date and may be paid (a) to the Person in whose name this Security (or one or more Predecessor Securities) is registered at the close of business on a special record date for the payment of such defaulted interest to be fixed by the Trustee (a “**Special Record Date**”), notice whereof will be given to Holders not less than 10 days prior to such Special Record Date, or (b) at any time in any other lawful manner not inconsistent with the requirements of any securities exchange on which the Securities may be listed, and upon such notice as may be required by such exchange, all as more fully provided in the Indenture.

Reference is hereby made to the further provisions of this Security set forth on the reverse side of this Security, which further provisions shall for all purposes have the same effect as if set forth at this place.

³ This phrase should be included only if the Security is a Global Security.

IN WITNESS WHEREOF, the Company has caused this instrument to be duly executed.

Dated: January 12, 2004

RED HAT, INC.

By: _____
Title:

TRUSTEE'S CERTIFICATE OF AUTHENTICATION

This is one of the Securities referred to in the within-mentioned Indenture.

Dated: January 12, 2004

U.S. BANK TRUST NATIONAL ASSOCIATION,
as Trustee

By: _____
Authorized Signatory

[FORM OF REVERSE OF SECURITY]

0.50% Convertible Senior Debentures due 2024

This Security is one of a duly authorized issue of 0.50% Convertible Senior Debentures due 2024 (the “**Securities**”) of RED HAT, INC., a Delaware corporation (including any successor corporation under the Indenture hereinafter referred to, the “**Company**”), issued under an Indenture, dated as of January 12, 2004 (the “**Indenture**”), between the Company and U.S. Bank Trust National Association, as trustee (the “**Trustee**”). The terms of the Security include those stated in the Indenture, those made part of the Indenture by reference to the Trust Indenture Act of 1939, as amended (“**TIA**”), and those set forth in this Security. This Security is subject to all such terms, and Holders are referred to the Indenture and the TIA for a statement of all such terms. To the extent permitted by applicable law, in the event of any inconsistency between the terms of this Security and the terms of the Indenture, the terms of the Indenture shall control. Capitalized terms used but not defined herein have the meanings assigned to them in the Indenture referred to below unless otherwise indicated.

1. Interest.

Interest on the Securities shall be computed on the basis of a 360-day year of twelve 30-day months.

If this Security is redeemed pursuant to Section 5 of this Security or the Holder elects to require the Company to repurchase this Security pursuant to Section 6 of this Security, on a date that is after the Regular Record Date and prior to the corresponding Interest Payment Date, interest and Liquidated Damages Amount, if any, accrued and unpaid hereon to, but not including, the applicable Redemption Date, Repurchase Date or Repurchase Event Repurchase Date will be paid to the same Holder to whom the Company pays the principal of such Security regardless of whether such Holder was the registered Holder on the Regular Record Date immediately preceding the applicable Redemption Date, Repurchase Date or Repurchase Event Repurchase Date.

Interest on Securities converted after the close of business on a Regular Record Date but prior to the opening of business on the corresponding Interest Payment Date will be paid to the Holder of the Securities on the Regular Record Date but, upon conversion, the Holder must pay the Company the interest which have accrued and will be paid on such Interest Payment Date. No such payment need be made with respect to Securities which will be converted after a Regular Record Date and prior to the corresponding Interest Payment Date if (i) the Company has specified a Redemption Date during the period from the close of business on any record date preceding any Interest Payment Date through and including such Interest Payment Date or (ii) any overdue interest exists at the time of conversion with respect to the Securities converted, but only to the extent of the amount of such overdue interest.

Upon conversion of this Security, the Company will pay accrued and unpaid Liquidated Damages Amount, if any, to but not including the date of conversion to the Holder delivering the Security for conversion.

Except as otherwise stated herein, any reference herein to interest accrued or payable as of any date shall include any Liquidated Damages Amount accrued or payable on such date as provided in the Registration Rights Agreement.

2. Method of Payment.

Payment of the principal of and interest and Liquidated Damages Amount, if any, on the Securities shall be in such coin or currency of the United States of America as at the time of payment is legal tender for payment of public and private debts or in Applicable Stock, as the case may be, as permitted in the Indenture. The Holder must surrender the Securities to the Paying Agent to collect payment of principal. Payment of interest and Liquidated Damages Amount, if any, on Certificated Securities will be made by check mailed to the address of the Person entitled thereto as such address appears in the Register. Notwithstanding the foregoing, so long as the Securities are registered in the name of a Depositary or its nominee, all payments with respect to the Securities shall be made by wire transfer of immediately available funds to the account of the Depositary or its nominee.

