TESSCO TECHNOLOGIES INC
Form 10-K
June 02, 2015

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

FORM 10 K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE FISCAL YEAR ENDED March 29, 2015

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 24746

TESSCO Technologies Incorporated
(Exact name of registrant as specified in its charter)

DELAWARE	52-0729657
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

11126 McCormick Road, Hunt Valley, Maryland	21031
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code (410) 229-1000

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, $0.01 par value	NASDAQ Global Select Market

Securities registered pursuant to Section 12(g) of the Act:

None

Indicate by check mark if the registrant is a well-known seasoned issuer (as defined in Rule 405 of the Act). Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act. Yes No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or other information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company (as defined in Rule 12b-2 of the Exchange Act). Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

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

The aggregate market value of Common Stock, $0.01 par value, held by non-affiliates of the registrant based on the closing sales price of the Common Stock as quoted on the NASDAQ Global Market as of September 28, 2014, was $182,901,110.

The number of shares of the registrant's Common Stock, $0.01 par value, outstanding as of May 26, 2015, was 8,266,863.

DOCUMENTS INCORPORATED BY REFERENCE: Portions of the definitive Proxy Statement for the registrant’s 2015 Annual Meeting of Shareholders, scheduled to be held July 21, 2015, are incorporated by reference into Part III of this Annual Report on Form 10-K.

TABLE OF CONTENTS

PART 1		
Item 1.	Business	3
Item 1A.	Risk Factors	12
Item 1B.	Unresolved Staff Comments	22
Item 2.	Properties	22
Item 3.	Legal Proceedings	23
Item 4.	Mine Safety Disclosures	23
PART II		
Item 5.	Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities	24
Item 6.	Selected Financial Data	27
Item 7.	Management's Discussion and Analysis of Financial Condition and Results of Operations	28
Item 7A.	Quantitative and Qualitative Disclosures About Market Risk	39
Item 8.	Financial Statements and Supplementary Data	40
Item 9.	Changes in and Disagreements With Accountants on Accounting and Financial Disclosure	64
Item 9A.	Controls and Procedures	64
Item 9B.	Other Information	66
PART III		
Item 10.	Directors, Executive Officers and Corporate Governance	66
Item 11.	Executive Compensation	66
Item 12.	Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters	66
Item 13.	Certain Relationships and Related Transactions, and Director Independence	66
Item 14.	Principal Accounting Fees and Services	66
Part IV		
Item 15.	Exhibits, Financial Statement Schedule	66
Schedule II:	Valuation and Qualifying Accounts	71
Signatures		72

Table of Contents
Part I

Item 1. Business.

General

TESSCO Technologies Incorporated (TESSCO, we, or the Company) is Your Total Source® for making wireless work. The convergence of wireless and the internet is revolutionizing the way the world lives, works and plays. New systems and applications are unlocking potential at an unprecedented rate. TESSCO is there, thinking in new ways for exceptional outcomes. TESSCO architects and delivers the product and value chain solutions to organizations responsible for building, operating, maintaining and reselling cellular, mobile communications, Wi-Fi, machine-to-machine, Internet of Things and wireless backhaul systems.

Our customers include a diversified mix of carrier and public network operators, tower owners, program managers, contractors and integrators, wireless internet service providers, industrial and enterprise self-maintained users (including railroads, utilities, mining operators, oil and gas operators and technicians), governments, manufacturers, and value-added resellers, tier 1, 2 and 3 retail carrier stores and their independent agents, dealers and consumers, as well as other local and national retailers. We currently serve an average of approximately 12,400 non-consumer customers per month.

We provide our customers with support, products and services to build and maintain these primary systems:

- Broadband Connectivity
- Base Station Infrastructure
- Critical Communications
- Indoor Network Architecture
- Maintenance Repair and Assembly
- Outdoor Network Architecture
- Remote Monitoring and Control
- Mobility and User Devices

We offer products in these categories: base station infrastructure, network systems, mobile devices and accessories, and installation, test and maintenance products. We source and develop our product offer from leading manufacturers throughout the world.

Our operational platform allows customers and manufacturers the opportunity to streamline the supply chain process and lower total inventories and costs by providing guaranteed availability and complete, on-time delivery to the point of use.

We began our "total source" operations in 1982, reincorporated as a Delaware corporation in 1987, and have been listed on the NASDAQ Market (currently, NASDAQ Global Select) (symbol: TESS), since 1994. We operate under ISO 9001:2008 and TL 9000 registrations.

For information regarding our website address and material available free of charge through the website, see the information appearing under the heading "Available Information" included in Item 7 to this Annual Report on Form 10-K for the fiscal year ended March 29, 2015.

Table of Contents

Customers

We evaluate our business and customers as one segment. However, to provide investors with increased visibility into the markets we serve, we report revenue and gross profit by the following customer market units: (1) public carriers, contractors and program managers that are generally responsible for building and maintaining the infrastructure system and provide airtime service to individual subscribers; (2) government system operators including federal agencies as well as state and local governments that run wireless networks for their own use; (3) private system operators such as major utilities and transportation companies that run wireless networks for their own use; (4) commercial dealers and resellers that sell, install and/or service cellular telephone, wireless networking, broadband and two-way radio communications equipment primarily for the enterprise market; (5) retailers, dealer agents and carriers; and (6) our Major 3PL relationship with AT&T Mobility (AT&T) that was fully transitioned by the end of fiscal year 2013. Beginning in the third quarter of fiscal 2015, we began reporting private system operators and government system operators as two separate market units. Our financial statements reflect this change for all periods presented.

Public carriers, contractors and program managers are system operators that are generally responsible for building and maintaining the public infrastructure system and providing airtime service to individual subscribers, and accounted for approximately 23% of fiscal year 2015 revenue. Government system operators including federal agencies and state and local governments accounted for 6% of fiscal 2015 revenues. Private system operators, including commercial entities, major utilities, transportation companies, manufacturers, and installation centers, accounted for 16% of fiscal 2015 revenues. Commercial dealers and resellers include dealers and resellers that sell, install and/or service cellular telephone, wireless networking, broadband and two-way radio communications equipment for the enterprise and consumer markets. These resellers include local and national value-added resellers and retailers, and accounted for 24% of fiscal 2015 revenues. Our retailers, independent dealer agents and carriers market accounted for 31% of fiscal 2015 revenues. Finally, our Major 3PL relationship contributed no revenue in fiscal year 2014 or 2015, as our relationship with AT&T was fully transitioned by the end of fiscal 2013.

Our top ten customer relationships totaled 20% of our total revenue for fiscal 2015, and no customer relationship accounted for more than 7% of our total revenues. In April 2012, we were notified by AT&T of their intention to transition their third party logistics retail store supply chain business away from us. As of the close of our fiscal 2013, this business was fully transitioned, and AT&T is no longer our largest customer. We continue to supply product to this customer’s other programs and to supply proprietary Ventev® products to AT&T retail stores.

Approximately 98% of our sales have been made to customers in the United States during each of the past three fiscal years, although we currently sell to customers in over 80 countries. Due to our diverse product offering and our wide customer base, our business is not significantly affected by seasonality in the aggregate. However, sales to our retailers generally peak in our second and third quarters in preparation for the winter holiday season. Also, our base station infrastructure sales are typically affected by weather conditions in the United States, especially in our fourth quarter.

For more detailed financial information regarding our operating segments for each of the past three fiscal years, see Note 9 to the Consolidated Financial Statements included in Item 8 to this Annual Report on Form 10-K for the fiscal year ended March 29, 2015.

Products and Services

We principally offer competitively priced, manufacturer brand-name products, ranging from simple hardware items to sophisticated test equipment, with per item prices ranging from less than $1 to over $150,000 and gross profit margins ranging from less than 5% to 98%. We offer products classified into our four business categories: base station infrastructure; network systems; installation, test and maintenance products, and mobile devices and accessories,

which accounted for approximately 41%, 17%, 8%, and 34% of fiscal year 2015 revenues, respectively. Base station infrastructure products are used to build, repair and upgrade wireless broadband systems. Products include base station antennas, cable and transmission lines, small towers, lightning protection devices, connectors, power systems, enclosures, grounding, jumpers, miscellaneous hardware, and mobile antennas. Our base station infrastructure service offering includes connector installation, custom jumper assembly, site kitting and logistics integration. Network systems products are used to build and upgrade public and private wireless broadband networks. Products include fixed and mobile broadband radio equipment, wireless networking filtering systems, distributed antenna systems, two-way radios and security and surveillance products. This product category also includes training classes, technical support and engineering design services. Installation, test and maintenance products are used to install, tune, and maintain wireless communications equipment. Products include sophisticated analysis equipment and various frequency-, voltage- and power-measuring devices, as well as an assortment of tools, hardware, GPS, safety and replacement and component parts and supplies required by service technicians. Mobile devices and accessory products include cellular and smart phone and data device accessories such as replacement batteries, cases, screen protectors, speakers, mobile amplifiers, power supplies, bluetooth and corded headsets, mounts, car antennas, music accessories and data and memory cards.

Table of Contents

While we principally provide manufacturer brand-name products, a variety of products are developed, manufactured and offered under TESSCO-owned brands including Ventev®, Wireless Solutions®, and TerraWave®. The products we offer under these brands generally consist of device accessory products that fall into the mobile device and accessory product category, as well as WLAN and network systems accessory products and remote monitoring and control solutions that fall into the network systems category. Also, our WLAN certification training is offered under our training unit GigaWave® trade name and is reported in the network systems category. We have not incurred significant research and development expenditures in any of the last three fiscal years. Sales of proprietary products were 13% of our total sales in fiscal year 2015.

Our products are sold as part of our integrated product and supply chain solutions. Our supply chain services for all product areas are grouped under Knowledge, Configuration, Delivery and Control. Knowledge solutions include the entire suite of TESSCO knowledge tools that focus on educating the industry, including product highlights, showcases and/or comparisons, with comprehensive specifications on the products, solutions and applications that are offered and reinforced by engineering, sales and technical support, as well as hands-on training programs. Configuration services are comprised of customized product solution kitting and assembly, logistics management and consumer and retail merchandising and marketing, allowing the products to be delivered ready for immediate use, installation or resale. Our delivery system allows the customer to select speed of delivery options, to specific delivery locations, designed to eliminate the customer's need for staging and warehousing. Our services that increase customer control include predetermined monthly pricing levels, the ability to monitor multi-site purchasing with pre-approved, customized parameters indicating who is able to order how much of which specific products, order delivery tracking, product usage tracking, history reporting and alternative financing options.

As part of our commitment to customer service, we typically allow most customers to return most products for any reason, for credit, within 30 days of the date of purchase. Total returns and credits have been less than 3% of revenues in each of the past three fiscal years.

Revenues from sales of products purchased from our largest vendor, CommScope Inc., accounted for 14% of total fiscal 2015 revenues. Sales of products purchased from our ten largest vendors generated approximately 41% of our total fiscal 2015 revenues.

The amount of purchases we make from each of our approximately 400 vendors may significantly increase or decrease over time. As the level of business changes, we may request, or be requested by our vendors, to adjust the terms of our relationships. Therefore, our ability to purchase and re-sell products from each of our vendors depends on being able to reach agreements with these vendors on business terms. In addition, the agreements and arrangements on which most of our larger vendor relationships are based are typically of limited duration and terminable for any or no reason by either party upon notice of varying lengths, usually between several months and two years. Generally, we believe that alternative sources of supply are available for many of the product types we carry.

The scope of products available for purchase from a given vendor may fluctuate, and is generally limited only by the scope of the vendor's catalog and available inventory. Therefore, we often source the same product type from multiple vendors, although in some instances the availability of a branded product is limited to a particular vendor, or other business concerns might dictate that we favor one vendor over another. The terms of the vendor contract typically apply to all products purchased from a particular vendor, whether or not the item is specifically identified in the contract.

Table of Contents

When negotiating with vendors, we seek the most favorable terms available under the circumstances. Our preferred terms include among others, terms that provide for product warranty and return rights, as well as product liability and intellectual property indemnification rights, in each case consistent with our preferred business methods and objectives. We have not been able, nor do we expect in the future to be able, to negotiate the inclusion of all our preferred terms, or our preferred language for those terms, in every contract. The degree of our success in this regard is largely a function of the parties' relative bargaining positions.

We are dedicated to superior performance, quality and consistency of service in an effort to maintain and expand vendor relationships but there can be no assurance that we will continue to be successful in this regard in the future, or that competitive pressures or other events beyond our control will not have a negative impact on our ability to maintain these relationships or to continue to derive revenues from these relationships.

Method of Operation

We believe that we have developed a highly integrated, technologically advanced and efficient method of operation based on the following key tenets:

- Understanding and anticipating customers' needs and building solutions by cultivating lasting relationships;
- Allowing customers to make the best decisions by delivering product knowledge, not just information, through our knowledge tools, including The Wireless Journal®, and the TESSCO.com®, Solution and Transaction System;
- Responding to what we refer to as "the moments of truth" by providing customers with sales, service and technical support, 24 hours a day, 7 days a week, 365 days a year;
- Providing customers what they need, when and where they need it by delivering integrated product and supply chain solutions; and
- Helping customers enhance their operations by providing real-time order tracking and performance measurement.

We operate as a team of teams structured to enhance marketing innovation, customer focus and operational excellence.

Market Development and Sales: In order to meet the needs of a dynamic and diverse marketplace, our sales and marketing activities are organized on an end-market basis. Sales teams are focused on our customers: 1) public carriers, contractors, and program managers, 2) government system operators 3) private system operators, 3) commercial dealers and resellers, 4) retailers, independent dealer agents and carriers, and 5) until its transition in fiscal 2013, our major 3PL relationship with AT&T. This organization allows for the development of unique product and solution offerings to meet the needs of our diverse customer base.

We attempt to understand and anticipate customers' needs and to build solutions by cultivating lasting relationships. Our commercial customer database contains detailed information on approximately 219,000 existing customers, including the names of key personnel, past contacts, inquiries, and buying and credit histories. Additionally, we have information on approximately 610,000 contacts that serve as potential new customers in our market. This extensive customer database enables us to identify and target potential customers and to market specific products to these targeted customers. Potential customers are identified through their responses to TESSCO.com®, direct marketing materials, advertisements in trade journals and industry trade shows, as well as through referrals from other TESSCO customers and vendors. Customer relationship representatives pursue these customer inquiries through distribution of our Knowledge Tools and through phone contact, electronic communications, and field visits. The information technology system tracks potential customer identification from the initial marketing effort through the establishment and development of a purchasing relationship. Once a customer relationship is established, we carefully analyze purchasing patterns and identify opportunities to encourage customers to make more frequent purchases of a broader array of products. Scheduled contacts are made to each regularly purchasing customer for the purpose of information dissemination, order generation, database maintenance, and the overall enhancement of the business relationship. The

process is aimed at attracting prospects to TESSCO, converting these prospects to buying customers, and ultimately migrating them to loyal, total-source monthly buyers.

Table of Contents

Solutions Development and Product Management: We actively monitor advances in technologies and industry trends, both through market research and continual customer and manufacturer interaction, and continue to enhance our product offering as new wireless communications products and technologies are developed. To complement our broad product portfolio, we provide technical expertise and consultation to assist our customers in understanding technology and choosing the right products for their specific application. Our Sale Architects offer applications engineering to market-specific applications such as Positive Train Control, Smart Grid and fiber networks, custom integrated solutions for power systems, and site kitting and flexible custom network design services for areas such as in-building coverage, tower design, and wireless video surveillance systems.

In addition to determining the product offering, our Product and Solutions Development Teams provide the technical foundation for both customers and our personnel. The Wireless Product Knowledge System (WPKS) is continually updated to add new products and additional technical information in response to manufacturer specification changes and customer inquiries. WPKS contains detailed information on each stock keeping unit (SKU) offered, including full product descriptions, category classifications, technical specifications, illustrations, product cost, pricing and delivery information, alternative and associated products, and purchase and sales histories. This information is available on a real-time basis to all of our personnel for product development, procurement, technical support, cataloging and marketing.

Strategic Marketing – As a thought leader in the wireless industry, TESSCO's marketing materials are used for both educating the industry and for promoting TESSCO's value. We utilize our WPKS to develop both broad-based and customized product solution information materials. These materials are designed to encourage both existing and potential customers to realize the value we provide in their product solution and supply chain decisions. These Knowledge Tools are an integrated suite of informational print and electronic media. They include: The Wireless Guide®, our product catalogue which is readily available electronically on TESSCO.com; The Wireless Journal®, a trade journal with a bimonthly circulation of approximately 107,300, which is designed to introduce the reader to our capabilities and product offerings, and contains information on significant industry trends and product reviews; The Wireless Update®, which is emailed on a regular basis to an average of 92,000 different individuals and is uniquely produced for various portions of our customer base; The Wireless Bulletin® family, including The Wireless Bulletin for Accessories for Handsets, Tablets & Music Devices which has a bimonthly circulation of approximately 12,200, The Wireless Bulletin for Installation, Test & Maintenance Products, The Wireless Bulletin for Security & Surveillance, The Wireless Bulletin for Site Planning, The Wireless Bulletin for Training, and The Wireless Bulletin for Wireless Networking Solutions, which are distributed on an as-need basis in a given year; Technical Application Notes, interactive Systems Supported Reference Drawings, and White Papers, which provide in-depth planning and installation instructions and diagrams; and TESSCO.com®. In addition, TESSCO publishes online, Web-browser-enabled, companion versions of its many printed publications, including The Wireless Bulletin Online, The Wireless Guide Online, and The Wireless Journal Online.

TESSCO.com® is our e-commerce site and the gateway to Your Total Source® for the knowledge, products, and solutions for building, using, and maintaining and reselling wireless broadband solutions. It offers online access to a real-time system of Knowledge, Configuration, Delivery and Control of product and supply chain solutions and is intended for our commercial customers. Its feature-rich capabilities include:

- Customer-specific home pages that offer customized presentations of relevant, market-specific content, tailored to logged-in users' specific roles in wireless;

Table of Contents

- Powerful product and knowledge search capabilities enabled by Google search engine logic;
- Real-time pricing and product availability;
- Easy ordering capabilities, including a Worksheet ordering tool which is the foundation for building end-to-end solutions and requirements, and which allows for the construction and configuration of a total-source order; Worksheets can be immediately converted to an order, as well as saved, copied, shared, uploaded and emailed;
- A Knowledge Center that unlocks all assets of TESSCO.com and enables the streamlined navigation of TESSCO's knowledge content (articles, white papers, Systems Supported illustrations, videos, installation guides, product selection guides, or any other content featured on TESSCO.com);
- A recommendation engine that offers product alternatives based on product attributes and past purchase history;
- A variety of useful customer service, financial and technical support pages, including the Your Account page which includes all of the tools necessary to manage or modify orders, update the account, find the right support, review Worksheets, handle warranty claims, and explore TESSCO's capabilities;
- Order confirmation – specifying the contents, order status, delivery date, tracking number and total cost of an order;
- An Order Tracking Center that provides online order status, at every step of the way, of all order items, available in the real-time Your Account Portal;
- Order reservations, order status, back-order details and four-month order history;
- The ability to view invoices online and customer specific pricing, based on our tiered pricing levels tied to a customer's aggregate purchase volume;
- Systems and Devices Supported pages feature interactive, how-to illustrations for a range of wireless applications that help with system design or device accessory support; the illustrations show the product required for a given application, allowing the user to configure an end-to-end solution and build a Worksheet;
- Manufacturer portal pages designed to showcase each manufacturer partner's offer in a custom fashion;
- A Feedback Center that makes it easy for customers to provide input on our services, Knowledge Tools and Website; and
- Interactive versions of various Knowledge Tools, including: several customized versions of The Wireless Bulletin®, The Wireless Update®, The Wireless Guide®, and The Wireless Journal®.

Our Knowledge Tools empower our customers to make better decisions by delivering product knowledge, rather than just information. These tools also afford our manufacturers the opportunity to develop their brands and promote their products to a broad and diverse customer base.

Customer Support and Order Entry: Our customer support teams are responsible for responding to what we refer to as "the moments of truth" by delivering sales and customer support services through an effective and efficient transaction system. We also continually monitor our customer service performance through report cards sent for each product delivery, customer surveys and regular interaction with customers. By combining our broad product offering with a commitment to superior customer service, we seek to reduce a customer's overall procurement costs by enabling the customer to consolidate the number of suppliers from which it obtains products, while also reducing the customer's need to maintain high inventory levels.

Our information technology system provides detailed information on every customer account, including recent inquiries, buying and credit histories, separate buying locations within a customer account and contact diaries for key personnel, as well as detailed product information, including technical, product availability and pricing information. The information technology system increases sales productivity by enabling any customer support representative to provide any customer with personalized service and also allows non-technical personnel to provide a high level of technical product information and order assistance.