3. Paying Agent, Registrar, Conversion Agent and Bid Solicitation Agent.

Initially, U.S. Bank Trust National Association will act as Paying Agent, Conversion Agent and Bid Solicitation Agent. The Company may appoint and change any Paying Agent, Registrar, Conversion Agent or Bid Solicitation Agent without notice, other than notice to the Trustee; provided that the Company will maintain at least one Paying Agent in the State of New York, The City of New York, Borough of Manhattan, which shall initially be an office or agency of the Trustee. The Company or any of its Subsidiaries or any of their Affiliates may act as Paying Agent, Registrar or Conversion Agent. None of the Company or any Subsidiary or any Affiliate of any of them may act as Bid Solicitation Agent.

4. Indenture.

The Securities are general unsecured obligations of the Company limited to up to \$600,000,000 aggregate principal amount. The Indenture does not limit other indebtedness of the Company, secured or unsecured.

5. Redemption at the Option of the Company.

The Company may, at its option, redeem the Securities for Cash at any time as a whole, or from time to time in part, on or after January 15, 2009, at a redemption price equal to 100% of the principal amount of Securities to be redeemed plus any accrued and unpaid interest and Liquidated Damages Amount, if any, on those Securities to, but not including, the Redemption Date.

Notice of redemption pursuant to this Section of this Security will be mailed at least 30 days but not more than 60 days before the Redemption Date to each Holder of Securities to be redeemed at the Holder's registered address. If Cash sufficient to pay the Redemption Price of all Securities (or portions thereof) to be redeemed on the Redemption Date is deposited with the Paying Agent prior to 10:00 a.m., New York City time, on the Redemption Date, then on

such Redemption Date interest and Liquidated Damages Amount, if any, cease to accrue on such Securities or portions thereof. Securities in denominations larger than \$1,000 of principal amount may be redeemed in part but only in multiples of \$1,000 of principal amount.

6. Repurchase By the Company at the Option of the Holder or Upon a Repurchase Event.

Subject to the terms and conditions of the Indenture, the Company shall become obligated to repurchase, at the option of the Holder, all or any portion of the Securities held by such Holder on January 15, 2009, January 15, 2014 and January 15, 2019 in multiples of \$1,000 at a repurchase price equal to 100% of the principal amount of those Securities plus accrued and unpaid interest and Liquidated Damages Amount, if any, to, but not including, such Repurchase Date. To exercise such right, a Holder shall deliver to the Paying Agent a Repurchase Notice containing the information set forth in the Indenture, at any time from 9:00 a.m., New York City time, on the date that is 20 Business Days immediately preceding such Repurchase Date until 5:00 p.m., New York City time, on the Business Day immediately preceding such Repurchase Date, and shall deliver the Securities to the Paying Agent as set forth in the Indenture.

Subject to the terms and conditions of the Indenture, the Company shall become obligated to repurchase, at the option of the Holder, all or any portion of the Securities held by such Holder upon a Repurchase Event in multiples of \$1,000 at the Repurchase Event Repurchase Price. To exercise such right, a Holder shall deliver to the Paying Agent a Repurchase Event Repurchase Notice containing the information set forth in the Indenture, at any time prior to 5:00 p.m., New York City time, on the Business Day immediately preceding the Repurchase Event Repurchase Date, and shall deliver the Securities to the Paying Agent as set forth in the Indenture.

Holders have the right to withdraw any Repurchase Notice or Repurchase Event Repurchase Notice by delivering to the Paying Agent a written notice of withdrawal in accordance with the provisions of the Indenture.

If Cash sufficient to pay the Repurchase Price or Repurchase Event Repurchase Price, as the case may be, of all Securities or portions thereof to be repurchased with respect to a Repurchase Date or Repurchase Event Repurchase Date, as the case may be, has been deposited with the Paying Agent, at 10:00 a.m., New York City time, on the Repurchase Date or Repurchase Event Repurchase Date, as the case may be, then, immediately after the Repurchase Date or Repurchase Event Repurchase Date, as applicable, such Securities will cease to be outstanding and interest and Liquidated Damages Amount, if any, on such Securities will cease to accrue and the Holder thereof shall have no other rights as such other than the right to receive the Repurchase Price or Repurchase Event Repurchase Price upon surrender of such Security.

7. Conversion.

Subject to and in compliance with the provisions of the Indenture (including, without limitation, the conditions to conversion of this Security set forth in Section 12.1 thereof), a Holder is entitled, at such Holder's option, to convert the Holder's Security (or any portion of the principal amount thereof that is \$1,000 or a multiple of \$1,000), into fully paid and

nonassessable shares of Common Stock at the Conversion Rate in effect on the date of conversion.

The Company will notify Holders of any event triggering the right to convert the Securities as specified above in accordance with the Indenture.

A Security in respect of which a Holder has delivered a Repurchase Notice or Repurchase Event Repurchase Notice, as the case may be, exercising the right of such Holder to require the Company to repurchase such Security may be converted only if such Repurchase Notice or Repurchase Event Repurchase Notice is withdrawn in accordance with the terms of the Indenture.

The initial Conversion Rate is 39.0753 shares per \$1,000 principal amount of Securities, subject to adjustment in certain events described in the Indenture.

To surrender a Security for conversion, a Holder must, in the case of Global Securities, comply with the Applicable Procedures of the Depositary in effect at that time, and in the case of Certificated Securities, (1) surrender the Security to the Conversion Agent, (2) complete and manually sign the conversion notice below (or complete and manually sign a facsimile of such notice) and deliver such notice to the Conversion Agent, (3) furnish appropriate endorsements and transfer documents and (4) pay all funds required, if any, relating to interest or Liquidated Damages Amount, if any, and any transfer or similar tax, if required.

No fractional share of Common Stock shall be issued upon conversion of any Security. Instead, the Company shall pay a Cash adjustment as provided in the Indenture.

No payment or adjustment will be made for accrued and unpaid interest or dividends on the shares of Common Stock, except as provided in the Indenture. Accrued and unpaid Liquidated Damages Amount, if any, to but not including the date of conversion shall be paid to the Holder that delivers the Security for conversion.

If the Company (i) is a party to a consolidation, merger, statutory share exchange or combination of the Company with another corporation as a result of which all the holders of Common Stock shall be entitled to receive stock, securities or other property or assets (including Cash or a combination thereof) with respect to or in exchange for all of their Common Stock, (ii) reclassifies or changes the shares of Common Stock or (iii) conveys, transfers or leases its properties and assets as, or substantially as, an entirety to any person, the right to convert a Security into shares of Common Stock may be changed to a right to convert a Security into the kind and amount of shares of stock and other securities or property or assets (including Cash) which such Holder would have been entitled to receive upon such reclassification, change, merger, consolidation, statutory share exchange, combination, sale or conveyance had such Holder converted its Security into Common Stock immediately prior to such transaction, in each case, in accordance with the Indenture.

8. Denominations; Transfer; Exchange.

The Securities are in fully registered form, without coupons, in denominations of \$1,000 of principal amount and multiples of \$1,000. A Holder may transfer or exchange Securities in accordance with the Indenture. The Registrar may require a Holder, among other things, to furnish appropriate endorsements and transfer documents and to pay any taxes and fees required by law or permitted by the Indenture. The Registrar need not transfer or exchange any Securities selected for redemption (except, in the case of a Security to be redeemed in part, the portion of the Security not to be redeemed) or any Securities in respect of which a Repurchase Notice or Repurchase Event Repurchase Notice has been given and not withdrawn (except, in the case of a Security to be repurchased in part, the portion of the Security not to be repurchased) or any Securities for a period of 15 days before the mailing of a notice of redemption of Securities to be redeemed.

9. Persons Deemed Owners.

The registered Holder of this Security may be treated as the owner of this Security for all purposes.

10. Unclaimed Money or Securities.

The Trustee and the Paying Agent shall return to the Company upon written request any Cash or securities held by them for the payment of any amount with respect to the Securities that remains unclaimed for two years, subject to applicable unclaimed property law. After return to the Company, Holders entitled to the money or securities must look to the Company for payment as general creditors unless an applicable abandoned property law designates another person.

11. Amendment; Waiver.

Subject to certain exceptions set forth in the Indenture, (i) the Indenture or the Securities may be amended with the written consent or affirmative vote of the Holders of not less than a majority in aggregate principal amount of the outstanding Securities and (ii) certain Defaults may be waived with the written consent or affirmative vote of the Holders of not less than a majority in aggregate principal amount of the outstanding Securities.