Table of Contents

We believe that our commitment to providing prompt, friendly and efficient customer service before, during and after the sale enables us to maximize sales, customer satisfaction and customer retention. The monthly average number of non-consumer customers decreased slightly from approximately 12,700 for fiscal year 2014 to approximately 12,400 in fiscal year 2015. The average monthly purchase from customers remained flat at approximately $3,700 in fiscal year 2014 and fiscal year 2015.

Procurement and Inventory Management: Our product management and purchasing system aims to provide customers with a total source of broad and deep product availability, while maximizing the return on our inventory investment.

We use our information technology system to monitor and manage our inventory. Historical sales results, sales projections and information regarding vendor lead times are all used to determine appropriate inventory levels. The information technology system also provides early warning reports regarding upcoming inventory requirements. As of March 29, 2015 and March 30, 2014, we had an immaterial level of backlog orders. Most backlog orders as of March 29, 2015, are expected to be filled within 90 days of fiscal year-end. For the fiscal years ended March 29, 2015 and March 30, 2014, inventory write-offs were 0.5% and 0.3% of total purchases, respectively. In many cases, we are able to return slow-moving inventory to our vendors pursuant to stock rotation agreements. Inventory turns for fiscal years 2015 and 2014 were 6.2 and 6.9, respectively.

Fulfillment and Distribution: Orders are received at our Timonium, Maryland, Reno, Nevada and San Antonio, Texas customer sales support centers. As orders are received, customer representatives have access to technical information, alternative and complementary product selections, product availability and pricing information, as well as customer purchasing and credit histories and recent inquiry summaries. An automated warehouse management system, which is integrated with the product planning and procurement system, allows us to ensure inventory control, to minimize multiple product shipments to complete an order and to limit inventory duplication. Bar-coded labels are used on every product, allowing distribution center personnel to utilize radio frequency scanners to locate products, fill orders and update inventory records in real-time, thus reducing overhead associated with the distribution functions. We contract with a variety of freight line and parcel transportation carrier partners to deliver orders to customers.

Performance and Delivery Guarantee (PDG) charges are generally calculated on the basis of the weight of the products ordered and on the delivery service requested, rather than on distance to the customer. We believe that this approach emphasizes on-time delivery instead of shipment dates, enabling customers to minimize their inventories and reduce their overall procurement costs while guaranteeing date specific delivery, thereby encouraging them to make us their total source supplier.

Information Technology: Our information technology system is critical to the success of our operations. We have made substantial investments in the development of this system, which integrates cataloging, marketing, sales, fulfillment, inventory control and purchasing, financial control and internal and external communications. The information technology system includes highly developed customer and product databases and is integrated with our Configuration, Fulfillment and Delivery system. The information contained in the system is available on a real-time basis to all of our employees as needed and is utilized in every area of our operations.

We believe that we have been successful to date in pursuing a highly integrated, technologically advanced and efficient method of operations; however, disruption to our day-to-day operations, including failure of our information technology system, distribution system, or freight carrier interruption, could impair our ability to receive and process orders or to ship products in a timely and cost-efficient manner.

Table of Contents

Competition

The wireless communications distribution industry is competitive and fragmented, and is comprised of distributors, such as Brightstar, D&H, Genco ATC Logistics, Superior Communications and VoiceComm in our retail market and Alliance Corporation, Anixter, Comstor, Graybar, Hutton Communication, KPG Logistics, Ingram Micro, Talley Communications, Tech Data, Site Pro 1, VAV Wireless, Westcon and Winncom in our other markets. In addition, many manufacturers sell and fulfill directly to customers. Barriers to entry for distributors are relatively low, particularly in the mobile devices and accessory market, and the risk of new competitors entering the market is high. In addition, the agreements or arrangements with our customers or vendors looking to us for product and supply chain solutions are typically of limited duration and are terminable by either party upon several months or otherwise short notice. Accordingly, our ability to maintain these relationships is subject to competitive pressures and challenges. Some of our current competitors have substantially greater capital resources and sales and distribution capabilities than we do. In response to competitive pressures from any of our current or future competitors, we may be required to lower selling prices in order to maintain or increase market share, and such measures could adversely affect our operating results. We believe, however, that our strength in service, the breadth and depth of our product offering, our information technology system, our knowledge and expertise in wireless technologies and the wireless marketplace, and our large customer base and purchasing relationships with approximately 400 manufacturers, provide us with a significant competitive advantage over new entrants to the market.

Continuing changes in the wireless communications industry, including risks associated with conflicting technology, changes in technology, inventory obsolescence, and consolidation among wireless carriers, could adversely affect future operating results.

We believe that the principal competitive factors in supplying products to the wireless communications industry are the quality and consistency of customer service, particularly timely delivery of complete orders, breadth and quality of products offered and total procurement costs to the customer. We believe that we compete favorably with respect to each of these factors. In particular, we believe we differentiate ourselves from our competitors based on the breadth of our product offering, our ability to quickly provide products and supply chain solutions in response to customer demand and technological advances, our knowledge and expertise in wireless technologies and the wireless marketplace, the level of our customer service and the reliability of our order fulfillment process.

Intellectual Property

We seek to protect our intellectual property through a combination of trademarks, service marks, confidentiality agreements, trade secret protection and, if and when appropriate, patent protection. Thus far, we have generally sought to protect our intellectual property, including our product data and information, customer information and information technology systems, through trademark filings and nondisclosure, confidentiality and trade secret agreements. We typically require our employees, consultants, and others having access to our intellectual property, to sign confidentiality and nondisclosure agreements. There can be no assurance that these confidentiality and nondisclosure agreements will be honored, or whether they can be fully enforced, or that other entities may not independently develop systems, technologies or information similar to that on which we rely.

TESSCO Communications Incorporated, a wholly-owned subsidiary of TESSCO Technologies Incorporated, maintains a number of registered trademarks and service marks in connection with our business activities, including: A Simple Way of Doing Business Better®, Delivering Everything for Wireless®, Delivering What You Need…When and Where You Need It®, GigaWave Technologies®, Going Beyond the Ordinary®, LinkUPS®, ORDERflow®, Solutions That Make Wireless Work®, TerraWave Solutions®, TESSCO®, TESSCO Making Wireless Work®, TESSCO Technologies®, TESSCO.com®, Ventev®, Ventev Innovations®, The Vital Link to a Wireless World®, The Wireless Bulletin®, The Wireless Guide®, The Wireless Journal®, Wireless Solutions®, The Wireless Update®, Your Total Source®, Your Virtual Inventory®, among many others. Our general policy is to file for trademark and service

mark protection for each of our trademarks and trade names and to enforce our rights against any infringement.

We currently hold one patent related to our online order entry system. We intend, if and when appropriate, to seek patent protection for any additional patentable technology. The ability to obtain patent protection involves complex legal and factual questions. Others may obtain patent protection for technologies that are important to our business, and as a result, our business may be adversely affected. In response to patents of others, we may need to license the right to use technology patented by others, or in the event that a license cannot be obtained, to design our systems around the patents of others.

Table of Contents

Environmental Regulation

We are subject to various laws and governmental regulations concerning environmental matters and employee safety and health in the United States. We are also subject to regulation by the Occupational Safety and Health Administration concerning employee safety and health matters. Compliance with these federal, state and local laws and regulations related to protection of the environment and employee safety and health has had no material effect on our business. There were no material capital expenditures for environmental projects in fiscal year 2015 and there are no material expenditures planned for such purposes in fiscal year 2016.

Employees

As of March 29, 2015, we had 786 full-time equivalent employees. Of our full-time equivalent employees, 402 were engaged in customer and vendor service, marketing, sales and product management, 276 were engaged in fulfillment and distribution operations and 108 were engaged in administration and technology systems services. No employees are covered by collective bargaining agreements. We consider our employee relations to be excellent.

Executive Officers

Executive officers are appointed annually by the Board of Directors and, subject to the terms of any applicable employment agreement, serve at the discretion of the Board of Directors. Information regarding our executive officers is as follows:

Name	Age	Position	
Robert B. Barnhill, Jr.	71	Chairman, President and Chief Executive Officer	Robert B. Barnhill, Jr. has served as President and Chief Executive Officer since founding the current business in 1982. Mr. Barnhill has been a director of the Company since 1982, and has served, and continues to serve, as Chairman of the Board since November 1993.
Aric Spitulnik	43	Senior Vice President, Secretary, and Chief Financial Officer	Aric Spitulnik joined the Company in 2000. Mr. Spitulnik was appointed Controller in 2005 and Vice President in 2006. In 2012, he was appointed Corporate Secretary and in 2014, he was appointed Senior Vice President. Since October 2013, Mr. Spitulnik has served as the Company’s Chief Financial Officer.
Douglas A. Rein	55	Senior Vice President of Performance Systems and Operations	Douglas A. Rein joined the Company in July 1999 as Senior Vice President of Performance Systems and Operations. Previously, he was director of operations for Compaq Computer Corporation and vice president, distribution and logistics operations for Intelligent Electronics.

Item 1A. Risk Factors.

We are not able to identify or control all circumstances that could occur in the future that may adversely affect our business and operating results. The following are certain risk factors that could adversely affect our business, financial position and results of operations. These risk factors and others described in this Annual Report on Form 10-K should be considered in connection with evaluating the forward-looking statements contained in this Annual Report on Form 10-K because these factors could cause the actual results and conditions to differ materially from those projected in the forward-looking statements. Additional risks and uncertainties that management is not aware of or focused on, or that management currently deems immaterial may also adversely affect our business, financial position and results of operations. If our business, financial position and results of operations are adversely affected by any of these or other adverse events, our stock price would also likely be adversely affected.

RISKS RELATING TO OUR BUSINESS

We face significant competition in the wireless communications distribution industry.

The wireless communications distribution industry is competitive and fragmented, and is comprised of several national distributors, as well as numerous regional distributors. In addition, many manufacturers sell and fulfill directly to customers. Barriers to entry for distributors are relatively low, particularly in the mobile devices and accessory market, and the risk of new competitors entering the market is high. Some of our current competitors have substantially greater capital resources and sales and distribution capabilities than we do. In response to competitive pressures from any of our current or future competitors, we may be required to lower selling prices in order to maintain or increase market share, and such measures could adversely affect our operating results.

We typically purchase and sell our products and services on the basis of individual sales or purchase orders, and even in those cases where we have standing agreements or arrangements with our customers and vendors, those agreements and arrangements typically contain no purchase or sale obligations and are otherwise terminable by either party upon several months or otherwise short notice.

Our sales to customers and our purchases from vendors are largely governed by individual sales or purchase orders, so there is no guarantee of future business. In some cases, we have formal agreements or arrangements with significant customers or vendors, but they are largely administrative in nature and are terminable by either party upon several months or otherwise short notice, and they typically contain no purchase or sale obligations. Many of our customer and vendor contracts contain “evergreen” clauses, although this too is largely a matter of administrative convenience, because the contracts are nevertheless typically terminable on short notice, and because no purchase and sale obligation in any event arises other than pursuant to an accepted purchase order. When negotiating with customers and vendors, we seek the most favorable terms available under the circumstances. Our preferred vendor terms include, among others, terms that provide for product warranty and return rights, as well as product liability and intellectual property indemnification rights, in each case consistent with our preferred business methods and objectives. We have not been able, nor do we expect in the future to be able to negotiate the inclusion of all our preferred terms, or our preferred language for those terms, in every contract. The degree of our success in this regard is largely a function of the parties’ relative bargaining positions.

When unable to negotiate the inclusion of our preferred terms or preferred language in a particular vendor contract, we assess any increased risk presented, as well as mitigating factors, analyze our overall business objectives, and then proceed accordingly. In some instances, we refuse the contract and seek other sources for the product, and in other instances business objectives and circumstances are determined to outweigh or mitigate any increased risk, or otherwise dictate that we proceed with the contract notwithstanding. We consistently seek to manage contractual risks, and are not aware of any significant unanticipated losses resulting from a vendor contract not including our preferred terms or language. However, even when we are successful in negotiating our preferred terms, performance

of these terms is not assured.

Table of Contents

If our vendors or suppliers refuse to, or for any reason are unable to supply products to us, and if we are not able to procure those products from alternative sources, we may not be able to maintain appropriate inventory levels to meet customer demand and our financial position and results of operations would be adversely affected. Similarly, if customers decide to make purchases from other sources, experience significant changes in demand internally or from their own customer bases, become financially unstable, or are acquired by another company, our ability to generate revenues from these customers may be significantly affected, resulting in an adverse effect on our financial position and results of operations.

The loss or any change in the business habits of key customers or vendors may have a material adverse effect on our financial position and results of operations.

Because our standing arrangements and agreements with our customers and vendors typically contain no purchase or sale obligations and are terminable by either party upon several months or otherwise relatively short notice, we are subject to significant risks associated with the loss or change at any time in the business habits and financial condition of key customers or vendors. In fiscal year 2013, sales to our largest customer relationship, AT&T Mobility, accounted for approximately 30% of total revenues. The transition of this retail store supply chain business with AT&T was completed in the fourth quarter of our fiscal 2013, and revenues from this business have therefore terminated.

After the transition of our relationship with AT&T, our customer concentration is now relatively small, with no customer accounting for more than 7% of total revenues in fiscal 2015. However, customer mix can change rapidly, and we may see changes in customer concentrations in the future.

Sales of products purchased from our largest vendor, CommScope Inc. generated approximately 14% of our total revenues in fiscal 2015, and sales from our largest ten vendors generated approximately 41% of total revenues. As is the case with many of our vendor and customer relationships, our contractual arrangement with CommScope Inc. is terminable by either party upon several months notice. If this contract and our relationship with CommScope Inc., or other significant vendor relationships, terminate for any reason and we are not able to procure those products from alternative sources, we may not be able to maintain appropriate inventory levels to meet customer demand and our financial position and results of operations would be adversely affected.

We have experienced the loss and changes in the business habits of significant customer and vendor relationships in the past and expect to do so in the future. It is the nature of our business. Over the past decade, however, we have generally been successful in replacing significant customer and vendor relationships when lost. However, the loss of customer relationships like AT&T, and the corresponding reduction in the volume of product sales identified to those relationships, can affect our negotiating ability with vendors supplying those products. This can affect our margins in sales of those products to other customers. If we are unable to replace those products at favorable pricing and terms, or if we are unable to acquire those products from vendors or offer those products to our customers on favorable terms, our competitiveness may suffer and result in reduced revenues and profits. There can be no assurance that we will be successful in replacing any of our past, present or future vendor or customer relationships if and when lost, or in the event of, or in response to, a substantial reduction in revenues from or attributable to any such relationship.

Changes in customer or product mix could cause our gross margin percentage to decline.

We continually experience changes in customer and product mix that affects gross margin. Changes in customer and product mix result primarily from changes in customer demand, customer acquisitions, selling and marketing activities and competition. If rapid growth in the public carriers, contractors and program managers market, and specifically for distributed antenna systems products, continues, we will face pressure to maintain current gross margins. There can be no assurance that we will be able to maintain historical gross margins in the future.

13

Table of Contents

Our business depends on the continued tendency of wireless equipment manufacturers and network operators to outsource aspects of their business to us in the future.

We provide functions such as distribution, inventory management, fulfillment, customized packaging, e-commerce solutions, and other outsourced services for many wireless manufacturers and network operators. Certain wireless equipment manufacturers and network operators have elected, and others may elect, to undertake these services internally. Additionally, our customer service levels, industry consolidation, competition, deregulation, technological changes or other developments could reduce the degree to which members of the global wireless industry rely on outsourced logistic services such as the services we provide. Any significant change in the market for our outsourced services could have a material adverse effect on our business. Our outsourced services are generally provided under short-term contractual arrangements. The failure to obtain renewals or otherwise maintain these agreements on terms, including price, consistent with our current terms could have a material adverse effect on our business.

We require substantial capital to operate, and the inability to obtain financing on favorable terms will adversely impact our business, financial position and results of operations.

Our business requires substantial capital to operate and to finance accounts receivable and product inventory that are not financed by trade creditors. We have historically relied upon cash generated from operations, revolving credit facilities and trade credit from our vendors to satisfy our capital needs and finance growth. As the financial markets change and new regulations come into effect, the cost of acquiring financing and the methods of financing may change. Changes in our credit rating or other market factors may increase our interest expense or other costs of capital, or capital may not be available to us on competitive terms to fund our working capital needs. Our credit facilities and long-term debt arrangements are of specified terms and contain various financial and other covenants that may limit our ability to borrow or limit our flexibility in responding to business conditions. While we generally expect to either extend or replace our credit facilities at term expirations, there can be no assurances that we will be able to do so on favorable terms, or at all. The inability to maintain or when necessary obtain adequate sources of financing could have an adverse effect on our business. Our current revolving credit facility expires in October 2016. Some of our existing financing instruments involve variable rate debt, thus exposing us to risk of fluctuations in interest rates. Such fluctuations in interest rates could have an adverse effect on our business, financial position and results of operations. We may in the future use interest rate swaps in an effort to achieve a desired proportion of fixed and variable rate debt. We would utilize these derivative financial instruments to enhance our ability to manage risk, including interest rate exposures that exist as part of our ongoing business operations. However, our use of these instruments may not effectively limit or eliminate our exposure to a decline in operating results due to changes in interest rates.

Our ability to borrow funds under our revolving credit agreement could be constrained by the level of eligible receivables and inventory and by any other failure to meet certain covenants included in our revolving and other credit agreements.

Our borrowing availability under our existing revolving credit facility is limited to certain amounts of eligible accounts receivable and inventory. If the value of eligible accounts receivable and inventory were to decrease significantly, the amount available for borrowing under the facility could decrease or our ability to borrow under our credit facility could be suspended or terminate. As of the end of fiscal 2015, our asset balance continues to support the full amount available under our current facility and our earnings have kept us in compliance with all current debt covenants. Borrowing under our revolving credit facility is also conditioned upon compliance with the other terms of our revolving credit agreement and other loan agreements, including the term loan secured by our Global Logistics Center. There are no assurances, however, that we will continue to comply with all applicable covenants and agreements, and in the event that we do not, our ability to borrow under our revolving credit facility could be suspended or terminate.

Table of Contents

Compliance with regulations regarding the use of “conflict minerals” could limit the supply and increase the cost of certain of our products, and customers may seek other sources if we are unable to demonstrate to their satisfaction that our products are conflict free.

Increased focus on environmental protection and social responsibility initiatives led to the passage of Section 1502 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act"), and its implementing SEC regulations. The Dodd-Frank Act imposes supply chain diligence and disclosure requirements for certain manufacturers of products containing specific minerals that may originate in or near the Democratic Republic of the Congo (the "DRC") and finance or benefit local armed groups. These "conflict minerals" are commonly found in certain of the products that we acquire from vendors and distribute to customers and are also found in certain products in our Ventev® product line that we contract to be manufactured by others or that we assemble. The implementation of these new regulations may limit the sourcing and availability of some of the raw materials used in certain of these products. This in turn may affect our ability to obtain sufficient quantities of our products and may affect related pricing. Because we are considered a manufacturer of certain of our Ventev® products, we are subject to additional “conflict minerals” diligence and disclosure requirements with regard to these products. Some of our customers may elect to disqualify us as a supplier if we are unable to verify that the products we sell to them are DRC conflict free.

The ongoing weakness in the global economic environment may have significant effects on our customers and suppliers that could result in material adverse effects on our business, operating results, and stock price.

Notwithstanding the slow economic recovery in the U.S., the ongoing weakness in the global economic environment – which has included, among other things, significant reductions in available capital and liquidity from banks and other providers of credit, substantial reductions and/or fluctuations in equity and currency values worldwide, significant decreases in consumer confidence and consumer and business spending, high rates of unemployment and concerns that the worldwide economy may continue to experience significant challenges – may materially adversely affect our customers’ access to capital or willingness to spend capital on our products, and/or their levels of cash liquidity with which to pay for our products. In addition, our suppliers’ access to capital and liquidity may continue to be affected, which may in turn adversely impact their ability to maintain inventories, production levels, and/or product quality, or cause them to raise prices or lower production levels, or result in their ceasing operation.

The potential effects of the weakness in the global economic environment are difficult to forecast and mitigate. As a consequence, our operating results for a particular period may be more difficult to predict. Any of the foregoing effects could have a material adverse effect on our results of operations and financial condition, and could adversely affect our stock price.

We may be unable to successfully execute our merchandising and marketing strategic initiatives.

We are focusing our sales and marketing efforts and initiatives to maximize sales. If we fail to successfully execute these initiatives, our business, financial position and results of operations could be adversely affected.

The telecommunications products marketplace is dynamic and challenging because of the continued introduction of new products and services.

We must constantly introduce new products, services and product features to meet competitive pressures. We may be unable to timely change our existing merchandise sales mix in order to meet these competitive pressures, which may result in increased inventory costs, inventory write-offs or loss of market share.

Additionally, our inventory may also lose value due to price changes made by our significant vendors, in cases where our arrangements with these vendors do not provide for inventory price protection, or in cases that the vendor is

unable or unwilling to provide these protections.