Without the consent of any Securityholder, the Company and the Trustee may amend the Indenture or the Securities to (i) add to the covenants of the Company for the benefit of the Holders of Securities, (ii) surrender any right or power conferred upon the Company in the Indenture, (iii) provide for the assumption of the Company's obligations to the Holders of Securities in the case of a merger, consolidation, conveyance, transfer, sale, lease or other disposition pursuant to Article VII of the Indenture, (iv) increase the Conversion Rate or reduce the Conversion Price; *provided, however*, that such increase in the Conversion Rate or reduction in the Conversion Price is in accordance with the terms of the Indenture or shall not adversely affect the interest of the Holders of Securities, (v) provide for a successor Trustee with respect to the Securities, (vi) add any additional Events of Default with respect to all or any of the Securities, (vii) secure the Securities, (viii) supplement any of the provisions of the Indenture to such extent as shall be necessary to permit or facilitate the discharge of the Securities, provided that such change or modification does not adversely affect the interests of the Holders of the

Securities, (ix) make any changes or modifications necessary in connection with the registration of the Securities under the Securities Act as contemplated in the Registration Rights Agreement; *provided, however*, that such action pursuant to this clause does not adversely affect the interests of the Holders of Securities in any material respect, (x) cure any ambiguity, correct or supplement any provision in the Indenture which may be inconsistent with any other provision therein or which is otherwise defective, or to make any other provisions with respect to matters or questions arising under the Indenture which the Company may deem necessary or desirable and which shall not be inconsistent with the provisions of the Indenture; *provided, however*, that such action pursuant to this clause does not adversely affect the interests of the Holders of Securities, (xi) add or modify any other provisions in the Indenture with respect to matters or questions arising thereunder which the Company and the Trustee may deem necessary or desirable and which would not adversely affect the interests of the Holders of Securities, (xii) comply with the requirements of the SEC in order to effect or maintain the qualification of this Indenture under the TIA, (xiii) provide for issuance of the Securities in coupon form; and (xiv) make provision with respect to the conversion rights of Holders of the Securities in accordance with this Indenture in connection with a reclassification, consolidation, combination, merger or sale of all or substantially all of the Company's property and assets.

12. Defaults and Remedies.

If any Event of Default other than as a result of certain events of bankruptcy, insolvency or reorganization of the Company or its Significant Subsidiaries occurs and is continuing, the principal of all the Securities may be declared due and payable in the manner and with the effect provided in the Indenture. If an Event of Default occurs as a result of certain events of bankruptcy, insolvency or reorganization of the Company or its Significant Subsidiaries, the principal of all the Securities shall become due and payable immediately without any declaration or other act on the part of the Trustee or any Holder, all as and to the extent provided in the Indenture.

13. Trustee Dealings with the Company.

Subject to certain limitations imposed by the TIA, the Trustee under the Indenture, in its individual or any other capacity, may become the owner or pledgee of Securities and may otherwise deal with and collect obligations owed to it by the Company or its Affiliates and may otherwise deal with the Company or its Affiliates with the same rights it would have if it were not Trustee.

14. Calculations in Respect of Securities.

The Company or its agents will be responsible for making all calculations called for under the Securities including, but not limited to, determination of the Market Price, Current Market Value and Sale Price of the Common Stock and the Applicable Stock, the number of shares of Common Stock or Applicable Stock issuable upon conversion and the amounts of interest and Liquidated Damages Amount, if any, on the Securities. Any calculations made in good faith and without manifest error will be final and binding on Holders of the Securities. The Company or its agents will be required to deliver to the Trustee a schedule of its calculations and

the Trustee will be entitled to conclusively rely upon the accuracy of such calculations without independent verification.

15. No Recourse Against Others.

No recourse under or upon any obligation, covenant or agreement contained in the Indenture, or in this Security, or because of any indebtedness evidenced thereby, shall be had against any incorporator, as such, or against any past, present or future stockholder, officer or director, as such, of the Company or of any successor, either directly or through the Company or any successor, under any rule of law, statute or constitutional provision or by the enforcement of any assessment or by any legal or equitable proceeding or otherwise, all such liability being expressly waived and released by the acceptance of the Securities by the Holders and as part of the consideration for the issue of the Securities.

16. Authentication.

This Security shall not be valid until an authorized signatory of the Trustee manually signs the Trustee's Certificate of Authentication on the other side of this Security.

17. Abbreviations.

Customary abbreviations may be used in the name of a Securityholder or an assignee, such as TEN COM (=tenants in common), TEN ENT (=tenants by the entireties), JT TEN (joint tenants with right of survivorship and not as tenants in common), CUST (=custodian), and U/G/M/A (=Uniform Gift to Minors Act).

18. INDENTURE TO CONTROL; GOVERNING LAW.

IN THE CASE OF ANY CONFLICT BETWEEN THE PROVISIONS OF THIS SECURITY AND THE INDENTURE, THE **PROVISIONS OF THE INDENTURE SHALL CONTROL**. THE INDENTURE AND THIS SECURITY SHALL BE GOVERNED BY, AND CONSTRUED IN ACCORDANCE WITH, THE LAWS OF THE STATE OF NEW YORK.

The Company will furnish to any Securityholder upon written request and without charge a copy of the Indenture. Requests may be made to:

RED HAT, INC.
1801 Varsity Drive
Raleigh, North Carolina 27606
Attn: General Counsel
Facsimile No. (919) 754-3704

19. Registration Rights.⁴

The Holders of the Securities are entitled to the benefits of a Registration Rights Agreement, dated as of January 12, 2004, between the Company and the Initial Purchaser named therein, including, in certain circumstances, the receipt of Liquidated Damages Amount upon a registration default (as defined in such agreement).

⁴ This section shall be deleted from any Securities that are not Transfer Restricted Securities.

ASSIGNMENT FORM

To assign this Security, fill in the form below:

I or we assign and transfer this Security to

(Insert assignee's soc. sec. or tax ID no.)

(Print or type assignee's name, address and zip code)

and irrevocably appoint agent to transfer this Security on the books of the Company. The agent may substitute another to act for him.

Your Signature:

Date: _____

(Sign exactly as your name appears on the other side of this Security)

Signature Guaranteed

Participant in a Recognized Signature Guarantee
Medallion Program

By: _____
Authorized Signatory

CONVERSION NOTICE

To convert this Security into shares of Common Stock of the Company, check the box ☐

To convert only part of this Security, state the principal amount to be converted (which must be \$1,000 or a multiple of \$1,000):

If you want the stock certificate made out in another person's name fill in the form below:

(Insert assignee's soc. sec. or tax ID no.)

(Print or type assignee's name, address and zip code)

Your Signature:

Date: _____

(Sign exactly as your name appears on the other side of this Security)

Signature Guaranteed

Participant in a Recognized Signature Guarantee
Medallion Program

By: _____
Authorized Signatory

TRANSFER CERTIFICATE⁵

Re: 0.50% Convertible Senior Debentures due 2024
(the “**Securities**”) of Red Hat, Inc. (the “**Company**”)

This certificate relates to \$ _____ principal amount of Securities owned in (check applicable box)

☐ book-entry or ☐ definitive form by _____ (the “**Transferor**”).

The Transferor has requested a Registrar or the Trustee to exchange or register the transfer of such Securities.

In connection with such request and in respect of each such Security, the Transferor does hereby certify that the Transferor is familiar with transfer restrictions relating to the Securities as provided in Sections 2.6 and 2.12 of the Indenture dated January 12, 2004 between the Company and U.S. Bank Trust National Association, as trustee (the “**Indenture**”), and the transfer of such Security is being made pursuant to an effective registration statement under the Securities Act of 1933, as amended (the “**Securities Act**”), or the transfer or exchange, as the case may be, of such Security does not require registration under the Securities Act because (check applicable box):

- ☐ Such Security is being transferred pursuant to an effective registration statement under the Securities Act; or
- ☐ Such Security is being transferred to the Company or a Subsidiary; or
- ☐ Such Security is being transferred inside the United States to a “qualified institutional buyer” in compliance with Rule 144A under the Securities Act; or
- ☐ Such Security is being transferred inside the United States to an “institutional accredited investor” that prior to such transfer has furnished to U.S. Bank Trust National Association as Trustee (or a successor trustee, as applicable) a signed letter containing certain representations and agreements relating to the restrictions on transfer of the Securities (in the form obtained from such Trustee or successor trustee, as applicable); or
- ☐ Such Security is being transferred outside the United States in compliance with Rule 904 under the Securities Act; or

⁵ This certificate should only be included if this Security is a Transfer Restricted Security.

- ☐ Such Security is being transferred pursuant to and in compliance with an exemption from the registration requirements under the Securities Act in accordance with Rule 144 (or any successor thereto) (“**Rule 144**”) under the Securities Act; or
- ☐ Such Security is being acquired for the Transferor’s own account, without transfer;

and unless the Such Security is being transferred to the Company or a Subsidiary box is checked, the undersigned confirms that such Security is not being transferred to an “affiliate” of the Company as defined in Rule 144 under the Securities Act.

DATE:

Signature(s) of Transferor

(If the registered owner is a corporation, partnership or fiduciary, the title of the person signing on behalf of such registered owner must be stated.)