Table of Contents

Consolidation among wireless service carriers could result in the loss of significant customers.

The wireless service carrier industry has experienced significant consolidation in recent years. If any of our significant customers or partners are acquired or consolidate with other carriers, or are otherwise involved in any significant transaction that results in them ceasing to do business with us, or significantly reducing the level of business that they do with us, our revenues from those customers could be significantly affected, possibly resulting in an adverse effect on our financial position and results of operations.

The failure of our information systems, or our inability to maintain or upgrade our information systems without incident or delay, could have a material adverse effect on our business, financial position and results of operations.

We are highly dependent upon our internal computer and telecommunication systems, many of which are proprietary, to operate our business. These systems support all aspects of our business operations, including inventory and order management, shipping, receiving and accounting. Most of our information systems contain a number of internally developed applications. In addition, these systems require continued maintenance and also require upgrading or replacement from time to time. There can be no assurance that our information systems will not fail or experience disruptions, that we will be able to attract and retain qualified personnel necessary for the operation of such systems, that we will be able to expand and improve our information systems, that we will be able to convert to new systems efficiently as and when necessary, or that we will be able to integrate new programs effectively with our existing programs. Any of such problems, or any significant damage or destruction of these systems, could have an adverse effect on our business, financial position and results of operations.

We depend heavily on e-commerce, and website security breaches or Internet disruptions could have a material adverse effect on our business, financial position and results of operations.

We rely on the Internet (including TESSCO.com®) for a significant percentage of our orders and information exchanges with our customers. The Internet and individual websites have experienced a number of disruptions and slowdowns, some of which were caused by organized attacks. In addition, some websites have experienced security breakdowns. There can be no assurances that our website will not experience any material breakdowns, disruptions or breaches in security. If we were to experience a security breakdown, disruption or breach that compromised sensitive information, this could harm our relationship with our customers or suppliers. Disruption of our website or the Internet in general could impair our order processing or more generally prevent our customers and suppliers from accessing information or placing orders. This could have an adverse effect on our business, financial position and results of operations.

System security breaches or data protection breaches could adversely disrupt our business and harm our reputation, financial position and results of operations.

We manage and store various proprietary information and sensitive or confidential data relating to our business. In addition, we routinely process, store and transmit large amounts of data, including sensitive and personally identifiable information. Breaches of our security measures or the accidental loss, inadvertent disclosure or unapproved dissemination of proprietary information or sensitive or confidential data about us or our customers or vendors, including the potential loss or disclosure of such information or data as a result of fraud, trickery or other forms of deception, could expose us, our customers or the individuals affected to a risk of loss or misuse of this information, result in litigation and potential liability for us, damage our brand and reputation or otherwise harm our business. In addition, the cost and operational consequences of implementing further data protection measures could be significant. Such breaches, costs and consequences could adversely affect our business, results of operations or cash flows.

The inability to hire or retain certain key professionals, management and staff could adversely affect our business, financial condition and results of operations.

The nature of our business includes (but is not limited to) a high volume of transactions, business complexity, wide geographical coverage, and broad scope of products, suppliers, and customers. In order to compete, we must attract, retain and motivate executives and other key employees, including those in managerial, technical, sales, marketing and support positions. Hiring and retaining qualified executives, information technology and business generation personnel are critical to our business. We rely heavily upon our senior management team, and since February 2015 have announced that the employment of two of our executive officers, Mr. Garland, who formerly served as Senior Vice President Product Lines of Business, and Mr. Tofighi, who formerly served as Senior Vice President Global Manufacturer Supply Chain and Ventev Innovations, would terminate. The loss of these individuals, or the loss of our President and the Chairman of our Board of Directors, Robert B. Barnhill, Jr., particularly at this time following the departure of Mr. Garland and with the pending departure of Mr. Tofighi, or the loss of any of the other members of our senior management team, could have a material adverse effect on our business, financial position and results of operations.

Table of Contents

To attract, retain and motivate qualified employees, we rely heavily on stock-based incentive awards such as Performance Stock Units (PSUs). If performance targets associated with these PSUs are not met, or the value of such stock awards does not appreciate as measured by the performance of the price of our common stock and/or if our other stock-based compensation otherwise ceases to be viewed as a valuable benefit, our ability to attract, retain and motivate our employees could be adversely impacted, which could negatively affect our business, financial position and results of operations and/or require us to increase the amount we spend on cash and other forms of compensation. Our ability to issue PSUs is also limited by the provisions of and our available shares under our current and/or future stock incentive plans, which may be subject to shareholder approval. As of the end of the year, there were 439,028 shares available for future awards under our incentive plans and we have no immediate plans to seek shareholder approval for an increase in such number.

These items may limit our ability to grant certain performance based equity instruments and therefore may have an adverse effect on our continued ability to attract and retain, and motivate, our employees.

The damage or destruction of any of our principal distribution or administrative facilities could materially adversely impact our business, financial position and results of operations.

If any of our distribution centers in Hunt Valley, Maryland or Reno, Nevada, were to be significantly damaged or destroyed, we could suffer a loss of product inventory and our ability to conduct our business in the ordinary course could be materially and adversely affected. Similarly, if our office locations in Maryland, Nevada or Texas were to be significantly damaged or destroyed, our ability to conduct marketing, sales and other corporate activities in the ordinary course could be adversely affected.

We depend on third parties to manufacture products that we distribute and, accordingly, rely on their quality control procedures.

Product manufacturers typically provide limited warranties directly to the end consumer or to us, which we generally pass through to our customers. If a product we distribute for a manufacturer has quality or performance problems, our ability to provide products to our customers could be disrupted, which could adversely affect our operations.

We are subject to potential declines in inventory value.

We are subject to the risk that the value of our inventory will decline as a result of price reductions by vendors or technological obsolescence. It is the policy of many of our vendors to protect distributors from the loss in value of inventory due to technological change or the vendors' price reductions. Some vendors (including those who manufacture our proprietary products), however, may be unwilling or unable to pay us for price protection claims or products returned to them under purchase agreements. No assurance can be given that such practices to protect distributors will continue, that unforeseen new product developments will not adversely affect us, or that we will be able to successfully manage our existing and future inventories.

Table of Contents

Our future operating results depend on our ability to purchase a sufficient amount of finished goods and bulk inventory to meet the demands of our customers.

Our ability to meet customers' demands depends, in part, on our ability to obtain timely and adequate delivery of inventory from our suppliers. We have experienced shortages in the past that have negatively impacted our operations. Although we work closely with our suppliers to avoid these types of shortages, there can be no assurances that we will not encounter these problems in the future. Furthermore, certain of our components are available only from a single source or limited sources. We may not be able to diversify sources in a timely manner. A reduction or interruption in supplies or a significant increase in the price of supplies could have a negative impact on our results of operations or financial condition.

If our business does not perform well, or if we otherwise experience a decline in the fair values of a portion or all of our business, we may be required to recognize impairments of our intangible or other long-lived assets, which could adversely affect our results of operations or financial condition.

Goodwill and indefinite lived intangible assets are initially recorded at fair value and are not amortized, but are reviewed for impairment at least annually or more frequently if impairment indicators are present.

In assessing the recoverability of goodwill and indefinite lived intangible assets, we make estimates and assumptions about sales, operating margin, growth rates and discount rates based on our budgets, business plans, economic projections, anticipated future cash flows and marketplace data. There are inherent uncertainties related to these factors and management’s judgment in applying these factors. We first perform a qualitative analysis to determine if it is more likely than not that goodwill or indefinite lived intangible assets are impaired. This analysis includes assumptions and estimates related to macroeconomic, industry and company specific events and trends. In the event that we find it is more likely than not that an impairment has occurred a quantitative analysis is performed. Goodwill and indefinite lived asset valuations are calculated using an income approach based on the present value of future cash flows of each reporting unit. We could be required to evaluate the recoverability of goodwill and indefinite lived assets prior to the annual assessment if we experience disruptions to the business, unexpected significant declines in operating results, divestiture of a significant component of our business or sustained market capitalization declines. These types of events and the resulting analyses could result in goodwill and indefinite lived asset impairment charges in the future. Impairment charges could substantially affect our financial results in the periods of such charges. In addition, impairment charges would negatively impact our financial ratios and could limit our ability to obtain financing in the future. As of March 29, 2015, we had $12.5 million of goodwill and indefinite lived intangible assets, which represented approximately 6.6% of total assets.

Deferred income tax represents the tax effect of the differences between the book and tax bases of assets and liabilities. Deferred tax assets are assessed periodically by management to determine if they are realizable. Factors in management’s determination include the performance of the business, projections of future taxable income, and the feasibility of ongoing tax planning strategies. If based on available information, it is more likely than not that the deferred income tax asset will not be realized then a valuation allowance must be established with a corresponding charge to net income. Such charges could have a material adverse effect on our results of operations or financial condition.

Our future results of operations may be impacted by the prolonged weakness in the current economic environment which may result in an impairment of any goodwill recorded and/or other long lived assets or the recording of a valuation allowance on our deferred tax assets, which could adversely affect our results of operations or financial condition.

Table of Contents

We primarily rely on trademark filings and confidentiality agreements to protect our intellectual property rights.

In an effort to protect our intellectual property, including our product data, customer information and information technology systems, through trademark filings and nondisclosure, confidentiality and trade secret agreements, we typically require our employees, consultants and others having access to this information or our technology to execute confidentiality and non-disclosure agreements. These agreements, however, may not provide us with adequate protection against improper use or disclosure of confidential information, and these agreements may be breached. A breach of confidentiality could adversely affect our business. In addition, in some situations, these agreements may conflict with, or be subject to, the rights of third parties with whom our employees, consultants and others have previous employment or consulting relationships. Also, others may independently develop substantially equivalent proprietary information and techniques or otherwise gain access to our trade secrets. Adequate remedies may not exist in the event of unauthorized use or disclosure of our confidential information. The disclosure of our proprietary information or trade secrets could impair our competitive position and could have a material adverse effect on our business, financial condition and results of operations. Others may obtain patent protection for technologies that are important to our business, and as a result, our business, financial position and results of operations may be adversely affected. In response to patents of others, we may need to license the rights to use the technology patented by others, or in the event that a license cannot be obtained, design our systems around the patents of others. There can be no assurances as to our ability to obtain any such licenses or to design around the patents of others, and our inability to do so could have an adverse effect on our business, financial position and results of operations.

We offer credit to our customers and, therefore, are subject to significant credit risk.

We sell our products to a large and diverse customer base. We finance a significant portion of such sales through trade credit, typically by providing 30-day payment terms. As a result, our business could be adversely affected in the event of a deterioration of the financial condition of our customers, resulting in the customers’ inability to repay us. This risk may increase if there is a general economic downturn affecting a large number of our customers and in the event our customers do not adequately manage their business or properly disclose their financial condition.

We may explore additional growth through acquisitions.

As part of our growth strategy, we may continue to pursue the acquisition of companies that either complement or expand our existing business. As a result, we regularly evaluate potential acquisition opportunities, which may be material in size and scope. In addition to those risks to which our business and the acquired businesses are generally subject to, the acquisition of these businesses gives rise to transactional and transitional risks, and the risk that the anticipated benefits will not be realized.

Risks associated with the foreign suppliers from whom our products are sourced could adversely affect our financial performance.

The products we sell are sourced from a wide variety of domestic and international suppliers. Global sourcing of many of the products we sell is an important factor in our financial performance. Since the onset of the weakness in the global economic environment in 2008, certain of our suppliers, particularly those in the far-east, have experienced financial difficulties and we believe it is possible that a limited number of suppliers may either cease operations or require increased prices in order to fulfill their obligations. Changes in our relationships with suppliers or increases in the costs of purchased raw materials, component parts or finished goods could result in delays, inefficiencies or our inability to market products. In addition, our profit margins would decrease if prices of purchased raw materials, component parts, or finished goods increase and we are unable to pass on those increases to our customers.

We rely on independent shipping companies to deliver inventory to us and to ship products to customers.

We rely on arrangements with independent shipping companies, for the delivery of our products from vendors and to customers. The failure or inability of these shipping companies to deliver products, or the unavailability of their shipping services, even temporarily, could have a material adverse effect on our business. We may also be adversely affected by an increase in freight surcharges due to rising fuel costs and added security. This could adversely impact our selling, general and administrative expenses or lead to price increases to our customers which could decrease customer demand for our products.

Table of Contents

Changes in accounting rules could have a material adverse impact on our results of operations.

We prepare our financial statements in conformity with accounting principles generally accepted in the United States. These accounting principles are subject to interpretation by the Financial Accounting Standards Board, the Public Company Accounting Oversight Board, the United States Securities and Exchange Commission (SEC), the American Institute of Certified Public Accountants and various other bodies formed to interpret and create appropriate accounting policies. A change in these policies or a new interpretation of an existing policy could have a significant effect on our reported results and may affect our reporting of transactions.

Changes in income tax and other regulatory legislation.

We operate in compliance with applicable laws and regulations and make plans for our structure and operations based upon existing laws and anticipated future changes in the law. When new legislation is enacted with minimal advance notice, or when new interpretations or applications of existing laws are made, we may need to implement changes in our policies or structure. We are susceptible to unanticipated changes in legislation, especially relating to income and other taxes, import/export laws, hazardous materials and other laws related to trade, accounting and business activities. Such changes in legislation may have a significant adverse effect on our business.

We may be subject to litigation.

We may be subject to legal claims or regulatory matters involving stockholder, consumer, antitrust, intellectual property and other issues. Litigation is subject to inherent uncertainties, and unfavorable rulings could occur. An unfavorable ruling could include monetary damages or other adverse effects. Were an unfavorable ruling to occur, there exists the possibility of a material adverse impact on our business, financial position and results of operations for the period in which the ruling occurred or future periods.

We may incur product liability claims which could be costly and could harm our reputation.

The sale of our products subjects us to the risk of product liability claims. We have also been increasing our focus on sales of TESSCO private labeled products and on providing an increased level of support services, including product and network designs, which also subjects us to risk of product liability and performance claim risk. We seek to allocate product liability risk to our vendors where available, but may not be successful in doing so. We currently maintain product liability insurance, but our product liability insurance coverage is subject to various coverage exclusions and limits and may not be obtainable in the future on terms acceptable to us, or at all. We do not know whether claims against us with respect to our products and services, if any, would be successfully defended or whether we might be successful in allocating that risk to others, or whether our insurance would be sufficient to cover liabilities resulting from such claims. Any claims successfully brought against us could adversely affect our financial condition, and if substantial and relating to our products or industry generally, could affect our business as a whole.

Our expanding offering of private labeled products may have a negative impact on our relationship with our manufacturer partners.

Our product offering includes a growing number of our own proprietary products, which represented approximately 13% of our sales in fiscal 2015. Our proprietary products often compete with other manufacturers' branded items that we offer. A manufacturer may choose to not sell its products to us, or may substantially increase the price of products to us, in response to the competition created by the sales of our proprietary branded products. Either could have a material adverse effect on our business and financial performance.

Table of Contents

Claims that our products infringe the proprietary rights of others could harm our business and cause us to incur significant costs.

Our industry has increasingly been subject to patent and other intellectual property rights litigation. We expect this trend to continue and accelerate and expect that we may be required to defend against this type of litigation, not only asserted against our own intellectual property rights, but also against the intellectual property of products which we have purchased for resale. Further, we may be obligated to indemnify and defend our customers if the products or services we supply to them are alleged to infringe a third party’s intellectual property rights. While we may be able to seek indemnification from our suppliers to protect our customers and us from such claims, there is no assurance that we will be successful in negotiating contractual terms with our suppliers to provide for such indemnification, or that we will otherwise be successful in obtaining such indemnification or that we will be protected from such claims. We may also be prohibited from marketing products, could be forced to market products without desirable features, or could incur substantial costs to defend legal actions, including where third parties claim that we or vendors who may or may not have indemnified us are infringing upon their intellectual property rights. In recent years, individuals and groups have begun purchasing intellectual property assets for the sole purpose of making claims of infringement and attempting to extract settlements from target companies. Even if we believe that such infringement claims are without merit, the claims can be time-consuming and costly to defend and divert management’s attention and resources away from our business. Claims of intellectual property infringement may require us to enter into costly settlements or pay costly damage awards, or face a temporary or permanent injunction prohibiting us from marketing or selling certain products or services, which could affect our ability to compete effectively. If an infringement claim is successful, we may be required to pay damages or seek royalty or license arrangements, which may not be available on commercially reasonable terms. Even if we have an agreement that indemnifies us against such costs, the indemnifying party may be unable or unwilling to uphold its contractual obligations to us.

We may be adversely affected by future laws or regulations.

We are subject to various U.S. Federal, state and local, and non-U.S. laws and regulations. We cannot predict the substance or impact of pending or future legislation or regulations, or the application thereof. The introduction of new laws or regulations or changes in existing laws or regulations, or the interpretations thereof, could increase the cost of doing business for us or our customers or vendors or restrict our actions and adversely affect our financial condition, operating results and cash flows. An example of such changing regulation is the adoption by the SEC of annual disclosure and reporting requirements for those SEC reporting companies who manufacture or contract to manufacture products that contain conflict minerals, when such minerals are necessary to the production or functionality of such product. Each reporting company is required to conduct a reasonable country of origin inquiry to determine whether such minerals were mined from the Democratic Republic of the Congo, or DRC., or adjoining countries. In certain instances, further due diligence measures are required, and the results of the reasonable country of origin inquiry and due diligence measures must be disclosed annually. There are costs and uncertainties associated with complying with these disclosure requirements, including for diligence to determine the sources of conflict minerals that we may find to be used in our products. In addition, some of our customers may elect to disqualify us as a supplier if we are unable to verify that the products we sell to them are DRC conflict free.

RISKS RELATED TO OWNERSHIP OF OUR COMMON STOCK

A significant portion of our voting stock is controlled by our executive officers, directors and beneficial owners of 5% or more of our common stock.

Our executive officers, directors and beneficial owners of 5% or more of our common stock and their affiliates, in the aggregate, beneficially owned approximately 66% of our outstanding common stock as of March 29, 2015. Robert B. Barnhill, Jr., our chairman, president and chief executive officer beneficially owned approximately 22% of our outstanding common stock as of March 29, 2015. Should these shareholders decide to act together, they would have

the ability to significantly influence all matters requiring shareholder approval, including the election of directors and any significant corporate transaction requiring shareholder approval.

21

Table of Contents

Without approval of our Board of Directors, it may be difficult for a third party to acquire control of the Company. This could affect the price of our common stock.

Certain provisions of our certificate of incorporation and bylaws, certain arrangements to which we are party, and applicable provisions of the Delaware General Corporation Law (DGCL) may each make it more difficult for or may prevent a third party from acquiring control of us or changing our Board of Directors and management. These provisions include advance notice bylaws and limitations on the removal of directors other than for cause, and then only upon the affirmative vote of 75% of our outstanding common stock. We are also afforded the protections of Section 203 of the DGCL, which will prevent us from engaging in a business combination with a person who acquires at least 15% of our common stock for a period of three years from the date such person acquired such common stock, unless Board of Director or shareholder approval were obtained. Some believe that the provisions described above, as well as any resulting delay or prevention of a change of control transaction or changes in our Board of Directors or management, could deter potential acquirers or prevent the completion of a transaction in which our shareholders could receive a substantial premium over the then current market price for their shares. We, on the other hand, believe that these provisions serve to protect our shareholders against abusive takeover tactics, to preserve and maximize the value of the Company for all shareholders, and to better ensure that each shareholder will be treated fairly in the event of an unsolicited offer to acquire the Company.

Potential uncertainty resulting from unsolicited acquisition proposals and related matters may adversely affect our business.

In the past we have received, and in the future we may receive, unsolicited proposals to acquire our company or our assets. For example, in September 2010, the Board of Directors received an unsolicited non-binding proposal from Discovery Group for the acquisition of all of our stock not then owned by Discovery Group. At the time, Discovery owned approximately 14% of the Company’s then outstanding common stock. The review and consideration of acquisition proposals and related matters could require the expenditure of significant management time and personnel resources. Such proposals may also create uncertainty for our employees, customers and vendors. Any such uncertainty could make it more difficult for us to retain key employees and hire new talent, and could cause our customers and vendors to not enter into new arrangements with us or to terminate existing arrangements. Additionally, we and members of our board of directors could be subject to future lawsuits related to unsolicited proposals to acquire us. Any such future lawsuits could become time consuming and expensive.

Our quarterly operating results are subject to significant fluctuation.

Our operating results have fluctuated from quarter to quarter in the past, and we expect that they will continue to do so in the future. Our earnings may not continue to grow at rates similar to the growth rates achieved in recent years and may fall short of either a prior fiscal period or investors’ expectations. Most of our operating expenses, such as compensation expenses, do not vary directly with the amount of sales and are difficult to adjust in the short term. As a result, if sales in a particular quarter are below expectations for that quarter, we may not proportionately reduce operating expenses for that quarter, and therefore such a sales shortfall would have a disproportionate effect on our net income for the quarter.