Signature Guaranteed

Participant in a Recognized Signature

EXHIBIT B

[FORM OF RESTRICTIVE LEGEND FOR COMMON STOCK ISSUED UPON CONVERSION]

[THIS SECURITY HAS NOT BEEN REGISTERED UNDER THE UNITED STATES SECURITIES ACT OF 1933 (THE “SECURITIES ACT”), AND MAY NOT BE OFFERED, SOLD OR OTHERWISE TRANSFERRED IN THE ABSENCE OF SUCH REGISTRATION OR AN APPLICABLE EXEMPTION THEREFROM. THE HOLDER OF THIS SECURITY AGREES FOR THE BENEFIT OF RED HAT, INC., THAT (A) THIS SECURITY MAY BE OFFERED, RESOLD, PLEDGED OR OTHERWISE TRANSFERRED, ONLY (I) IN THE UNITED STATES TO A PERSON WHOM THE SELLER REASONABLY BELIEVES IS A QUALIFIED INSTITUTIONAL BUYER (AS DEFINED IN RULE 144A UNDER THE SECURITIES ACT) IN A TRANSACTION MEETING THE REQUIREMENTS OF RULE 144A, (II) INSIDE THE UNITED STATES TO AN INSTITUTIONAL ACCREDITED INVESTOR THAT, PRIOR TO SUCH TRANSFER, FURNISHES TO AMERICAN STOCK AND TRANSFER COMPANY, AS TRANSFER AGENT (OR A SUCCESSOR TRANSFER AGENT, AS APPLICABLE), A SIGNED LETTER CONTAINING CERTAIN REPRESENTATIONS AND AGREEMENTS RELATING TO THE RESTRICTIONS ON TRANSFER OF THE SECURITIES (THE FORM OF WHICH LETTER CAN BE OBTAINED FROM SUCH TRANSFER AGENT OR A SUCCESSOR TRANSFER AGENT, AS APPLICABLE), (III) OUTSIDE THE UNITED STATES IN AN OFFSHORE TRANSACTION IN ACCORDANCE WITH RULE 904 UNDER THE SECURITIES ACT, (IV) PURSUANT TO AN EXEMPTION FROM REGISTRATION UNDER THE SECURITIES ACT PROVIDED BY RULE 144 THEREUNDER (IF AVAILABLE) OR (V) PURSUANT TO AN EFFECTIVE REGISTRATION STATEMENT UNDER THE SECURITIES ACT, IN EACH OF CASES (I) THROUGH (V) IN ACCORDANCE WITH ANY APPLICABLE SECURITIES LAWS OF ANY STATE OF THE UNITED STATES, AND (B) THE HOLDER WILL, AND EACH SUBSEQUENT HOLDER IS REQUIRED TO, NOTIFY ANY PURCHASER OF THIS SECURITY FROM IT OF THE RESALE RESTRICTIONS REFERRED TO IN (A) ABOVE. IN ANY CASE, THE HOLDER HEREOF WILL NOT, DIRECTLY OR INDIRECTLY, ENGAGE IN ANY HEDGING TRANSACTIONS WITH REGARD TO THE SECURITIES EXCEPT AS PERMITTED UNDER THE SECURITIES ACT.]

EXHIBIT C

[Form of Repurchase Notice]

_____, _____
U.S. Bank Trust National Association
[address]

Re: Red Hat, Inc. (the “**Company**”)
0.50% Convertible Senior Debentures due 2024

This is a Repurchase Notice as defined in Section 4.1 of the Indenture dated as of January 12, 2004 (the “**Indenture**”) between the Company and U.S. Bank Trust National Association, as Trustee. Terms used but not defined herein shall have the meanings ascribed to them in the Indenture.

Certificate No(s). of Securities: _____

I intend to deliver the following aggregate Principal Amount of Securities for purchase by the Company pursuant to Section 4.1 of the Indenture (in multiples of \$1,000):

\$ _____

I hereby agree that the Securities will be purchased on the Repurchase Date pursuant to the terms and conditions specified in the Securities and the Indenture.

Signed: _____

EXHIBIT D

[Form of Repurchase Event Repurchase Notice]

_____, _____
U.S. Bank Trust National Association
[address]

Re: Red Hat, Inc. (the “**Company**”)
0.50% Convertible Senior Debentures due 2024

This is a Repurchase Event Repurchase Notice as defined in Section 5.1 of the Indenture dated as of January 12, 2004 (the “**Indenture**”) between the Company and U.S. Bank Trust National Association, as Trustee. Terms used but not defined herein shall have the meanings ascribed to them in the Indenture.

Certificate No(s). of Securities: _____

I intend to deliver the following aggregate Principal Amount of Securities for purchase by the Company pursuant to Section 5.1 of the Indenture (in multiples of \$1,000):

\$ _____

I hereby agree that the Securities will be purchased on the Repurchase Event Repurchase Date pursuant to the terms and conditions specified in the Securities and the Indenture.

Signed: _____

**RED HAT, INC.
RESTRICTED STOCK AWARD AGREEMENT**

THIS RESTRICTED STOCK AWARD AGREEMENT is made and entered into on the 17th day of December, 2003, by and between RED HAT, INC., a Delaware corporation (the “Company”), and Matthew J. Szulik (the “Employee”).

1. Discounted Sale. Subject to the restrictions and conditions set forth in this Agreement, the Company hereby agrees to sell to the Employee, not in lieu of salary or other compensation, five hundred thousand (500,000) shares of the Company’s Common Stock at the price of \$0.50 per share (the “Restricted Shares”), upon Employee’s delivery to the Company of a check in the amount of the total purchase price for the Restricted Shares. Employee hereby agrees with the restrictions and conditions set forth in this Agreement.

2. Forfeiture Restrictions. The Restricted Shares may not be sold, assigned, pledged, exchanged, hypothecated or otherwise transferred, encumbered or disposed of voluntarily, by operation of law, pursuant to a court decree or legal process (including without limitation any interspousal transfer by court decree or order in connection with an equitable distribution of marital assets) or otherwise to the extent the Restricted Shares are then subject to forfeiture and the Company’s right to repurchase the Restricted Shares to the Company upon the occurrence of certain events pursuant to paragraph 3 below (the “Forfeiture Restrictions”).

3. Lapse of Forfeiture Restrictions. The Forfeiture Restrictions shall lapse with respect to the Restricted Shares in accordance with the following schedule provided that the Employee has been continuously employed by the Company from the date of this Agreement through the lapse date and no other event of forfeiture has occurred:

<u>Lapse Date</u>	<u>Number of Restricted Shares as to which Forfeiture Restrictions Lapse</u>
March 17, 2004	62,500
June 17, 2004	62,500
September 17, 2004	62,500
December 17, 2004	62,500
March 17, 2005	62,500
June 17, 2005	62,500
September 17, 2005	62,500
December 17, 2005	62,500

In the event the Employee voluntarily elects to terminate employment with the Company, the Company shall have the right to repurchase from the Employee all such Restricted Shares at their sale price of \$0.50 per share to the extent such shares are then subject to the Forfeiture Restrictions; provided, however, any such repurchase shall not take place sooner than thirty (30) days following Employee’s last day of employment with the Company, during which thirty-day period Employee’s exercise rights shall continue. The rights set forth in Section 1, and as limited by Sections 2 and 3, are cumulative and may be exercised only before the earlier of (a) the date which is ten (10) years from the date of this Agreement or (b) the date which is 120 days following Employee’s last date of employment with the Company.

4. Certificates. Upon payment of the purchase price, a certificate evidencing the Restricted Shares shall be issued by the Company in the Employee’s name, and the Employee shall have voting rights and shall be entitled to receive all dividends paid with respect to the Restricted Shares unless and until the Restricted Shares are repurchased pursuant to the provisions of this Agreement. The certificate shall bear a legend evidencing the Forfeiture Restrictions, if any, remaining in effect. The Company shall cause the certificate to be delivered upon issuance to the Secretary of the Company as a depository for safekeeping until a forfeiture occurs or the

Forfeiture Restrictions lapse pursuant to the terms of this Agreement, and the Employee shall deliver to the Company a stock power relating to the Restricted Shares in the form attached hereto as Exhibit A. Upon the lapse of the Forfeiture Restrictions without forfeiture, the Company shall cause a new certificate or certificates to be issued without legend in the name of the Employee for the shares as to which the Forfeiture Restrictions have lapsed. Notwithstanding any other provisions of this Agreement, the issuance or delivery of any shares (whether subject to restrictions or unrestricted) may be postponed for such period as may be required to comply with applicable requirements of any national securities exchange or any requirements under any law or regulation applicable to the issuance or delivery of such shares.

5. Withholding of Tax. To the extent that the sale of the Restricted Shares or the lapse of the Forfeiture Restrictions results in income to the Employee for federal, state or local income or employment tax purposes, the Employee shall deliver to the Company at the time of such receipt or lapse, as the case may be, such amount of money as the Company may require to meet its withholding obligation under applicable tax laws or regulations, and, if the Employee fails to do so, the Company is authorized to withhold from any cash remuneration then or thereafter payable to the Employee any tax required to be withheld by reason of such income.

6. Status of Restricted Shares. The Employee agrees that the Restricted Shares will not be sold or otherwise disposed of in any manner which would constitute a violation of any applicable federal or state securities laws.

7. No Right to Employment. This Agreement shall not confer upon the Employee any right to continued employment with the Company, nor shall it interfere in any way with the right of the Company to terminate the employment of the Employee.

8. Binding Effect. This Agreement shall be binding upon and inure to the benefit of any successors to the Company and all persons lawfully claiming under the Employee.