Item 1B. Unresolved Staff Comments.

None.

Item 2. Properties.

Our corporate headquarters and primary distribution center, known as the Global Logistics Center (GLC), is located in a Company-owned 184,000 square-foot facility north of Baltimore, in Hunt Valley, Maryland.

22

Table of Contents

Our sales, marketing and administrative offices are located in leased office space near the GLC, in Timonium Maryland. On February 15, 2011, this lease was amended and now expires on December 31, 2017. On June 4, 2012, this lease was further amended to increase the amount of leased space to 102,200 square feet, and monthly rent payments now range from $162,600 to $177,700 throughout the remaining lease term.

In addition, we lease 66,000 square feet of office and warehouse space adjacent to the GLC in Hunt Valley, Maryland. On December 2, 2013, we exercised an extension option under the terms of this lease, extending the expiration date from July 31, 2014 to July 31, 2017. Under the terms of the extension, we have an ongoing annual option to terminate this lease. Monthly rent for this facility ranges from $33,000 to $35,700 throughout the extended lease term.

Additional sales and marketing offices are located in 13,100 square feet of leased office space in San Antonio, Texas. Our San Antonio office moved to a new location in January 2013. Monthly rent payments range from $15,300 to $16,900 and the lease expires October 31, 2018.

West coast sales and fulfillment are facilitated by our Company-owned 115,000 square-foot Americas Sales & Logistics Center (ALC) located in Reno, Nevada. The ALC is used to configure and fulfill product and supply chain solutions, provide disaster backup for the GLC, and allow for future growth of staffing and increased fulfillment capabilities.

While we anticipate the need for additional space, we believe our existing facilities are generally adequate for our current requirements and that suitable additional space will be available as needed to accommodate future expansion of our operations. The GLC is encumbered by a deed of trust as security for a term loan. See Note 7 to our Consolidated Financial Statements included in Item 8 of this Annual Report on Form 10-K.

Item 3. Legal Proceedings.

Lawsuits and claims are filed against us from time to time in the ordinary course of business. We do not believe that any lawsuits or claims currently pending against the Company, individually or in the aggregate, are material, or will have a material adverse effect on our financial condition or results of operations. In addition, from time to time, we are also subject to review from federal and state taxing authorities in order to validate the amounts of income, sales and/or use taxes which have been claimed and remitted. No federal, state and local tax returns are currently under examination, except for the following state sales tax audits:

- Maryland for the tax period of January 2011 through December 2014
- Florida for the tax period of November 2011 through October 2014
- New York for the tax period of June 2012 through February 2015

As we are routinely audited by state taxing authorities, we have estimated exposure and established reserves for our estimated sales tax audit liability.

Item 4. Mine Safety Disclosures

Not applicable.

Table of Contents
Part II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.

Our common stock has been publicly traded on the NASDAQ Global Select Market, since September 28, 1994, under the symbol "TESS." The quarterly range of prices per share during fiscal years 2014 and 2015 are as follows:

	High	Low	Dividends Declared
Fiscal Year 2014			
First Quarter	$26.57	$18.60	$ 0.18
Second Quarter	34.32	26.35	0.18
Third Quarter	41.99	32.55	0.18
Fourth Quarter	41.24	31.28	0.20
Fiscal Year 2015			
First Quarter	$38.49	$30.05	$ 0.20
Second Quarter	32.76	29.37	0.20
Third Quarter	34.28	26.67	0.20
Fourth Quarter	29.45	21.63	0.20

As of May 26, 2015, the number of shareholders of record of the Company was 116. We estimate that the number of beneficial owners as of that date was approximately 2,644.

On July 28, 2009, we announced that our Board of Directors decided to commence a dividend program and we have since declared dividends on a quarterly basis. Any future declaration of dividends and the establishment of any corresponding record and payment dates remains subject to further determination from time to time by the Board of Directors. Additional information with respect to the quarterly dividends declared in fiscal years 2015 and 2014 is contained in our Selected Financial Data. The declaration and payment of future dividends will depend on many factors, including, but not limited to, our earnings, financial condition, business development needs and regulatory considerations, and is at the discretion of our Board of Directors. Our revolving credit facility limits the amount of cash dividends that we may pay to $8.0 million in any twelve month period. Additionally, on November 30, 2012 this agreement was further amended to allow for a special one-time dividend of $0.75 per share of common stock, or $6.04 million, paid on December 27, 2012.

On April 23, 2014, the Board of Directors expanded the Company’s existing stock buyback program and authorized the purchase on a non-accelerated basis of up to $10.0 million of the Company’s stock over a 24-month period, ending in April 2016. Shares may be purchased from time to time in the open market, by block purchase, or through negotiated transactions, or possibly other transactions managed by broker-dealers. Through the end of fiscal year 2015, we had repurchased 157,954 shares under the expanded stock buyback program for approximately $4.6 million, or an average cost of $29.17 per share. No shares were repurchased during the fourth quarter of fiscal 2015. As of March 29, 2015, $5.4 million remained available for repurchase under this program.

We also withhold shares from our employees and directors from time to time to facilitate employees’ minimum federal and state tax withholdings related to vested performance stock units, restricted stock and exercised stock options. For fiscal years 2015 and 2014 the total value of shares withheld for taxes were $1,612,900 and $1,646,300, respectively.

Table of Contents

Our revolving credit facility and term loan with Wells Fargo Bank, National Association and SunTrust Bank limit to $30.0 million the aggregate dollar value of shares that may be repurchased from May 31, 2007 forward. At March 29, 2015, we had the ability to repurchase approximately $11.7 million in additional shares of our common stock without violating this covenant.

The information required by Item 201(d) of Regulation S-K, pursuant to paragraph (a) of Item 5 of Form 10-K, is incorporated by reference to the information set forth under the caption “Equity Compensation Plan Information” in the Company’s Proxy Statement for the 2015 Annual Meeting of Shareholders, which is anticipated to be filed pursuant to Regulation 14A no later than one hundred twenty (120) days following the end of the fiscal year reported on.

Table of Contents

Stock Performance Graph

The graph set forth below shows the value of an investment of $100 on March 28, 2010 in each of the Company's Common Stock, the Russell 2000 Index and a peer group for the period of March 28, 2010 to March 29, 2015. The graph assumes that all dividends, if any, were reinvested.

	3/28/2010	3/27/2011	4/1/2012	3/31/2013	3/30/2014	3/29/2015
TESSCO Technologies Incorporated	$ 100.00	$ 77.06	$ 173.43	$ 157.68	$ 262.15	$ 195.36
Russell 2000	100.00	122.81	125.56	146.04	179.10	195.40
Peer Group [1]	100.00	126.97	166.44	170.72	209.15	192.86

[1] – The Peer Group consists of the following: Ingram Micro Inc., W.W. Grainger, Inc., Anixter International Inc., ScanSource, Inc., InfoSonics Corporation, and Tech Data Corp.

The peer group was selected based on a review of publicly available information about these companies and the Company's determination that they are engaged in business similar to that of the Company.

Table of Contents

Item 6. Selected Financial Data.

	Fiscal Years Ended				
	March 29, 2015	March 30, 2014	March 31, 2013	April 1, 2012	March 27, 2011
STATEMENT OF INCOME DATA					
Revenues	$549,619,000	$560,086,600	$752,565,000	$733,389,900	$605,219,200
Cost of goods sold	418,730,500	421,928,700	605,525,800	584,733,700	471,938,600
Gross profit	130,888,500	138,157,900	147,039,200	148,656,200	133,280,600
Selling, general and administrative expenses	115,936,700	111,668,000	117,820,600	121,652,400	117,305,100
Restructuring charge	573,400	--	--	--	--
Operating expenses	116,510,100	111,668,000	117,820,600	121,652,400	117,305,100
Income from operations	14,378,400	26,489,900	29,218,600	27,003,800	15,975,500
Interest, net	167,300	177,700	224,200	292,900	420,600
Income before provision for income taxes	14,211,100	26,312,200	28,994,400	26,710,900	15,554,900
Provision for income taxes	5,576,800	10,063,100	11,200,500	10,274,000	5,536,700
Net income	$8,634,300	$16,249,100	$17,793,900	$16,436,900	$10,018,200
Diluted earnings per share	$1.04	$1.94	$2.15	$2.03	$1.27
Cash dividends declared per common share	$0.80	$0.74	$1.47	$0.55	$0.40
Percentage of Revenues					
Revenues	100.0 %	100.0 %	100.0 %	100.0 %	100.0 %
Cost of goods sold	76.2	75.3	80.5	79.7	78.0
Gross profit	23.8	24.7	19.5	20.3	22.0
Selling, general and administrative expenses	21.1	19.9	15.7	16.6	19.4
Restructuring charge	0.1	0.0	0.0	0.0	0.0
Operating expenses	21.2	19.9	15.7	16.6	19.4
Income from operations	2.6	4.7	3.9	3.7	2.6
Interest, net	0.0	0.0	0.0	0.1	0.1
Income before provision for income taxes	2.6	4.7	3.9	3.6	2.6
Provision for income taxes	1.0	1.8	1.5	1.4	0.9
Net income	1.6	2.9 %	2.4 %	2.2 %	1.7 %
SELECTED OPERATING DATA					
Average non-consumer buyers per month	12,400	12,700	13,000	13,000	12,700
Return on assets [(1)]	4.6 %	8.5 %	9.0 %	9.1 %	6.4 %
Return on equity [(2)]	7.6 %	14.9 %	18.1 %	19.1 %	13.5 %
BALANCE SHEET DATA					
Working capital	$86,076,900	$88,090,400	$76,551,700	$65,779,800	$49,379,000
Total assets	189,600,700	186,960,300	194,300,000	202,497,700	158,701,800
Short term debt	250,700	250,200	249,700	249,200	359,100
Long term debt	1,957,500	2,208,200	2,458,300	2,708,000	2,959,100
Shareholders' equity	113,142,100	114,828,100	102,802,600	93,651,900	78,880,100

(1) Net income divided by the average total assets.
(2) Net income divided by the average total equity.

Table of Contents

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

This Management's Discussion and Analysis of Results of Operations and Financial Condition (MD&A) should be read in conjunction with the other sections of this Annual Report on Form 10-K, including Part I, "Item 1: Business," Part II, "Item 6: Selected Financial Data," and Part II, "Item 8: Financial Statements and Supplementary Data." The various sections of this MD&A contain a number of forward-looking statements, all of which are based on our current expectations and could be affected by the uncertainties and risk factors described throughout this filing, including Part I, "Item 1A: Risk Factors." Our actual results may differ materially from those described in any such forward-looking statement.

Business Overview and Environment

TESSCO Technologies Incorporated (TESSCO, we, or the Company) architects and delivers innovative product and value chain solutions to support wireless systems. Although we sell products to customers in over 80 countries, approximately 98% of our sales are to customers in the United States. We have operations and office facilities in Timonium and Hunt Valley, Maryland, Reno, Nevada and San Antonio, Texas.

We evaluate our business and customer base as one segment. This segment includes the following markets: (1) public carriers, contractors, and program managers that are generally responsible for building and maintaining the infrastructure system and provide airtime service to individual subscribers; (2) government system operators including federal agencies and state and local governments that run wireless networks for their own use; (3) private system operators including commercial entities such as major utilities and transportation companies that run wireless networks for their own use; (4) commercial dealers and resellers that sell, install and/or service cellular telephone, wireless networking, broadband and two-way radio communications equipment primarily for the enterprise market; (5) retailers, independent dealer agents and carriers; and (6) our Major 3PL Relationship with AT&T, that was fully transitioned at the end of fiscal 2013. Beginning in the third quarter of fiscal 2015, we began reporting private system operators and government system operators as two separate market units. Our financial statements included here reflect this change for all periods presented.

We offer a wide range of products that are classified into four business categories: base station infrastructure; network systems; installation, test and maintenance; and mobile devices and accessories. Base infrastructure products are used to build, repair and upgrade wireless telecommunications. Sales of traditional base station infrastructure products, such as base station radios, cable and transmission lines and antennas are in part dependent on capital spending in the wireless communications industry. Network systems products are used to build and upgrade computing and Internet networks. We have also been growing our offering of wireless broadband, network equipment, security and surveillance products, which are not as dependent on the overall capital spending of the industry. Installation, test and maintenance products are used to install, tune, and maintain wireless communications equipment. This category is made up of sophisticated analysis equipment and various frequency-, voltage- and power-measuring devices, replacement parts and components as well as an assortment of tools, hardware and supplies required by service technicians. Mobile devices and accessory products include cellular phone and data device accessories. Our customers generally have the ability to purchase any of our product categories.

The wireless communications distribution industry is competitive and fragmented, and is comprised of several national distributors. In addition, many manufacturers sell direct. Barriers to entry for distributors are relatively low, particularly in the mobile devices and accessory market, and the risk of new competitors entering the market is high. Consolidation of larger wireless carriers has and will most likely continue to impact our current and potential customer base. In addition, the agreements or arrangements with our customers or vendors looking to us for product and supply chain solutions are typically of limited duration and are terminable by either party upon several months or otherwise short notice. Our ability to maintain these relationships is subject to competitive pressures and challenges. We believe, however, that our strength in service, the breadth and depth of our product offering, our information

technology system, our large customer base and our purchasing relationships with approximately 400 manufacturers provide us with a significant competitive advantage over new entrants to the market.

Table of Contents

Results of Operations

The following tables summarize the results of our operations for fiscal years 2015, 2014 and 2013:

(Dollars in thousands, except per share data)			2014 to 2015			2013 to 2014	
	2015	2014	$ Change	% Change	2013	$ Change	% Change
Market Revenues							
Public Carriers, Contractors & Program Managers	$127,426	$149,196	$(21,770)	(14.6%)	$111,146	$38,050	34.2%
Government System Operators	31,495	33,757	(2,262)	(6.7%)	35,857	(2,100)	(5.9%)
Private System Operators	86,725	81,559	5,166	6.3%	85,456	(3,897)	(4.6%)
Commercial Dealers & Resellers	134,195	140,552	(6,357)	(4.5%)	138,737	1,815	1.3%
Retailers, Independent Dealer Agents & Carriers	169,778	155,023	14,755	9.5%	167,895	(12,872)	(7.7%)
Revenues, excluding Major 3PL relationship	549,619	560,087	(10,468)	(1.9%)	539,091	20,996	3.9%
Major 3PL relationship	--	--	--	--	213,474	(213,474)	(100.0%)
Total Revenues	$549,619	$560,087	$(10,468)	(1.9%)	$752,565	$(192,478)	(25.6%)

(Dollars in thousands, except per share data)			2014 to 2015			2013 to 2014	
	2015	2014	$ Change	% Change	2013	$ Change	% Change
Market Gross Profit							
Public Carriers, Contractors & Program Managers	$24,081	$31,013	$(6,932)	(22.4%)	$24,183	$6,830	28.2%
Government System Operators	8,283	8,497	(214)	(2.5%)	9,231	(734)	(8.0%)
Private System Operators	22,926	23,110	(184)	(0.8%)	24,365	(1,255)	(5.2%)
Commercial Dealers & Resellers	37,977	39,396	(1,419)	(3.6%)	38,345	1,051	2.7%
Retailers, Independent Dealer Agents & Carriers	37,622	36,142	1,480	4.1%	35,903	239	0.7%
Gross Profit, excluding Major 3PL relationship	130,889	138,158	(7,269)	(5.3%)	132,027	6,131	4.6%
Major 3PL relationship	--	--	--	--	15,012	(15,012)	(100.0%)
Total Gross Profit	130,889	138,158	(7,269)	(5.3%)	147,039	(8,881)	(6.0%)
Selling, general and administrative expenses	115,937	111,668	4,269	3.8%	117,821	(6,153)	(5.2%)
Restructuring Charge	573	--	573	--	--	--	--
Operating Expenses	116,510	111,668	4,842	4.3%	117,821	(6,153)	(5.2%)
Income from operations	14,378	26,490	(12,112)	(45.7%)	29,218	(2,728)	(9.3%)
Interest, net	167	178	(11)	(5.9%)	224	(46)	(20.7%)
Income before provision for income taxes	14,211	26,312	(12,101)	(46.0%)	28,994	(2,682)	(9.3%)
Provision for income taxes	5,577	10,063	(4,486)	(44.6%)	11,200	(1,137)	(10.2%)
Net income	$8,634	$16,249	(7,615)	(46.9%)	$17,794	$(1,545)	(8.7%)

Diluted earnings per share	$1.04	$1.94	(0.90)	(46.3%)	$2.15	$(0.21)	(9.7%)

Table of Contents

Fiscal Year 2015 Compared to Fiscal Year 2014

Revenues. Revenues for fiscal year 2015 decreased 1.9% as compared to fiscal year 2014. Revenue from the public carriers, contractors and program managers market decreased by 14.6% due to a dramatic slowdown in purchases by our cellular carriers, and primarily the two largest U.S. carriers and the general contractors and integrators doing work on their behalf. This slowdown also affected our commercial dealers and resellers market which decreased by 4.5%. Revenue within the government system operators market decreased by 6.7% for fiscal year 2015 as compared to fiscal year 2014. We expect to see growth within the government system operators market in fiscal 2016 due to an increase in demand for the maintenance and operations of Land Mobile Radio networks coupled with our continued investment in this market. These declines were partially offset by increases in the private system operators and the retail, independent dealer agent and carriers markets of 6.3% and 9.5%, respectively. Growth in our retail, independent dealer agent and carriers market was largely driven by the launch of various new Samsung and Apple devices.

Gross Profit. Gross profit decreased 5.3% in fiscal year 20ottom" ALIGN="right">68,781

Infrastructure-related subscription revenue, excluding foreign currency impact

391,641 332,897 17.6% 1,158,539 983,915 17.7%

Application development-related and other emerging technology subscription revenue, as reported

84,397 61,802 36.6% 234,049 172,246 35.9%

Adjustment for foreign currency exchange rates

5,330 18,212

Application development-related and other emerging technology subscription revenue, excluding foreign currency impact

	89,727	61,802	45.2%	252,261	172,246	46.5%
Total subscription revenue, as reported						
	457,488	394,699	15.9%	1,323,807	1,156,161	14.5%
Adjustment for foreign currency exchange rates						
	23,880			86,993		

Total subscription revenue, excluding foreign currency impact	481,368	394,699	22.0%	1,410,800	1,156,161	22.0%
Total training and services revenue, as reported	66,092	61,196	8.0%	184,921	169,387	9.2%
Adjustment for foreign currency exchange rates	4,603			15,487		

Total training and services revenue, excluding foreign currency impact	70,695	61,196	15.5%	200,408	169,387	18.3%
Total subscription and training and services revenue, as reported	523,580	455,895	14.8%	1,508,728	1,325,548	13.8%
Adjustment for foreign currency exchange rates	28,483			102,480		

Total subscription and training and services revenue, excluding foreign currency impact	$552,063	$455,895	21.1%	$1,611,208	$1,325,548	21.6%

32

Revenue from our non-U.S. operations has been translated into U.S. dollars using the average exchange rates for each month of the three and nine months ended November 30, 2015. In an effort to provide a comparable framework for assessing how our business performed when compared to the three and nine months ended November 30, 2014 in light of the effect of exchange rate differences, we believe it is helpful to exclude the impact of foreign currency exchange rate fluctuations by translating revenue from our non-U.S. operations for each of the three and nine months ended November 30, 2015 using the average foreign currency exchanges rates for each of the three and nine months ended November 30, 2014.

Subscription revenue

Our enterprise technologies are delivered primarily under subscription agreements. These agreements typically have a one- or three-year subscription period. A subscription generally entitles a customer to, among other things, a specified level of support, as well as new versions of the software, security updates, fixes, functionality enhancements, upgrades to the technology, if and when available, and compatibility with an ecosystem of certified hardware and software. Subscription revenue increased sequentially for the first, second and third quarters of fiscal 2016 and for each quarter of fiscal 2015 and fiscal 2014 and was driven primarily by the increased use of our offerings by customers and our expansion of sales channels and geographic footprint during these periods.

Subscription revenue increased 15.9%, or $62.8 million, for the three months ended November 30, 2015 as compared to the three months ended November 30, 2014. Excluding the impact of foreign currency exchange rate fluctuations, subscription revenue increased by 22.0% for the three months ended November 30, 2015. The increase in subscription revenue is driven primarily by additional subscriptions related to our principal RHEL and Red Hat JBoss Middleware offerings, which continue to gain broader market acceptance in mission-critical areas of computing, and the expansion of our sales channels and our geographic footprint. The increase is, in part, a result of the continued migration of enterprises in industries such as financial services, government, technology and telecommunications to our open source solutions from proprietary technologies.

Training and services revenue

Training and services revenue increased 8.0%, or $4.9 million, for the three months ended November 30, 2015 as compared to the three months ended November 30, 2014. Excluding the impact of foreign currency exchange rates, training and services revenue increased by 15.5%. The increase is driven primarily by customer interest in new products and increased demand for our open source solutions.

We believe our success is influenced by:

- the extent to which we can expand the breadth and depth of our offerings;
- our ability to enhance the value of Red Hat offerings through frequent and continuing innovation while maintaining stable platforms over multi-year periods;

our involvement and leadership in key open source communities which enables us to develop, enhance and maintain our offerings;

our ability to generate increasing revenue from partners and other strategic relationships, including CCSPs, distributors, embedded technology partners, IHVs, ISVs, original equipment manufacturers (OEMs), systems integrators, and value added resellers;

our ability to generate new and recurring revenue for Red Hat offerings;

the widespread and increasing deployment of open source technologies by enterprises and similar institutions, such as government agencies and universities; and

our ability to provide customers with consulting and training services that generate additional revenue.

Deferred revenue and billings proxy

Year-to-date deferred revenue

Our deferred revenue, current and long-term, balance at November 30, 2015 was $1.49 billion. Total deferred revenue at November 30, 2015 increased 0.3%, or $4.8 million, as compared to the balance of $1.48 billion at February 28, 2015. The slight increase in deferred revenue is primarily attributable to our typically-lower, seasonal first and second quarter billings and the year-to-date impact of foreign currency exchange rate fluctuations as discussed in the following paragraph. Because of our subscription model and revenue recognition policies, deferred revenue improves predictability of future revenue. For example, current deferred revenue provides a baseline for revenue to be recognized over the next twelve months. Similarly, long-term deferred revenue provides a baseline for revenue to be recognized beyond twelve months. Revenue derived from CCSPs for the delivery of our technologies as a service available on demand is recognized by us in the period earned and billed in arrears. As a result, revenue derived from CCSPs has no associated deferred revenue.

The increase in deferred revenue reported on our Consolidated Balance Sheets of $4.8 million differs from the increase of $40.1 million we reported on our Consolidated Statements of Cash Flows for the nine months ended November 30, 2015 as the amount reported on our Consolidated Statements of Cash Flows for the nine months ended November 30, 2015 excludes (i) the impact of changes in foreign currency exchange rates used to translate deferred revenue balances from our foreign subsidiaries functional currency into U.S. dollars and (ii) deferred revenue acquired as part of business combinations.

Year-over-year deferred revenue

Total deferred revenue increased by 14.4%, or $187.0 million, to $1.49 billion at November 30, 2015 from $1.30 billion at November 30, 2014. Excluding the impact of foreign currency exchange rate fluctuations, total deferred revenue increased by 20.4%, or $265.0 million, from November 30, 2014 to November 30, 2015. This increase in deferred revenue of $265.0 million is the summation of the changes in deferred revenue that we reported on our Consolidated Statements of Cash Flows for each quarter of the four-fiscal-quarter period ended November 30, 2015, plus $0.2 million related to deferred revenue acquired from business combinations during the same period.

Current deferred revenue increased by 14.8%, or $139.1 million, to $1.08 billion at November 30, 2015 from $941.4 million at November 30, 2014 and long-term deferred revenue increased by 13.3%, or $47.9 million, to $406.6 million at November 30, 2015 from $358.7 million at November 30, 2014. Excluding the impact of foreign currency exchange rate fluctuations, current deferred revenue increased by 20.1%, or $189.2 million, and long-term deferred revenue increased by 21.1%, or $75.8 million, from November 30, 2014 to November 30, 2015.

Billings proxy

We approximate our quarterly billings by adding revenue recognized on our Consolidated Statements of Operations to the change in total deferred revenue reported on our Consolidated Statements of Cash Flows. We use the change in deferred revenue as reported on our Consolidated Statements of Cash Flows because the amount has been adjusted for the impact of changes in foreign currency exchange rates used to translate deferred revenue balances from our foreign subsidiaries functional currencies into U.S. dollars.

For the four-fiscal-quarter period ended November 30, 2015, our rolling average billings proxy increased by 14.8%, or $72.3 million, to $559.4 million from $487.1 million for the four-fiscal-quarter period ended November 30, 2014. Using the average foreign currency exchange rates for each quarter of our four-fiscal-quarter period ended

November 30, 2014, our rolling average billings proxy for the four-fiscal-quarter period ended November 30, 2015 would have increased by approximately 21.3%, or $103.7 million. For information regarding seasonality, see Part II, Item 7 under Overview of our Annual Report on Form 10-K for the fiscal year ended February 28, 2015.

34

Revenue by geography

For the three months ended November 30, 2015, approximately $216.8 million, or 41.4%, of our revenue was generated outside the United States compared to approximately $191.7 million, or 42.0%, for the three months ended November 30, 2014. The relative decrease in the percentage of revenue generated outside of the United States for the three months ended November 30, 2015 compared to the percentage of revenue generated outside of the United States for the three months ended November 30, 2014 is due to foreign currency exchange rate fluctuations. Our international operations are expected to grow as our international sales force and channels become more mature and as we enter new locations or expand our presence in existing locations. As of November 30, 2015, we had offices in more than 85 locations throughout the world.

We operate our business in three geographic regions: the Americas (U.S., Latin America and Canada); EMEA (Europe, Middle East and Africa); and Asia Pacific (principally Australia, China, India, Japan, Singapore and South Korea). Revenue generated by the Americas, EMEA and Asia Pacific for the three months ended November 30, 2015 and the three months ended November 30, 2014 was as follows (in thousands):

	Americas	EMEA	Asia Pacific	Consolidated
Three Months Ended November 30, 2015	$ 342,368	$ 114,909	$ 66,303	$ 523,580
Three Months Ended November 30, 2014	$ 290,525	$ 105,755	$ 59,615	$ 455,895

Year-over-year revenue growth rates in U.S. dollars for our three geographical regions were as follows for the three months ended November 30, 2015 and three months ended November 30, 2014:

	Americas	EMEA	Asia Pacific	Consolidated
Three Months Ended November 30, 2015	17.8%	8.7%	11.2%	14.8%
Three Months Ended November 30, 2014	16.3%	12.7%	12.5%	15.0%

Excluding the impact of foreign currency exchange rate fluctuations, Americas, EMEA, Asia Pacific and Consolidated revenue grew 19.3%, 24.8%, 23.0% and 21.1%, respectively, for the three months ended November 30, 2015 as compared to the three months ended November 30, 2014.

As we expand further within each region, we anticipate revenue growth rates in local currencies to be similar among our geographic regions due to the similarity of products and services offered and the similarity in customer types or classes.

Gross profit

Gross profit margin was 84.5% and 84.3% for each of the three months ended November 30, 2015 and November 30, 2014, respectively. A favorable mix shift, as subscription revenue increased relative to services, was partially offset by increased costs to deliver our services. Such increases in costs to deliver our consulting services result from investments in personnel, infrastructure and processes to support our emerging technologies.

Gross profit margin by geography

Gross profit margins by our geographic regions for the three months ended November 30, 2015 and November 30, 2014 were as follows:

	Americas	EMEA	Asia Pacific	Consolidated (1)
Three Months Ended November 30, 2015	85.5%	86.3%	82.5%	84.5%
Three Months Ended November 30, 2014	85.5%	86.0%	82.4%	84.3%

(1) Consolidated gross margin includes corporate (non-allocated) share-based compensation expense for the three months ended November 30, 2015 and November 30, 2014 of $4.1 million and $3.9 million, respectively. For additional information, see NOTE 11 Segment Reporting to our Consolidated Financial Statements.

Table of Contents

Regional year-over-year variations in gross profit margins are primarily due to slight product mix shifts between subscriptions and services.

As we continue to expand our sales and support services within our geographic regions, we expect gross profit margins across geographic regions to further converge over the long run due to the similarity of products and services offered, similarity in production and distribution methods and the similarity in customer types or classes. These geographic profit margins exclude the impact of share-based compensation expense, which was not allocated to our geographic regions.

Income from operations

Operating income as a percentage of revenue decreased to 13.2% for the three months ended November 30, 2015 from 14.7% for the three months ended November 30, 2014. The decrease was primarily driven by the integration of our recent business combinations.

Income from operations by geography

Operating income as a percentage of revenue generated by our geographic regions for the three months ended November 30, 2015 and the three months ended November 30, 2014 was as follows:

	Americas	EMEA	Asia Pacific	Consolidated (1)
Three Months Ended November 30, 2015	21.4%	20.7%	22.7%	13.2%
Three Months Ended November 30, 2014	23.6%	18.7%	20.8%	14.7%

(1) Consolidated operating income as a percentage of revenue includes corporate (non-allocated) share-based compensation expense for the three months ended November 30, 2015 and November 30, 2014 of $43.4 million and $33.6 million, respectively. For additional information, see NOTE 11 Segment Reporting to our Consolidated Financial Statements.

Operating margin for Americas decreased for the three months ended November 30, 2015 as compared to the three months ended November 30, 2014 primarily as a result of closing and integrating the Ansible acquisition.

These geographic operating margins exclude the impact of share-based compensation expense, which was not allocated to our geographic segments.

Cash, cash equivalents, investments in debt securities and cash flow from operations

Cash, cash equivalents and short-term and long-term available-for-sale investments in debt securities balances at November 30, 2015 totaled $1.87 billion. Cash generated from operating activities for the three months ended November 30, 2015 totaled $139.6 million which represents an increase of 5.0% in operating cash flow as compared to the three months ended November 30, 2014. This increase is due to increases in subscription revenue and services revenues, billings and collections during the same periods.

Our significant cash and investment balances give us a measure of flexibility to take advantage of opportunities such as acquisitions, increasing investment in our international operations and repurchasing our common stock.

Foreign currency exchange rates   impact on results of operations

Approximately 41.4% of our revenue for the three months ended November 30, 2015 was produced 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 of net income. The income statements of our non-U.S. operations are translated into U.S. dollars at the average exchange rates for each applicable month in a period. To the extent the U.S. dollar weakens

against foreign currencies, the translation of these foreign-currency-denominated transactions results in increased revenue and operating expenses from operations for our non-U.S. operations. Similarly, our revenue and operating expenses will decrease for our non-U.S. operations if the U.S. dollar strengthens against foreign currencies.

Three Months Ended November 30, 2015

Using the average foreign currency exchange rates from the third quarter of our prior fiscal year ended February 28, 2015, our revenue and operating expenses from non-U.S. operations for the three months ended November 30, 2015 would have been higher than we reported by approximately $28.5 million and $24.1 million, respectively, which would have resulted in income from operations being higher by $4.4 million.

Nine Months Ended November 30, 2015

Using the average foreign currency exchange rates for the nine months ended November 30, 2014, our revenue and operating expenses from non-U.S. operations for the nine months ended November 30, 2015 would have been higher than we reported by approximately $102.5 million and $78.5 million, respectively, which would have resulted in income from operations being higher by $24.0 million.

Business combinations

Ansible

On October 15, 2015 we completed our acquisition of all of the shares of Ansible for total consideration of $126.3 million. Ansible is a provider of IT automation solutions that allows its users to manage applications across hybrid cloud environments. The acquisition is intended to augment our management portfolio and help customers deploy and manage applications across private and public clouds, speed service delivery through development/operations initiatives, streamline OpenStack installations and upgrades and accelerate container adoption by simplifying orchestration and configuration.

FeedHenry

On October 8, 2014, we completed our acquisition of all of the shares of FeedHenry for approximately $80.2 million. FeedHenry is a provider of cloud-based enterprise mobile application platforms. The acquisition is intended to expand our portfolio of application development, integration and platform-as-a-service (Paas) solutions, enabling us to support mobile application development in public and private environments.

eNovance

On June 24, 2014, we completed our acquisition of all of the shares of eNovance, a provider of open source cloud computing services, for $67.6 million. The acquisition is intended to assist in advancing our market position in OpenStack, and the addition of eNovance s systems integration capabilities and engineering talent is expected to help meet growing demand for enterprise OpenStack consulting, design and deployment.

Inktank

On April 30, 2014, we completed our acquisition of all of the shares of Inktank, a provider of scale-out, open source storage systems, whose flagship technology, Inktank Ceph Enterprise, delivers object and block storage software to enterprises deploying public or private clouds for consideration of $152.5 million. The acquisition is intended to

complement our existing GlusterFS-based storage and Red Hat Enterprise Linux OpenStack Platform offerings.

Convertible note offering

On October 7, 2014, we completed our offering of $805.0 million aggregate principal amount of our 0.25% Convertible Senior Notes due 2019 (the convertible notes). The convertible notes were sold in a private placement under a purchase agreement, dated as of October 1, 2014, entered into by and among us and Morgan Stanley & Co. LLC, Merrill Lynch, Pierce, Fenner & Smith Incorporated, Citigroup Global Markets Inc. and J.P. Morgan Securities LLC as representatives of the several initial purchasers named therein, for resale to qualified institutional buyers pursuant to Rule 144A under the Securities Act of 1933, as amended.

We used $148.0 million of the net proceeds from the offering of the convertible notes to pay the cost of the privately-negotiated convertible note hedge transactions described in NOTE 15 Convertible Notes to our Consolidated Financial Statements. Proceeds of $79.8 million were received by us from the sale of warrants pursuant to the warrant transactions also described in NOTE 15 Convertible Notes to our Consolidated Financial Statements.

In addition, we used $375.0 million of the net proceeds from the offering of the convertible notes to repurchase shares of our common stock under an accelerated share repurchase program pursuant to an agreement that we entered into on October 1, 2014, as described in NOTE 10 Share Repurchase Programs to our Consolidated Financial Statements.

We intend to use the remaining net proceeds from the offering for working capital and other general corporate purposes, which may include capital expenditures, potential acquisitions or strategic transactions.

Table of Contents

RESULTS OF OPERATIONS

Three months ended November 30, 2015 and November 30, 2014

The following table is a summary of our results of operations for the three months ended November 30, 2015 and November 30, 2014 (in thousands):

	Three Months Ended (Unaudited)			
	November 30, 2015	November 30, 2014	$ Change	% Change
Revenue:				
Subscriptions	$ 457,488	$ 394,699	$ 62,789	15.9%
Training and services	66,092	61,196	4,896	8.0
Total subscription and training and services revenue	523,580	455,895	67,685	14.8
Cost of subscription and training and services revenue:				
Cost of subscriptions	32,246	28,574	3,672	12.9
As a % of subscription revenue	7.0%	7.2%		
Cost of training and services	48,802	42,791	6,011	14.0
As a % of training and services revenue	73.8%	69.9%		
Total cost of subscription and training and services revenue	81,048	71,365	9,683	13.6
As a % of total revenue	15.5%	15.7%		
Total gross profit	442,532	384,530	58,002	15.1
Operating expense:				
Sales and marketing	215,784	187,218	28,566	15.3
Research and development	104,906	90,613	14,293	15.8
General and administrative	52,965	39,502	13,463	34.1
Total operating expense	373,655	317,333	56,322	17.7
Income from operations	68,877	67,197	1,680	2.5
Interest income	2,874	2,196	678	30.9
Interest expense	5,817	3,441	2,376	69.0
Other income (expense), net	49	1,559	(1,510)	(96.9)
Income before provision for income taxes	65,983	67,511	(1,528)	(2.3)
Provision for income taxes	19,135	19,578	(443)	(2.3)
Net income	$ 46,848	$ 47,933	$ (1,085)	(2.3)%

Gross profit margin-subscriptions	93.0%	92.8%
Gross profit margin-training and services	26.2%	30.1%
Gross profit margin	84.5%	84.3%
As a % of total revenue:		
Subscription revenue	87.4%	86.6%
Training and services revenue	12.6%	13.4%
Sales and marketing expense	41.2%	41.1%
Research and development expense	20.0%	19.9%
General and administrative expense	10.1%	8.7%
Total operating expenses	71.4%	69.6%
Income from operations	13.2%	14.7%
Income before provision for income taxes	12.6%	14.8%
Net income	8.9%	10.5%
Estimated annual effective income tax rate	29.0%	29.0%

Revenue

Subscription revenue

Subscription revenue, which is primarily comprised of direct and indirect sales of Red Hat offerings, increased by 15.9%, or $62.8 million, to $457.5 million for the three months ended November 30, 2015 from $394.7 million for the three months ended November 30, 2014.

Revenue derived from the sale of subscriptions supporting our Infrastructure-related offerings increased by 12.1%, or $40.2 million, to $373.1 million for the three months ended November 30, 2015 from $332.9 million for the three months ended November 30, 2014. The increase in subscription revenue is primarily due to increases in volumes sold, including additional subscriptions attributable to geographic expansion and the continued migration of customers to our open source Linux platform from proprietary operating systems.

Revenue derived from the sale of subscriptions supporting our Application development-related and other emerging technology offerings increased by 36.6%, or $22.6 million, to $84.4 million for the three months ended November 30, 2015 from $61.8 million for the three months ended November 30, 2014. The increase is primarily due to additional subscriptions for Red Hat JBoss Middleware offerings. We expect the growth rate of revenue derived from our Application development-related and other emerging technology offerings to exceed the growth rate of revenue derived from our Infrastructure-related offerings as our Application development-related and other emerging technology offerings continue to gain broader market acceptance in the enterprise IT environment.

Training and services revenue

Training revenue includes fees paid by our customers for delivery of educational materials and instruction. Services revenue includes fees received from customers for consulting services regarding our offerings, deployment of Red Hat technologies and for delivery of added functionality to Red Hat technologies for our major customers and OEM partners. Total training and services revenue increased by 8.0%, or $4.9 million, to $66.1 million for the three months ended November 30, 2015 from $61.2 million for the three months ended November 30, 2014. The increase is due to services revenue which increased by 13.8%, or $6.2 million, as a result of an increase in consulting engagements driven by increased demand for our open source solutions. Training revenue decreased by 7.6%, or $1.3 million. Training revenue in the current year decreased relative to the prior year s training revenue which included incremental revenue related to the then recently released RHEL 7 offering. Combined training and services revenue decreased as a percentage of total revenue to 12.6% for the three months ended November 30, 2015 from 13.4% for the three months ended November 30, 2014.

Cost of revenue

Cost of subscription revenue

The cost of subscription revenue primarily consists of expenses we incur to support, distribute and package Red Hat offerings. These costs include labor-related costs to provide technical support, security updates and fixes, as well as costs for fulfillment, physical media, literature, packaging and shipping. Cost of subscription revenue increased by 12.9%, or $3.7 million, to $32.2 million for the three months ended November 30, 2015 from $28.6 million for the three months ended November 30, 2014. The increase is primarily due to the expansion of our technical staff in order to meet the demands of our growing subscriber base for support, security updates and fixes, and includes additional compensation of $2.7 million. The remaining increase is driven primarily by incremental travel and outside services costs. Gross profit margin on subscriptions was 93.0% and 92.8%, respectively, for each of the three months ended

November 30, 2015 and November 30, 2014. As the number of our open source technology subscriptions continues to increase, we expect associated support cost will continue to increase, although we anticipate this will occur at a rate slower than that of subscription revenue growth due to economies of scale.

Table of Contents

Cost of training and services revenue

Cost of training and services revenue is mainly comprised of personnel and third-party consulting costs for the design, development and delivery of custom engineering, training courses and professional services provided to various types of customers. Cost of training and services revenue increased by 14.0%, or $6.0 million, to $48.8 million for the three months ended November 30, 2015 from $42.8 million for the three months ended November 30, 2014. Costs to deliver our services revenue increased by 17.6%, or $6.0 million, and relate to additional third-party consulting costs incurred to meet a surge in demand for and additional employee compensation and travel associated with additions to our emerging technologies staff. Total costs to deliver training and services as a percentage of training and services revenue was 73.8% and 69.9% for each of the three month periods ended November 30, 2015 and November 30, 2014, respectively.

Gross profit

Gross profit margin was 84.5% and 84.3% for the three months ended November 30, 2015 and November 30, 2014, respectively. A favorable mix shift, as subscription revenue increased relative to services, was partially offset by increased costs to deliver our services. Such increases in costs to deliver our consulting services result from investments in personnel, infrastructure and processes to support our emerging technologies.

Operating expenses

Sales and marketing

Sales and marketing expense consists primarily of salaries and other related costs for sales and marketing personnel, sales commissions, travel, public relations and marketing materials and trade shows. Sales and marketing expense increased by 15.3%, or $28.6 million, to $215.8 million for the three months ended November 30, 2015 from $187.2 million for the three months ended November 30, 2014. This increase was partially due to a $17.1 million increase in selling costs, which includes $12.3 million of additional employee compensation expense attributable to the expansion of our sales force from the prior year. The remaining increase relates to marketing costs, which grew 25.5%, or $11.5 million, for the three months ended November 30, 2015 as compared to the three months ended November 30, 2014 and includes incremental employee compensation and marketing program costs of $4.4 million and $6.5 million, respectively. Sales and marketing expense increased as a percentage of revenue to 41.2% for the three months ended November 30, 2015 from 41.1% for the three months ended November 30, 2014.