9. Multiple Originals. This Agreement is executed in multiple originals, one of which is being retained by each of the parties hereto and each of which shall be deemed an original hereof.

10. Governing Law. The Agreement and all actions taken thereunder shall be governed by and construed in accordance with the laws of the State of North Carolina.

IN WITNESS WHEREOF, the Company has caused this Agreement to be executed by its duly authorized officer, and the Participant has hereunto set the Participant's hand and seal, all as of the day and year first above written.

RED HAT, INC.

By: /s/ Kevin B. Thompson

Kevin B. Thompson, Executive Vice President and CFO

/s/ Matthew J. Szulik [SEAL]

Matthew J. Szulik

SUBSIDIARIES OF THE REGISTRANT

The following is a list of our subsidiaries as of February 29, 2004, omitting some subsidiaries which, considered in the aggregate, would not constitute a significant subsidiary.

<u>Subsidiary</u>	<u>Jurisdiction</u>
Americas	
Red Hat, Inc.	Delaware
Red Hat Canada Limited	Ontario, Canada
Red Hat Professional Consulting, Inc.	Georgia
Red Hat Financial Holdings, Inc.	Delaware
Europe	
Red Hat UK Limited	United Kingdom
Red Hat GmbH	Germany
Red Hat Ireland Limited	Ireland
Red Hat France SARL	France
Red Hat Italia S.p.A.	Italy
Red Hat S.L.	Spain
Asia-Pacific/Japan	
Red Hat Asia-Pacific Pty. Ltd.	Australia
Red Hat Asia-Pacific Pte. Ltd.	Singapore
Red Hat KK	Japan
Red Hat India Private Ltd.	India

CONSENT OF INDEPENDENT ACCOUNTANTS

We hereby consent to the incorporation by reference in the Registration Statements on Form S-8 (Nos. 333-112557, 333-71912, 333-59306, 333-55968, 333-45980, 333-45042, 333-37884, 333-96163 and 333-88159) and Form S-3 (Nos. 333-106856, 333-113312 and 333-115389) of Red Hat, Inc. of our report dated May 6, 2004 relating to the consolidated financial statements which appears in this Form 10-K.

/s/ PRICEWATERHOUSECOOPERS LLP

Raleigh, North Carolina
May 11, 2004

**CERTIFICATION OF CHIEF EXECUTIVE OFFICER, PURSUANT TO RULE 13a-14(a) UNDER THE
SECURITIES EXCHANGE ACT OF 1934**

I, Matthew J. Szulik, certify that:

1. I have reviewed this annual report on Form 10-K of Red Hat, Inc.;
2. Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report.
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
 - a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) [Paragraph omitted in accordance with SEC transition instructions contained in SEC Release 34-47986]
 - c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) all significant deficiencies in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

May 14, 2004

By: /s/ MATTHEW J. SZULIK
Matthew J. Szulik
President and Chief Executive Officer

**CERTIFICATION OF CHIEF FINANCIAL OFFICER, PURSUANT TO RULE 13a-14(a) UNDER THE
SECURITIES EXCHANGE ACT OF 1934**

I, Kevin B. Thompson, certify that:

1. I have reviewed this annual report on Form 10-K of Red Hat, Inc.;
2. Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report.
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
 - a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) [Paragraph omitted in accordance with SEC transition instructions contained in SEC Release 34-47986]
 - c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) all significant deficiencies in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

May 14, 2004

By: /s/ KEVIN B. THOMPSON
Kevin B. Thompson
Chief Financial Officer
(Principal Financial Officer)

**CERTIFICATION OF CHIEF EXECUTIVE OFFICER AND CHIEF FINANCIAL OFFICER, PURSUANT
TO RULE 13a-14(a) UNDER THE SECURITIES EXCHANGE ACT OF 1934 AND U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

Each of the undersigned hereby certifies, for the purposes of section 1350 of chapter 63 of title 18 of the United States Code, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, in his capacity as an officer of Red Hat, Inc. (Red Hat), that, to his knowledge, the Annual Report of Red Hat on Form 10-K for the period ended February 29, 2004, (the "Report") fully complies with the requirements of Section 13(a) of the Securities and Exchange Act of 1934 and that the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of Red Hat.

May 14, 2004

By: /s/ MATTHEW J. SZULIK
Matthew J. Szulik
Chief Executive Officer, President and
Chairman of the Board of Directors
(Principal Executive Officer)

May 14, 2004

By: /s/ KEVIN B. THOMPSON
Kevin B. Thompson
Chief Financial Officer
(Principal Financial Officer)