Research and development

Research and development expense consists primarily of personnel and related costs for development of software technologies and systems management offerings. Research and development expense increased by 15.8%, or $14.3 million, to $104.9 million for the three months ended November 30, 2015 from $90.6 million for the three months ended November 30, 2014. The increase in research and development costs primarily resulted from the expansion of our engineering group as a result of both direct hires and business combinations as we continue investing in cloud management and our other emerging technologies. Employee compensation and travel costs increased by $12.2 million and $0.4 million, respectively. Research and development expense was 20.0% and 19.9% of total revenue for the three months ended November 30, 2015 and November 30, 2014, respectively.

General and administrative

General and administrative expense consists primarily of personnel and related costs for general corporate functions, including information systems, finance, accounting, legal, human resources and facilities expense. General and administrative expense increased by 34.1%, or $13.5 million, to $53.0 million for the three months ended November 30, 2015 from $39.5 million for the three months ended November 30, 2014. General and

administrative expenses include increased compensation-related expense of $6.0 million, transaction costs related to business combinations of $2.7 million and infrastructure and facilities costs of $2.2 million. General and administrative expense increased as a percentage of revenue to 10.1% for the three months ended November 30, 2015 from 8.7% for the three months ended November 30, 2014. Although general and administrative expense increased as a percentage of total revenue for the three months ended November 30, 2015, we expect such costs to decrease relative to revenue as we begin to leverage benefits from investments made during the current year to expand and enhance our corporate processes and technology infrastructure.

Interest income

Interest income increased by 30.9%, or $0.7 million, for the three months ended November 30, 2015 as compared to the three months ended November 30, 2014. The increase in interest income for the three months ended November 30, 2015 is attributable to slightly higher yields earned on larger cash and investment balances.

Interest expense

Interest expense increased by $2.4 million, for the three months ended November 30, 2015 as compared to the three months ended November 30, 2014. The increase in interest expense for the three months ended November 30, 2015 is attributable to the issuance of convertible notes during the three months ended November 30, 2014 which is described in NOTE 15 Convertible Notes to our Consolidated Financial Statements.

Other income (expense), net

Other income (expense), net decreased by $1.5 million, for the three months ended November 30, 2015 as compared to the three months ended November 30, 2014. The decrease is primarily due to net gains recognized from the settlement of foreign currency transactions during the three months ended November 30, 2014 that were not repeated during the three months ended November 30, 2015.

Income taxes

During the three months ended November 30, 2015, we recorded $19.1 million of income tax expense, which is based on an estimated annual effective tax rate of 29%. Our estimated annual effective tax rate of 29% is less than the U.S. federal statutory rate of 35% primarily due to foreign income taxed at lower rates, state income taxes net of federal benefits and the domestic production activities deduction.

During the three months ended November 30, 2014, we recorded $19.6 million of income tax expense, which was based on a then estimated annual effective tax rate of 29%. Our estimated annual effective tax rate of 29% was less than the U.S. federal statutory rate of 35% primarily due to foreign income taxed at lower rates.

Table of Contents

Nine months ended November 30, 2015 and November 30, 2014

The following table is a summary of our results of operations for the nine months ended November 30, 2015 and November 30, 2014 (in thousands):

	Nine Months Ended (Unaudited)			
	November 30, 2015	November 30, 2014	$ Change	% Change
Revenue:				
Subscriptions	$ 1,323,807	$ 1,156,161	$ 167,646	14.5%
Training and services	184,921	169,387	15,534	9.2
Total subscription and training and services revenue	1,508,728	1,325,548	183,180	13.8
Cost of subscription and training and services revenue:				
Cost of subscriptions	93,088	84,125	8,963	10.7
As a % of subscription revenue	7.0%	7.3%		
Cost of training and services	135,321	118,857	16,464	13.9
As a % of training and services revenue	73.2%	70.2%		
Total cost of subscription and training and services revenue	228,409	202,982	25,427	12.5
As a % of total revenue	15.1%	15.3%		
Total gross profit	1,280,319	1,122,566	157,753	14.1
Operating expense:				
Sales and marketing	619,757	538,576	81,181	15.1
Research and development	304,824	275,817	29,007	10.5
General and administrative	139,462	125,786	13,676	10.9
Total operating expense	1,064,043	940,179	123,864	13.2
Income from operations	216,276	182,387	33,889	18.6
Interest income	8,484	6,048	2,436	40.3
Interest expense	17,265	3,591	13,674	380.8
Other income (expense), net	(1,398)	1,777	(3,175)	(178.7)
Income before provision for income taxes	206,097	186,621	19,476	10.4
Provision for income taxes	59,768	54,120	5,648	10.4
Net income	$ 146,329	$ 132,501	$ 13,828	10.4%
Gross profit margin-subscriptions	93.0%	92.7%		

Gross profit margin-training and services	26.8%	29.8%
Gross profit margin	84.9%	84.7%
As a % of total revenue:		
Subscription revenue	87.7%	87.2%
Training and services revenue	12.3%	12.8%
Sales and marketing expense	41.1%	40.6%
Research and development expense	20.2%	20.8%
General and administrative expense	9.2%	9.5%
Total operating expenses	70.5%	70.9%
Income from operations	14.3%	13.8%
Income before provision for income taxes	13.7%	14.1%
Net income	9.7%	10.0%
Estimated annual effective income tax rate	29.0%	29.0%

Revenue

Subscription revenue

Subscription revenue increased by 14.5%, or $167.6 million, to $1.32 billion for the nine months ended November 30, 2015 from $1.16 billion for the nine months ended November 30, 2014.

Revenue derived from the sale of subscriptions supporting our Infrastructure-related offerings increased by 10.8%, or $105.8 million, to $1.09 billion for the nine months ended November 30, 2015 from $983.9 million for the nine months ended November 30, 2014 and includes a favorable revenue adjustment of $5.3 million related to cloud-usage revenues through our CCSP program, as described further in NOTE 2 Summary of Significant Accounting Policies to our Consolidated Financial Statements. The remaining increase in subscription revenue is primarily due to increases in volumes sold, including additional subscriptions attributable to geographic expansion and the continued migration of customers to our open source Linux platform from proprietary operating systems.

Revenue derived from the sale of subscriptions supporting our Application development-related and other emerging technology offerings increased by 35.9%, or $61.8 million, to $234.0 million for the nine months ended November 30, 2015 from $172.2 million for the nine months ended November 30, 2014. The increase is primarily due to additional subscriptions for Red Hat JBoss Middleware offerings.

Training and services revenue

Total training and services revenue increased by 9.2%, or $15.5 million, to $184.9 million for the nine months ended November 30, 2015 from $169.4 million for the nine months ended November 30, 2014. The increase is due to services revenue which increased by 12.4%, or $15.6 million, as a result of an increase in consulting engagements driven by increased demand for our open source solutions. Training revenue decreased by 0.2%, or $0.1 million. Combined training and services revenue decreased as a percentage of total revenue to 12.3% for the nine months ended November 30, 2015 from 12.8% for the nine months ended November 30, 2014.

Cost of revenue

Cost of subscription revenue

Cost of subscription revenue increased by 10.7%, or $9.0 million, to $93.1 million for the nine months ended November 30, 2015 from $84.1 million for the nine months ended November 30, 2014. The increase is primarily due to the expansion of our technical staff in order to meet the demands of our growing subscriber base for support, security updates and fixes, and includes additional compensation of $6.9 million. The remaining increase is driven primarily by incremental travel, outside services and equipment costs of $1.2 million. Gross profit margin on subscriptions was 93.0% and 92.7%, respectively, for each of the nine months ended November 30, 2015 and November 30, 2014. Excluding the favorable revenue adjustment of $5.3 million related to cloud-usage revenue, gross profit margin on subscriptions for the nine months ended May 31, 2015 was 92.9%.

Cost of training and services revenue

Cost of training and services revenue increased by 13.9%, or $16.5 million, to $135.3 million for the nine months ended November 30, 2015 from $118.9 million for the nine months ended November 30, 2014. Costs to deliver our services revenue increased by 16.7%, or $16.0 million, and relate to additional third-party consulting costs incurred to meet a surge in demand for and additional employee compensation and travel associated with additions to our

emerging technologies staff. Total costs to deliver training and services as a percentage of training and services revenue was 73.2% and 70.2% for each of the nine months ended November 30, 2015 and November 30, 2014, respectively.

Table of Contents

Gross profit

Excluding the favorable revenue adjustment of $5.3 million described previously, gross profit margin increased slightly to 84.8% for the nine months ended November 30, 2015 from 84.7% for the nine months ended November 30, 2014. The increase was due to a favorable mix shift as subscription revenue increased relative to services and was partially offset by increased costs to deliver our services due to additions to our emerging technologies staff.

Operating expenses

Sales and marketing

Sales and marketing expense increased by 15.1%, or $81.2 million, to $619.8 million for the nine months ended November 30, 2015 from $538.6 million for the nine months ended November 30, 2014. This increase was partially due to a $53.0 million increase in selling costs, which includes $43.4 million of additional employee compensation expense attributable to the expansion of our sales force from the prior year. The remaining increase relates to marketing costs, which grew 22.0%, or $28.1 million, for the nine months ended November 30, 2015 as compared to the nine months ended November 30, 2014 and includes incremental employee compensation and marketing program costs of $12.2 million and $14.9 million, respectively. Primarily as a result of expanded sales and marketing staffing, sales and marketing expense increased as a percentage of revenue to 41.1% for the nine months ended November 30, 2015 from 40.6% for the nine months ended November 30, 2014.

Research and development

Research and development expense increased by 10.5%, or $29.0 million, to $304.8 million for the nine months ended November 30, 2015 from $275.8 million for the nine months ended November 30, 2014. The increase in research and development costs primarily resulted from the expansion of our engineering group as a result of both direct hires and business combinations as we continue investing in cloud management and our other emerging technologies. Employee compensation increased by $26.2 million and travel costs increased by $1.2 million. Research and development expense was 20.2% and 20.8% of total revenue for the nine months ended November 30, 2015 and November 30, 2014, respectively.

General and administrative

General and administrative expense increased by 10.9%, or $13.7 million, to $139.5 million for the nine months ended November 30, 2015 from $125.8 million for the nine months ended November 30, 2014. General and administrative expenses include increased compensation-related expense of $9.2 million and infrastructure and facilities costs of $2.6 million. General and administrative expense decreased as a percentage of revenue to 9.2% for the nine months ended November 30, 2015 from 9.5% for the nine months ended November 30, 2014.

Interest income

Interest income increased by 40.3%, or $2.4 million, for the nine months ended November 30, 2015 as compared to the nine months ended November 30, 2014. The increase in interest income for the nine months ended November 30, 2015 is attributable to slightly higher yields earned on larger cash and investment balances.

Interest expense

Interest expense increased by $13.7 million, for the nine months ended November 30, 2015 as compared to the nine months ended November 30, 2014. The increase in interest expense for the nine months ended November 30, 2015 is attributable to the issuance of convertible notes during the nine months ended November 30, 2014 which is described in NOTE 15 Convertible Notes to our Consolidated Financial Statements.

45

Other income (expense), net

Other income (expense), net decreased by $3.2 million, for the nine months ended November 30, 2015 as compared to the nine months ended November 30, 2014. The decrease is primarily due to net gains realized on the sale of non-marketable, cost-basis investments in equity securities during the nine months ended November 30, 2014 that were not repeated during the nine months ended November 30, 2015.

Income taxes

During the nine months ended November 30, 2015, we recorded $59.8 million of income tax expense, which is based on an estimated annual effective tax rate of 29%. Our estimated annual effective tax rate of 29% is less than the U.S. federal statutory rate of 35% primarily due to foreign income taxed at lower rates, state income taxes net of federal benefits and the domestic production activities deduction.

During the nine months ended November 30, 2014, we recorded $54.1 million of income tax expense, which was based on a then estimated annual effective tax rate of 29%. Our estimated annual effective tax rate of 29% was less than the U.S. federal statutory rate of 35% primarily due to foreign income taxed at lower rates.

LIQUIDITY AND CAPITAL RESOURCES

We derive our liquidity and operating capital primarily from cash flows from operations. Historically, we also received cash from the sale of equity securities, including private sales of preferred stock and the sale of common stock in our initial and follow-on public offerings, and the issuance of convertible notes, including our recent issuance of convertible notes with par value totaling $805.0 million described previously in Overview Convertible note offering and in detail in NOTE 15 Convertible Notes to our Consolidated Financial Statements. At November 30, 2015, we had total cash and investments of $1.87 billion, which was comprised of $942.0 million in cash and cash equivalents, $194.0 million of short-term, available-for-sale, fixed-income investments and $735.4 million of long-term, available-for-sale fixed-income investments. This compares to total cash and investments of $1.81 billion at February 28, 2015.

With $942.0 million in cash and cash equivalents on hand, we believe our cash and cash equivalent balances, together with our ability to generate additional cash from operations, should be sufficient to satisfy our cash requirements for the next twelve months and for the foreseeable future. However, we may take advantage of favorable capital market conditions that may arise from time to time to raise additional capital. We presently do not intend to liquidate our short- and long-term investments in debt securities prior to their scheduled maturity dates. However, in the event that we liquidate these investments prior to their scheduled maturities and there are adverse changes in market interest rates or the overall economic environment, we could be required to recognize a realized loss on those investments when we liquidate those investments. At November 30, 2015, net accumulated unrealized losses on our available-for-sale debt securities totaled $2.2 million, versus accumulated unrealized gains of $0.2 million as of February 28, 2015.

Nine months ended November 30, 2015

Cash flows overview

At November 30, 2015, cash and cash equivalents totaled $942.0 million, a decrease of $105.4 million as compared to February 28, 2015. The decrease in cash and cash equivalents for the nine months ended November 30, 2015 is primarily the result of net purchases of available-for-sale debt securities of $194.4 million, business combinations

which included net cash consideration paid of $126.7 million, the repurchase of 1,882,115 shares of our common stock for $148.3 million and payments made in return for common shares received from employees to satisfy employees minimum tax withholding obligations related to share awards vesting of $60.8 million. Partially offsetting cash used in investing and financing activities was cash provided by operations which generated $468.6 million for the nine months ended November 30, 2015.

Table of Contents

Cash flows from operations

Cash provided by operations of $468.6 million during the nine months ended November 30, 2015 includes net income of $146.3 million, adjustments to exclude the impact of non-cash revenues and expenses, which totaled a $208.6 million net source of cash, and changes in operating assets and liabilities, which totaled a $113.7 million net source of cash. Cash provided by changes in operating assets and liabilities for the nine months ended November 30, 2015 was primarily the result of collections on our billings.

Cash flows from investing

Cash used in investing activities of $361.9 million for the nine months ended November 30, 2015 includes net purchases of available-for-sale debt securities of $194.4 million and net cash of $126.7 million used to acquire businesses. Investments in property and equipment totaled $29.5 million and primarily relate to information technology infrastructure and leasehold improvements. Investments in other intangible assets, primarily patents, totaled $8.1 million during the nine months ended November 30, 2015.

Cash flows from financing

Cash used in financing activities of $189.1 million for the nine months ended November 30, 2015 includes $148.3 million to repurchase 1,882,115 shares of our common stock and payments made in return for common shares received from employees to satisfy employees minimum tax withholding obligations related to restricted share awards vesting during the nine months ended November 30, 2015 of $60.8 million. Partially offsetting financing activities using cash were proceeds from excess tax benefits related to share-based employee compensation, which totaled $18.0 million and proceeds from employees exercise of common stock options, which totaled $3.3 million. Payments on other borrowings totaled $1.4 million for the nine months ended November 30, 2015.

Investments in debt securities

Our investments are comprised primarily of debt securities that are classified as available for sale and recorded at their fair market values. At November 30, 2015 and February 28, 2015, the vast majority of our investments were priced with the assistance of pricing vendors. These pricing vendors use the most recent observable market information in pricing these securities or, if specific prices are not available for these securities, use other observable inputs. In the event observable inputs are not available, we assess other factors to determine the securities market values, including broker quotes or model valuations. Independent price verifications of all of our holdings are performed by the pricing vendors, which we review. In the event a price fails a pre-established tolerance check, it is researched so that we can assess the cause of the variance to determine what we believe is the appropriate fair market value.

Capital requirements

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 technologies, the expansion of our services operations and our acquisition activity. Our capital requirements during the fiscal year ending February 29, 2016 will depend on numerous factors, including the amount of resources we devote to:

- funding the continued development of our technology offerings;

improving and extending our services and the technologies used to market and deliver these services to our customers and support our business;

pursuing strategic acquisitions and alliances;

investing in or acquiring businesses, products and technologies; and

investing in enhancements to the systems we use to run our business and the expansion of our office facilities.

We have utilized, and will continue from time to time to utilize, cash and investments to fund, among other potential uses, purchases of our common stock, purchases of fixed assets, purchases of intangible assets (primarily patents) and mergers and acquisitions. Given our historically strong operating cash flow and the $1.87 billion of cash and investments held at November 30, 2015, we believe our cash and cash equivalent balances, together with our ability to generate additional cash from operations, should be sufficient to satisfy our cash requirements for the next twelve months and for the foreseeable future. However, we may take advantage of favorable capital market conditions that may arise from time to time to raise additional capital.

We believe that cash flows from operations will continue to increase; however, there can be no assurances that we will increase our cash flows 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 or that cash may be located in or generated in the appropriate geographic region where we can effectively use such cash. 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.

As of November 30, 2015, our cash, cash equivalents and available-for-sale investment securities totaled $1.87 billion, of which $761.5 million was held outside the U.S. Our intent is to reinvest the earnings of foreign subsidiaries indefinitely outside the U.S. to fund both organic growth and acquisitions. From time to time, however, we may remit a portion of these earnings to the extent it is economically prudent. For further discussion related to geographic segments, see NOTE 11 Segment Reporting to our Consolidated Financial Statements.

With $1.11 billion, or 59.3%, of our available cash, cash equivalents and available-for-sale investments held within the U.S. as of November 30, 2015, we do not anticipate a need to repatriate any foreign earnings for the foreseeable future. However, if cash held outside the U.S. were needed to fund our U.S. operations, under current tax law we would be subject to additional taxes on the portion related to repatriated earnings of our foreign subsidiaries. As of February 28, 2015, cumulative undistributed foreign earnings totaled $420.0 million. For further discussion, see NOTE 11 Income Taxes to our Consolidated Financial Statements contained in our Annual Report on Form 10-K for the year ended February 28, 2015.

Off-balance sheet arrangements

As of November 30, 2015 and February 28, 2015, 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.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are exposed to the impact of interest rate changes, foreign currency exchange rate fluctuations and changes in the market value of our investments.

Interest rate risk

Our exposure to market rate risk for changes in interest rates relates primarily to our investment portfolio. The primary objective of our 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 short-term and long-term investments in a variety of available-for-sale fixed and floating rate debt securities, including both government and corporate obligations and money market funds. Investments in both fixed rate and floating rate interest earning instruments carry a degree of interest rate risk. Fixed rate securities may have their fair market value adversely impacted due to a rise in prevailing interest rates, while floating rate securities may produce less income than expected if interest rates fall. Due in part to these factors, our future investment income related to these securities may fall short of expectations due to changes in interest rates, or we may suffer losses in principal if forced to sell securities which have declined in market value due to changes in interest rates or perceived credit risk related to the securities issuers. A hypothetical one-half percentage point change in interest rates, assuming a parallel shift of all interest rates, would result in an approximate $0.5 million change in annual interest income derived from investments in our portfolio as of November 30, 2015. For further discussion related to our investments as of November 30, 2015 and February 28, 2015, see NOTE 6 Assets and Liabilities Measured at Fair Value on a Recurring Basis to our Consolidated Financial Statements.

Investment risk

The fair market value of our available-for-sale investment portfolio is subject to interest rate risk. Based on a sensitivity analysis performed on this investment portfolio, a hypothetical one percentage point increase in prevailing interest rates would result in an approximate $17.7 million decrease in the fair value of our available-for-sale investment securities as of November 30, 2015. For further discussion related to our investments as of November 30, 2015 and February 28, 2015, see NOTE 6 Assets and Liabilities Measured at Fair Value on a Recurring Basis to our Consolidated Financial Statements.

Credit risk

Investments in debt and equity securities

The fair market values of our investment portfolio and cash balances are exposed to counterparty credit risk. Accordingly, while we periodically review our portfolio in an effort to mitigate counterparty risk, the principal values of our cash balances, money market accounts and investments in available-for-sale securities could suffer a loss of value.

Accounts receivable

As of November 30, 2015 and February 28, 2015, no individual customer accounted for 10% or more of our total accounts receivable.

Foreign currency risk

Approximately 41.4% of our revenue for the three months ended November 30, 2015 was produced 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 of net income. The income statements of our non-U.S. operations are translated into U.S. dollars

at the average exchange rates for each applicable month in a period. To the extent the U.S. dollar weakens against foreign currencies, the translation of these foreign currency statements results in increased revenue and operating expenses for our non-U.S. operations. Similarly, our revenue and operating expenses for our non-U.S. operations decreases if the U.S. dollar strengthens against foreign currencies.

Using the average foreign currency exchange rates from the third quarter of our prior fiscal year ended February 28, 2015, our revenue and operating expenses from non-U.S. operations for the three months ended November 30, 2015 would have been higher than we reported by approximately $28.5 million and $24.1 million, respectively, which would have resulted in income from operations being higher by $4.4 million.

Using the average foreign currency exchange rates for the nine months ended November 30, 2014, our revenue and operating expenses from non-U.S. operations for the nine months ended November 30, 2015 would have been higher than we reported by approximately $102.5 million and $78.5 million, respectively, which would have resulted in income from operations being higher by $24.0 million.

Convertible notes

In October 2014, we issued $805.0 million of 0.25% convertible notes due 2019. The convertible notes have a fixed annual interest rate of 0.25%, and therefore we do not have economic interest rate exposure on the convertible notes. However, the fair market value of the convertible notes is exposed to interest rate risk. Generally, the fair market value of the convertible notes will increase as interest rates fall and decrease as interest rates rise. For further discussion regarding the fair value of the convertible notes, see NOTE 15 Convertible Notes to our Consolidated Financial Statements.

In connection with the sale of the convertible notes, we entered into convertible note hedge transactions and warrant transactions. The convertible note hedge transactions are expected to offset the potential dilution with respect to shares of our common stock upon any conversion of the convertible notes and/or offset any cash payments that we are required to make in excess of the principal amount of the converted notes, as the case may be. The warrant transactions will have a dilutive effect with respect to our common stock to the extent that the market price per share of our common stock, as measured under the terms of the warrant transactions, exceeds the applicable strike price of the warrants. However, subject to certain conditions, we may elect to settle all of the warrants in cash. The initial strike price of the warrants is $101.65 per share. The number of shares of our common stock underlying the warrants is 10,965,630 shares, subject to anti-dilution adjustments. The convertible note hedge and warrants are both considered indexed to our common stock and classified as equity; therefore, the convertible note hedge and warrants are not accounted for as derivative instruments.

Derivative instruments

We transact business in various foreign countries and are, therefore, subject to risk of foreign currency exchange rate fluctuations. From time to time we enter into forward contracts to economically hedge transactional exposure associated with commitments arising from trade accounts receivable, trade accounts payable and fixed purchase obligations denominated in a currency other than the functional currency of the respective operating entity. All derivative instruments are recorded on the Consolidated Balance Sheets at their respective fair market values. We have elected not to prepare and maintain the documentation required to qualify our forward contracts for hedge accounting treatment and, therefore, changes in fair value are recorded in our Consolidated Statements of Operations. For further discussion related to our management of foreign currency risk see NOTE 7 Derivative Instruments to our Consolidated Financial Statements.

The aggregate notional amount of outstanding forward contracts at November 30, 2015 was $38.1 million. The fair value of these outstanding contracts at November 30, 2015 was a gross $0.1 million asset and a gross $0.4 million liability, and is recorded in Other current assets and Accounts payable and accrued expenses, respectively, on our Consolidated Balance Sheets. The forward contracts generally expire within three months of

the period ended November 30, 2015. The forward contracts will settle in Euros, Japanese yen, Norwegian krona, Singapore dollars, Swedish krona, Swiss francs and U.S. dollars.

The aggregate notional amount of outstanding forward contracts at February 28, 2015 was $108.1 million. The fair value of these outstanding contracts at February 28, 2015 was a gross $0.1 million asset and a gross $0.7 million liability, and is recorded in Other current assets and Accounts payable and accrued expenses, respectively, on our Consolidated Balance Sheets. The forward contracts generally expired within three months of the period ended February 28, 2015. The forward contracts settled in Australian dollars, Euros, Hong Kong dollars, Japanese yen, Norwegian krona, Singapore dollars, Swedish krona, Swiss francs and U.S. dollars.

RECENT ACCOUNTING PRONOUNCEMENTS

In November 2015, the FASB issued Accounting Standards Update 2015-17, *Income Taxes (Topic 740): Balance Sheet Classification of Deferred Taxes* (ASU 2015-17). ASU 2015-17 removes the requirement that deferred tax assets and liabilities be classified as either current or noncurrent in a classified statement of financial position and instead considers deferred tax assets and liabilities to be classified as noncurrent. This guidance is effective for us as of the first quarter of our fiscal year ending February 28, 2018. We do not believe that this updated standard will have a material impact on our consolidated financial statements.

In September 2015, the FASB issued Accounting Standards Update 2015-16, *Business Combinations (Topic 805): Simplifying the Accounting for Measurement-Period Adjustments* (ASU 2015-16). The FASB issued ASU 2015-16 to simplify US GAAP to require that the acquirer record, in the same period s financial statements, the effect of changes to provisional, measurement period amounts calculated as if the accounting had been completed at the acquisition date and disclose the portion of the amount recorded in current-period earnings by line item that would have been recorded in previous reporting periods if the adjustment to the provisional amounts had been recognized as of the acquisition date. This guidance is effective for us as of the first quarter of our fiscal year ending February 28, 2017. We do not believe that this updated standard will have a material impact on our consolidated financial statements.

In April 2015, the FASB issued Accounting Standards Update 2015-03, *Interest Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs* (ASU 2015-03). The FASB issued ASU 2015-03 to simplify the presentation of debt issuance costs related to a recognized debt liability to present the debt issuance costs as a direct deduction from the carrying value of the debt liability rather than showing the debt issuance costs as a deferred charge on the balance sheet. This guidance is effective for fiscal years, and interim periods within those years, beginning after December 15, 2015, and is effective for us as of the first quarter of the fiscal year ending February 28, 2017. We do not believe that this updated standard will have a material impact on the Company s consolidated financial statements.

In May 2014, the FASB issued Accounting Standards Update 2014-09, *Revenue from Contracts with Customers* (ASU 2014-09). The FASB issued ASU 2014-09 to clarify the principles for recognizing revenue and to develop a common revenue standard for GAAP and International Financial Reporting Standards. The standard outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes the most current revenue recognition guidance. This guidance is effective for fiscal years and interim periods within those years beginning after December 15, 2017, which is effective for us as of the first quarter of the fiscal year ending February 28, 2019. We are evaluating the impact that the implementation of this standard will have on our consolidated financial statements.

ITEM 4. CONTROLS AND PROCEDURES

Role of Controls and Procedures

Our management, including our chief executive officer and chief financial officer, does not expect that our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) or our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934) will prevent all errors 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 the 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 a 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 and 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. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected. Also projections of any evaluation of effectiveness of controls and procedures to future periods are subject to the risk that the controls and procedures may become inadequate because of changes in conditions, or that the degree of compliance with the controls and procedures may have deteriorated.

Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our chief executive officer and chief financial officer, evaluated the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report. Based on this evaluation, our chief executive officer and chief financial officer concluded that, as of the end of the period covered by this report, our disclosure controls and procedures were effective at a reasonable assurance level.

Changes in Internal Control Over Financial Reporting

No changes in our internal control over financial reporting occurred during the fiscal quarter covered by this report that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents

PART II

ITEM 1. LEGAL PROCEEDINGS

The Company experiences routine litigation in the normal course of its business, including patent litigation. The Company presently believes that the outcome of this routine litigation will not have a material adverse effect on its financial position, results of operations or cash flows.

ITEM 1A. RISK FACTORS

Set forth below are certain risks and cautionary statements, which supplement other disclosures in this report. Please carefully consider the following risks and cautionary statements. If any event related to the following risk factors occurs, our business, financial condition, operating results and cash flows could be materially adversely affected.

RISKS RELATED TO BUSINESS UNCERTAINTY

We face intense competition.

The enterprise software industry is rapidly evolving and intensely competitive, and is subject to changing technologies, shifting customer needs, and frequent introductions of new products and services. We compete based on our ability to provide our customers with enterprise software offerings that best meet their needs at a compelling price. We expect that competition will continue to be intense, and there is a risk that our competitors products may provide better performance or include additional features when compared to our offerings. Competitive pressures could also affect the prices we may charge or the demand for our offerings, resulting in reduced profit margins and loss of market share.

Our current and potential competitors range from large and well-established companies to emerging start-ups. Some of our competitors have significantly greater financial resources and name recognition, larger development and sales staffs and more extensive marketing and distribution capabilities. Certain competitors also bundle hardware and software offerings, making it more difficult for us to penetrate their customer bases. As the enterprise software industry evolves, the competitive pressure for us to innovate encompasses a wider range of products and services, including new offerings that require different expertise than our current offerings. Some competitors may be able to innovate and provide products and services faster than we can.

Given the rapid evolving nature of the enterprise software industry, the competitive landscape and the nature of the competition is constantly changing. Industry consolidation may affect competition by creating larger and potentially stronger competitors in the markets in which we compete. Moreover, other companies may currently be planning to or are under pressure by stockholders to divest businesses. These divestitures may result in additional competitors that may have an advantage by focusing on a single product or service. We also compete in certain areas with our partners and potential partners, and this may adversely impact our relationship with an individual partner or a number of partners.

Our efforts to compete effectively may not be sufficient, which may adversely affect our business, financial condition, operating results and cash flows.

Our continued success depends on our ability to adapt to a rapidly changing industry. Investment in new offerings, business strategies and initiatives could disrupt our ongoing business and may present risks not originally contemplated.

We operate in highly competitive markets that are characterized by rapid technological change and frequent new product and service announcements. Our continued success will depend on our ability to adapt to rapidly changing technologies, to adapt our offerings to evolving industry standards, to predict user preferences and

industry changes and to improve the performance and reliability of our offerings. Our failure to adapt to such changes could harm our business. In addition, the widespread adoption of other technological changes could require substantial expenditures on our part to modify or adapt our offerings or infrastructure. Delays in developing, completing or delivering new or enhanced offerings and technologies could result in delayed or reduced revenue for those offerings and could also adversely affect customer acceptance of those offerings and technologies. The success of new and enhanced offering introductions depends on several factors, including our ability to invest significant resources in research and development in order to enhance our existing offerings and introduce new offerings in a timely manner, successfully promote the offerings, manage the risks associated with the offerings, make sufficient resources available to support the offerings and address any quality or other defects in the early stages of introduction.

Moreover, we believe that our continued success depends on our investing in new business strategies or initiatives that complement our strategic direction and technology road map. Such endeavors may involve significant risks and uncertainties, including distraction of management s attention away from other business operations, and insufficient revenue generation to offset liabilities and expenses undertaken with such strategies and initiatives. Because these endeavors may be inherently risky, no assurance can be given that such endeavors will not adversely affect our business, financial condition, operating results and cash flows.

If we fail to continue to establish and maintain strategic 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 relationships with industry-leading cloud service providers, hardware original equipment manufacturers, independent software vendors and system integrators, such as Amazon.com, Inc., Cisco Systems, Inc., Dell Inc., Fujitsu Limited, Hewlett-Packard Co., International Business Machines Corporation, NEC Corporation, Oracle Corporation, SAP AG and others. Many of these strategic partners have engineered and certified that their products and services run on or with our offerings, and in some cases have built their products using our offerings. We may not be able to maintain these relationships or replace them on attractive terms in the future. Some of our strategic partners offer competing products and services. As a result of these factors, many of the companies with which we have strategic alliances may choose to pursue alternative technologies and develop alternative products and services in addition to or in lieu of our offerings, 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 offerings effectively or continue to devote the resources necessary to provide us with effective sales, marketing and technical support. As our agreements with strategic partners terminate or expire, we may be unable to renew or replace these agreements on comparable terms, or at all.

We rely, to a significant degree, on indirect sales channels for the distribution of our offerings, and disruption within these channels could adversely affect our business, financial condition, operating results and cash flows.

We use a variety of different indirect distribution methods for our offerings, including channel partners, such as cloud service providers, distributors, embedded technology partners, hardware original equipment manufacturers, independent software vendors, system integrators and value added resellers. A number of these partners in turn distribute via their own networks of channel partners with whom we have no direct relationship. These relationships allow us to offer our technologies to a much larger customer base than we would otherwise be able through our direct sales and marketing efforts.

We rely, to a significant degree, on each of our channel partners to select, screen and maintain relationships with its distribution network and to distribute our offerings in a manner that is consistent with applicable law and regulatory requirements and our quality standards. If our channel partners or a partner in its distribution network violate

applicable law or regulatory requirements or misrepresent the functionality of our offerings, our reputation could be damaged and we could be subject to potential liability. Furthermore, our channel partners may offer their own products and services that are competitive with our offerings or may not distribute and

market our offerings effectively. Moreover, our existing channel partner relationships do not, and any future channel partner relationships may not, afford us any exclusive marketing or distribution rights. In addition, if a channel partner is acquired by a competitor or its business units are reorganized or divested, our revenue derived from that partner may be adversely impacted.

Recruiting and retaining qualified channel partners and training them in the use of our enterprise technologies requires significant time and resources. If we fail to devote sufficient resources to support and expand our network of channel partners, our business may be adversely affected. In addition, because we rely on channel partners for the indirect distribution of our enterprise technologies, we may have little or no contact with the ultimate end-users of our technologies, thereby making it more difficult for us to establish brand awareness, ensure proper delivery and installation of our software, support ongoing customer requirements, estimate end-user demand, respond to evolving customer needs and obtain subscription renewals from end-users.

A portion of our sales to government entities have been made indirectly through our channel partners. Government entities may have statutory, contractual, or other legal rights to terminate contracts with our channel partners for convenience or due to a default, and any such termination may adversely impact our future operating results. Governments routinely investigate and audit government contractors administrative processes, and any unfavorable audit could result in the government refusing to continue buying our offerings, a reduction of revenue or fines or civil or criminal liability if the audit uncovers improper or illegal activities.

If our indirect distribution channel is disrupted, we may be required to devote more resources to distribute our offerings directly and support our customers, which may not be as effective and could lead to higher costs, reduced revenue and growth that is slower than expected.

We have entered into and may continue to enter into or seek to enter into business combinations and acquisitions, which may be difficult to complete and integrate, disrupt our business, divert management s attention, adversely affect our business, financial condition, operating results and cash flows or dilute stockholder value.

As part of our business strategy, we have in the past entered into business combinations and acquisitions, and we may continue to do so in the future. These types of transactions can increase the expense of running our business and present significant challenges and risks, including:

- Identifying acquisition targets that complement our strategic direction and technology road map;

- Integrating the acquired business accounting, financial reporting, management, information and information security, human resource and other administrative systems to permit effective management and reporting, and the lack of control if such integration is delayed or not implemented;

- Gathering full information regarding a business or technology prior to a transaction, including the identification and assessment of liabilities, claims or other circumstances that could result in litigation or regulatory exposure, unfavorable accounting treatment, unexpected tax implications and other adverse effects on our business;

Increasing or additional operating expenses related to the acquired business or technology;

Maintaining or establishing acceptable standards, controls, procedures and policies;

Disrupting of our ongoing business and distraction of management;

Impairing of relationships with our employees, partners or customers as a result of any integration of new management and other personnel, products or technology or as a result of the changes in the competitive landscape affected by the transaction;

Maintaining good relationships with customers or business partners of the acquired business;

Table of Contents

- Effectively evaluating of talent at an acquired business or cultural challenges associated with integrating employees from the acquired business into our organization;
- Losing of key employees of the acquired business;
- Incorporating and further developing acquired products or technology into our offerings and maintaining quality standards consistent with our brands;
- Achieving the expected benefits of the transaction, which may include generating greater market acceptance of our technologies, increasing our revenues or integrating the assets acquired into one or more of our current offerings;
- Incurring expenses related to the transaction;
- Assuming claims and liabilities we may assume from the acquired business or technology, or that are otherwise related to the transaction;
- Entering into new markets in which we have little or no experience or in which competitors may have stronger market positions;
- Impairing of intangible assets and goodwill acquired in transactions; and
- For foreign transactions, managing additional risks related to the integration of operations across different cultures and languages, and the economic, political, compliance and regulatory risks associated with specific countries.

There can be no assurance that we will manage these challenges and risks successfully. Moreover, if we are not successful in completing transactions that we have pursued or may pursue, our business may be adversely affected, and we may incur substantial expenses and divert significant management time and resources. In addition, in pursuing and completing such transactions, we could use substantial portions of our available cash as all or a portion of the purchase price for these transactions or as retention incentives to employees of the acquired business, or we may incur substantial debt. We could also issue additional securities as all or a portion of the purchase price for these transactions or as retention incentives to employees of the acquired business, which could cause our stockholders to suffer significant dilution. Any transaction may not generate additional revenue or profit for us, or may take longer to do so than expected, which may adversely affect our business, financial condition, operating results and cash flows.

The duration and extent of economic downturns, regional financial instability, and economic and market conditions generally could adversely affect our business, financial condition, operating results and cash flows.

Economic weakness and uncertainty, tightened credit markets and constrained IT spending from time to time contribute to slowdowns in the technology industry, as well as in the customer segments and geographic regions in

which we operate, which may result in reduced demand and increased price competition for our offerings. Our operating results in one or more geographic regions or customer segments may also be affected by uncertain or changing economic conditions within that region or segment. Continuing uncertainty about future economic conditions may, among other things, negatively impact our current and prospective customers and result in delays or reductions in technology purchases or lengthen our sales cycle. Adverse economic conditions also may negatively impact our ability to obtain payment for outstanding debts owed to us by our customers or other parties with whom we do business. In addition, these conditions may impact our investment portfolio, and we could determine that some of our investments have experienced an other-than-temporary decline in fair value, requiring an impairment charge that could adversely impact our financial condition and operating results. Also, these conditions may make it more difficult to forecast operating results. If global economic conditions, or economic conditions in the U.S., Europe, Asia or in other key geographic regions or customer segments, remain uncertain or persist, spread or deteriorate further, current and prospective customers may delay or reduce their IT spending, which could adversely affect our business, financial condition, operating results and cash flows.

If we fail to effectively manage our growth, our business, financial condition, operating results and cash flows could be adversely affected.

We have expanded our operations rapidly in recent years. For example, our total revenue increased from $1.53 billion for the fiscal year ended February 28, 2014 to $1.79 billion for the fiscal year ended February 28, 2015. Moreover, the total number of our employees increased from approximately 6,300 as of February 28, 2014 to approximately 7,300 as of February 28, 2015. In addition, we continue to explore ways to extend our offerings and geographic reach. Our growth has placed and will likely continue to place a strain on our management systems, information systems, resources and internal controls. Our ability to successfully provide our offerings and implement our business plan requires adequate information systems and resources, internal controls and oversight from our senior management. As we expand in international markets, these challenges increase as a result of the need to support a growing business in an environment of multiple languages, cultures, customs, legal systems, dispute resolution systems, regulatory systems and commercial practices. As we grow, (i) we may not be able to adequately screen and hire or adequately train, supervise, manage or develop sufficient personnel, and (ii) we may not be able to develop or effectively manage our controls, oversight functions or information systems. If we are unable to effectively manage our growth, our business, financial condition, operating results and cash flows could be adversely affected.

Industry consolidation and divestitures may lead to increased competition and may adversely affect our business, financial condition, operating results and cash flows.

There has been a trend of both consolidation and divestitures in the technology industry. We expect these trends to continue as companies attempt to strengthen or hold their market positions in an evolving industry. For example, as the computing, networking, storage, and software technologies that comprise the enterprise data center converge, many companies seek to position themselves as key or single-source vendors providing end-to-end technology solutions for the data center. Also, some of our current and potential competitors have made acquisitions or announced new strategic alliances designed to position them as a key or single-source vendor. As a result of these developments, we face greater competition, including competition from entities that are among our key business partners. This increased competition could adversely affect our business, financial condition, operating results and cash flows.

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

One of the characteristics of open source software is that anyone may modify and redistribute the existing open source software and use it to compete with us. Such competition can develop without the degree of overhead and lead time required by traditional proprietary software companies. It is possible for competitors with greater resources than ours to develop their own open source solutions, potentially reducing the demand for, and putting price pressure on, our offerings. In addition, some competitors make their open source software available for free download and use on an ad hoc basis or may position their open source software as a loss leader. We cannot guarantee that we will be able to compete successfully against current and future competitors or that competitive pressure and/or the availability of open source software will not result in price reductions, reduced operating margins and loss of market share, any one of which could adversely affect our business, financial condition, operating results and cash flows.

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

Our future success depends on the continued services and effectiveness of a number of key management personnel, including our CEO. The loss of these individuals, particularly to a competitor, some of which may be in a position to offer greater compensation, could adversely affect our business or stock price.

Our ability to retain key management personnel or hire capable new management personnel as we grow may be challenged to the extent that other companies are able to offer more attractive opportunities to the individuals we seek to hire or retain. In addition, historically we have used share-based compensation as a key component of

57

our compensation packages. Changes in the accounting for share-based compensation could adversely affect our earnings or make it more beneficial for us to use more cash compensation to attract and retain capable personnel. If the price of our common stock falls, the value of our share-based awards to recipients is reduced. Such events, or if we are unable to secure stockholder approval for increases in the number of shares eligible for share-based compensation grants, could adversely affect our ability to successfully attract and retain key management personnel. Effective succession planning is also important to our long-term success. Failure to ensure effective transfer of knowledge and smooth transitions involving key management personnel could hinder our strategic planning and execution.

We depend on our key non-management employees, and our inability to attract and retain such employees could adversely affect our business or diminish our brands.

Competition in our industry for qualified employees, especially technical employees, is intense and our competitors directly target our employees. Our inability to attract and retain key employees could hinder our influence in open source projects and seriously impede our success. Moreover, the loss of these individuals, particularly to a competitor, some of which may be in a position to offer greater compensation, and any resulting loss of customers could reduce our market share and diminish our brands. We have from time to time in the past experienced, and we may experience in the future, difficulty in hiring and retaining highly skilled employees with appropriate qualifications. Also, to the extent we hire personnel from competitors, we may be subject to allegations that they have been improperly solicited, that they have divulged proprietary or other confidential information, or that their former employers own their inventions or other work product.

A number of our key employees have become, or will become, vested in a significant amount of their equity compensation awards. Employees may be more likely to leave us after a significant portion of their equity compensation awards fully vest, especially if the shares underlying the equity awards have significantly appreciated in value. Additionally, as we grow, there may be less equity compensation to award per employee. If we do not succeed in attracting and retaining key personnel, our business, financial performance, operating results and cash flows may be adversely affected.

Our corporate culture has contributed to our success, and if we cannot maintain this culture as we grow, we could lose the innovation, creativity and collaboration fostered by our culture, and our business may be adversely affected.

We believe that a critical contributor to our success has been our corporate culture, which we believe fosters innovation, creativity and collaboration. As our organization grows, our employees (including remote workers) and our resources become more globally dispersed and our organizational management structures become more complex, we may find it increasingly difficult to maintain these beneficial aspects of our corporate culture. If we are unable to maintain our corporate culture, we may find it difficult to attract and retain motivated employees, continue to perform at current levels or execute on our business strategy. As a result, our business, financial condition, operating results and cash flows could be adversely affected.

Our subscription-based business model may encounter customer resistance or we may experience a decline in the demand for our offerings.

We provide Red Hat enterprise technologies primarily under annual or multi-year subscriptions. A subscription generally entitles a customer to, among other things, a specified level of support, as well as new versions of the software, security updates, fixes, functionality enhancements and upgrades to the technology, if and when available, and compatibility with an ecosystem of certified hardware and software. While we believe this practice complies with the requirements of the GNU General Public License, and while we have reviewed this practice with the Free

Software Foundation, the organization that maintains and provides interpretations of the GNU General Public License, we may still encounter customer resistance to this distribution model or customers may fail to honor the terms of our subscription agreements. To the extent we are unsuccessful in promoting or defending this distribution model, our business, financial condition, operating results and cash flows could be adversely affected.

Demand for our offerings depends substantially on the general demand for enterprise software, which fluctuates based on numerous factors, including the spending levels and growth of our current and prospective customers, and general economic conditions. In addition, our customers generally undertake a significant evaluation process that may result in a lengthy sales cycle. We spend substantial time, effort, and money on our sales efforts, including developing and implementing appropriate go-to-market strategies and training our sales force and channel partners in order to effectively market new offerings, without any assurance that our efforts will produce any sales. The purchase of our offerings may be discretionary and can involve significant expenditures. If our current and prospective customers cut costs, then they may significantly reduce their enterprise software expenditures.

As technologies and the markets for our enterprise offerings change, our subscription-based business model may no longer meet the needs of our customers. For example, a business model based on annual or multi-year subscriptions may no longer be competitive in an environment where disruptive technologies (such as virtualization and cloud) enable customers to consume computing resources on an hourly basis or for free. We also develop and offer these disruptive technologies with consumption-based pricing, which may have an effect on the demand for our subscription-based offerings.

An increased focus on developing and providing virtualization, storage and cloud offerings may require a greater focus on marketing more holistic solutions, rather than individual offerings. Consequently, we may need to develop appropriate marketing and pricing strategies for our offerings, our customers purchasing decisions may become more complex and require additional levels of approval and the duration of sales cycles for our offerings may increase.

If we are unable to adapt our business model to changes in the marketplace or if demand for our offerings declines, our business, financial condition, operating results and cash flows could be adversely affected.

If our customers do not renew their subscription agreements with us, or if they renew on less favorable terms, our business, financial results, operating results and cash flows may be adversely affected.

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

If third-party enterprise hardware and software providers do not continue to make their products and services compatible with our offerings, our software may cease to be competitive and our business, financial condition, operating results and cash flows may be adversely affected.

The competitive position of our offerings is dependent on their compatibility with products and services of third-party enterprise hardware and software companies. To the extent that a hardware or software vendor might have or develop products and services that compete with ours, the vendor may have an incentive to seek to limit the performance, functionality or compatibility of our offerings when used with one or more of the vendor s offerings. In addition, these vendors may fail to support or issue statements of compatibility or certification of our offerings when used with their offerings. We intend to encourage the development of additional applications that operate on both current and new

versions of our offerings by, among other means, attracting third-party developers to our offerings, providing open source tools to create these applications and maintaining our existing developer relationships through marketing and technical support. We intend to encourage the compatibility of

our software with various third-party hardware and software offerings by maintaining and expanding our relationships, both business and technical, with relevant independent hardware and software vendors. If we are not successful in achieving these goals, however, our offerings may not be competitive and our business, financial condition, operating results and cash flows may be adversely affected.

If open source software programmers, most of whom we do not employ, do not continue to develop and enhance open source technologies, we may be unable to develop new technologies, adequately enhance our existing technologies or meet customer requirements for innovation, quality and price.

We rely to a significant degree on a number of largely informal communities of independent open source software programmers to develop and enhance our enterprise technologies. For example, Linus Torvalds, a prominent open source software developer, and a relatively small group of software engineers, many of whom are not employed by us, are primarily responsible for the development and evolution of the Linux kernel, which is the heart of the Red Hat Enterprise Linux operating system. If these groups of programmers fail to adequately further develop and enhance open source technologies, we would have to rely on other parties to develop and enhance our offerings or we would need to develop and enhance our offerings with our own resources. We cannot predict whether further developments and enhancements to these technologies would be available from reliable alternative sources. In either event, our development expenses could be increased and our technology release and upgrade schedules could be delayed. Moreover, if third-party software programmers fail to adequately further develop and enhance open source technologies, the development and adoption of these technologies could be stifled and our offerings could become less competitive. Delays in developing, completing or delivering new or enhanced offerings could result in delayed or reduced revenue for those offerings and could also adversely affect customer acceptance of those offerings.

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

Despite our testing procedures, errors have been and may continue to be found in our offerings after deployment. This risk is increased by the fact that much of the code in our offerings is developed by independent parties over whom we exercise no supervision or control. If errors are discovered, we may have to make significant expenditures of capital and devote significant technical resources to analyze, correct, eliminate or work around them, and we may not be able to successfully do so in a timely manner or at all. Errors and failures in our offerings could result in a loss of, or delay in, market acceptance of our enterprise technologies, loss of existing or potential customers and delayed or lost revenue and could damage our reputation and our ability to convince enterprise users of the benefits of our technologies.

In addition, errors in our technologies could cause system failures, loss of data or other adverse effects for our customers who may assert warranty and other claims for substantial damages against us. Although our agreements with our customers often contain provisions which seek to limit our exposure to potential product liability claims, it is possible that these provisions may not be effective or enforceable under the laws of some jurisdictions. While we seek to insure against these types of claims, our insurance policies may not adequately limit our exposure to such claims. These claims, even if unsuccessful, could be costly and time-consuming to defend and could adversely affect our business, financial conditions, operating results and cash flows.

Our virtualization, storage and cloud offerings are based on emerging technologies and business models, and the potential market for these offerings remains uncertain.

Our virtualization, storage and cloud offerings are based on emerging technologies and business models, the success of which will depend on the perceived technological and operational benefits and cost savings associated with the

adoption of these technologies. Virtualization, storage and cloud technologies are rapidly evolving, and their development is a complex and uncertain process requiring high levels of innovation and investment as well as the accurate anticipation of technology trends, market demand and customer needs. We expect competition to remain intense and, as with many emerging IT sectors, these technologies may be subject to a first mover

60

effect pursuant to which certain product offerings rapidly capture a significant portion of market share and developer attention. Moreover, we may make errors in reacting to relevant business trends and predicting which technologies are successful or otherwise develop into industry standards.

Adoption of virtualization, storage and cloud offerings may occur more slowly or less pervasively than we expect and the revenue growth associated with these offerings may be slower than currently expected. Moreover, even if virtualization, storage and cloud technologies are adopted widely by enterprises, our offerings in these areas may not attract a sufficient number of users or generate attractive financial results. We incur expenses associated with these offerings in advance of our ability to generate associated revenue. Demand for our virtualization, storage and cloud offerings may unfavorably impact demand for our other offerings, including software subscriptions and related professional services. If the market for our virtualization, storage and cloud offerings fails to develop adequately, it could have an adverse effect on our business, financial condition, operating results and cash flows.

Our continued success depends on our ability to maintain and enhance strong brands.

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

If our growth rate slows, our stock price could be adversely affected.

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

Security breaches and data loss may expose us to liability, harm our reputation and adversely affect our business.

Our business involves the production and distribution of enterprise software technologies, as well as hosting applications. As part of our business, we (or third parties with whom we contract) receive, store and process our data, as well as our customers and partners data. While we take security and testing measures relating to our offerings and operations, those measures may not prevent security breaches and data loss that could harm our business or the businesses of our customers and partners. Advances in computer capabilities, new discoveries in the field of cryptography, inadequate technology or facility security measures or other factors may result in data loss or a compromise or breach of our systems and the data we receive, store and process (or systems and the data received, stored and processed by third parties with whom we contract). These security measures may be breached or data lost as a result of actions by third parties, employee error (such as weak passwords or unencrypted devices), malfeasance or vulnerabilities or security bugs found in software code. A party who is able to circumvent security measures or exploit inadequacies in security measures, could, among other things, misappropriate proprietary information (including information about our employees, customers and partners, our customers information, financial data and data that others could use to compete against us), cause the loss or disclosure of some or all of this information, cause interruptions or denial of service in our or our customers operations, cause delays in development efforts or expose customers (and their customers) to computer viruses or other disruptions or vulnerabilities. A compromise to these

systems could remain undetected for an extended period of time, exacerbating the impact of that compromise. These risks may increase as we continue to grow our cloud and services offerings and as we receive, store and process more of our customers data. Actual or perceived vulnerabilities may lead to regulatory investigations, claims against us by customers, partners or other

third parties, or costs, such as those related to providing customer notifications and fraud monitoring. While our customer agreements typically contain provisions that seek to limit our liability, there is no assurance these provisions will be enforceable and effective under applicable law. In addition, the cost and operational consequences of implementing further data protection measures could be significant. Moreover, because the techniques used to obtain unauthorized access, disable or degrade service or sabotage systems change frequently and often are not recognized until launched against a target, we may be unable to anticipate these techniques or to implement adequate preventative measures. Any loss of data or compromise of our systems or the data we receive, store or process (or systems and the data received, stored and processed by third parties with whom we contract) could result in a loss of confidence in the security of our offerings, damage our reputation, loss of channel or strategic partners, lead to legal liability and adversely affect our business, financial condition, operating results and cash flows.

We are vulnerable to technology infrastructure failures, which could harm our reputation and adversely affect our business.

We rely on our technology infrastructure, and the technology infrastructure of third parties, for many functions, including selling our offerings, supporting our partners, fulfilling orders and billing, collecting and making payments. This technology infrastructure may be vulnerable to damage or interruption from natural disasters, power loss, telecommunication failures, terrorist attacks, computer intrusions, vulnerabilities and viruses, software errors, computer denial-of-service attacks and other events. A significant number of the systems making up this infrastructure are not redundant, and our disaster recovery planning may not be sufficient for every eventuality. This technology infrastructure may fail or be vulnerable to damage or interruption because of actions by third parties or employee error or malfeasance. We may not carry business interruption insurance sufficient to protect us from all losses that may result from interruptions in our services as a result of technology infrastructure failures or to cover all contingencies. Any interruption in the availability of our websites and on-line interactions with customers or partners may cause a reduction in customer or partner satisfaction levels, which in turn could cause additional claims, reduced revenue or loss of customers or partners. Despite any precautions we may take, such problems could result in, among other consequences, a loss of data, loss of confidence in the stability and reliability of our offerings, damage to our reputation, and legal liability, all of which may adversely affect our business, financial condition, operating results and cash flows interruptions.

A decline in or reprioritization of funding in the U.S. or foreign government budgets or delays in the budget process could adversely affect our business, financial condition, operating results and cash flows.

We derive, and expect to continue to derive, a portion of our revenue from U.S. and foreign governments. Government deficit reduction and austerity measures, along with continued economic challenges, continue to place pressure on U.S. and foreign government spending. The termination of, or delayed or reduced funding for, government-sponsored programs and contracts from which we derive revenue could adversely affect our business, financial condition, operating results and cash flows.

We may be unable to predict the future course of open source technology development, which could reduce the market appeal of our offerings, damage our reputation and adversely affect our business, financial condition, operating results and cash flows.

We do not exercise control over many aspects of the development of open source technology. Different groups of open source software programmers compete with one another to develop new technology. Typically, the technology developed by one group will become more widely used than that developed by others. If we acquire or adopt new technology and incorporate it into our offerings but competing technology becomes more widely used or accepted, the market appeal of our offerings may be reduced and that could harm our reputation, diminish our brands and adversely

affect our business, financial condition, operating results and cash flows.

Table of Contents

We include software licensed from other parties in our offerings, the loss of which could increase our costs and delay availability of our offerings.

We utilize various types of software licensed from unaffiliated third parties in our offerings. Aspects of our business could be disrupted if any of the software we license from others or functional equivalents of this software were no longer available to us, no longer offered to us on commercially reasonable terms or changed in ways or included defects that made the third-party software unsuitable for our use. In these cases, we would be required to either redesign our technologies to function with software available from other parties, develop these components ourselves or eliminate the functionality, which could result in increased costs, the need to mitigate customer issues, delays in delivery of our offerings and the release of new offerings and limit the features available in our current or future offerings.

RISKS RELATED TO LEGAL UNCERTAINTY

If our technologies are found or alleged to infringe third-party intellectual property rights, we may be required to take costly and time-consuming actions to meet our commitments to customers.

We regularly commit to our subscription customers that if portions of our offerings are found to infringe third-party intellectual property rights we will, at our expense and option: (i) obtain the right for the customer to continue to use the technology consistent with their subscription agreement with us; (ii) modify the technology so that its use is non-infringing; or (iii) replace the infringing component with a non-infringing component, and indemnify them against specified infringement claims. Although we cannot predict whether we will need to satisfy these commitments and we often have limitations on these commitments, satisfying the commitments could be costly, be time-consuming, divert the attention of technical and management personnel, and adversely affect our business, financial condition, operating results and cash flows. In addition, our insurance policies would likely not adequately cover our exposure to this type of claim. Finally, because we have agreed to indemnify our subscription customers against specified infringement claims arising from the use of our offerings, we could become involved in litigation brought against such customers if our services and technology are allegedly implicated.

We are vulnerable to claims that our technologies infringe third-party intellectual property rights and an unfavorable legal decision affecting our intellectual property could adversely affect our business.

We are vulnerable to claims that our technologies infringe third-party intellectual property rights, including patents, copyrights, trademarks and trade secrets, because our technologies are comprised of software components, many of which are developed by numerous independent parties. We are also unlikely to be able to assess adequately the relevance of patents to our technologies, and may be unable to take appropriate responsive action in a timely or economic manner because, among other reasons, the scope of software patent protection is often not well defined or readily determinable, patent applications in the U.S. are not publicly disclosed at the time of filing, and the number of software patents that are issued each year is significant and growing. Our exposure to risks associated with the use of intellectual property may increase as a result of acquisitions. In addition, third parties may make infringement and similar or related claims after we have acquired technology that had not been asserted prior to our acquisition of such technology.

In the past, our technologies have been subject to intellectual property infringement claims. Some of these claims have been brought by entities that do not design, manufacture, or distribute products or services or that acquire intellectual property like patents for the sole purpose of monetizing their acquired intellectual property through asserting claims of infringement. As these entities do not have operating businesses of their own and therefore have limited risk of counterclaims for damages or injunctive relief, it may be difficult to deter them from bringing intellectual property

infringement claims. We expect to face the possibility of more intellectual property infringement claims as our prominence increases, business activities expand, market share and revenue grow, the number of products and competitors in our industry grows and the functionality of products in different portions of the industry overlap. We may not be able to accurately assess the risk related to these suits, and we may be unable to accurately assess our level of exposure.

Defending patent and other intellectual property claims, even claims without significant merit, can be time-consuming, costly and can divert the attention of technical and management personnel. We may receive unfavorable preliminary or interim rulings in the course of litigation, and there can be no assurances that favorable final outcomes will be obtained in all cases. We may decide to settle certain lawsuits and disputes on terms that are disadvantageous to us. Similarly, if any litigation to which we are a party is resolved adversely, we may be subject to an unfavorable judgment that may not be reversed upon appeal. The terms of such a settlement or judgment may require us to cease offering certain of our technologies or pay substantial amounts to the other party. In addition, we may have to seek a license to continue offering technologies found to be in violation of a third party s rights, which may not be available on reasonable terms, or at all, and may significantly increase our operating costs and expenses. As a result, we may also be required to develop alternative non-infringing technology or practices or discontinue the practices. The development of alternative non-infringing technology or practices could require significant effort and expense or may not be feasible.

An unfavorable legal decision regarding the intellectual property in and to our technology and other offerings could adversely affect our business, financial condition, operating results and cash flows. See Part II, Item 1, Legal Proceedings for additional information.

Our activities, or the activities of our partners, may violate anti-corruption laws and regulations that apply to us.

In many foreign countries, particularly in certain developing economies, it is not uncommon to engage in business practices that are prohibited by regulations that may apply to us, such as the U.S. Foreign Corrupt Practices Act and similar laws. Although we have policies and procedures designed to help promote compliance with these laws, our employees, contractors, partners and agents, as well as those companies to which we outsource certain of our business operations, may take actions in violation of our policies and procedures. Any violation of these laws and regulations could result in fines, criminal sanctions against us, our officers, or our employees, prohibitions on the conduct of our business, and damage to our reputation.

We could be prevented from selling or developing our software if the GNU General Public License and similar licenses under which our technologies are developed and licensed are not enforceable or are modified so as to become incompatible with other open source licenses.

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

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

Our collection of trademarks is valuable and important to our business. The protective steps we have taken in the past may have been, and may in the future continue to be, inadequate to protect and deter misappropriation of our trademark rights. We may be unable to detect the unauthorized use of, or take appropriate steps to enforce, our trademark rights in a timely manner. We have registered some of our trademarks in countries in North America, South America, Europe, Asia, Africa and Australia and have other trademark applications pending in various countries around the world. Effective trademark protection may not be available in every country in

which we offer or intend to distribute our offerings. We may be unable to prevent third parties from acquiring domain names that are similar to, infringe upon, or diminish the value of our trademarks and other proprietary rights. Failure to adequately protect our trademark rights could damage or even destroy one or more of our brands and impair our ability to compete effectively. Furthermore, defending or enforcing our trademark rights could result in the expenditure of significant financial and managerial resources.

Efforts to assert intellectual property ownership rights in our technologies could impact our standing in the open source community, which could limit our technology innovation capabilities and adversely affect our business.

When we undertake actions to protect and maintain ownership and control over our intellectual property, including patents, copyrights and trademark rights, our standing in the open source community could be adversely affected. This in turn could limit our ability to continue to rely on this community, upon which we are dependent, as a resource to help develop and improve our technologies and further our research and development efforts, and could adversely affect our business.

Our Patent Promise on software patents limits our ability to enforce our patent rights in certain circumstances.

As part of our commitment to the open source community, we provide our Patent Promise on software patents. Under our Patent Promise, we agree, subject to certain limitations, not to enforce our patent rights against users of open source software covered by certain open source licenses, including the GNU General Public License version 2.0 and version 3.0, GNU Lesser General Public License version 2.1 and version 3.0, IBM Public License version 1.0, Common Public License version 1.0, Q Public License version 1.0, Open Software License version 3.0 and any other open source license granted by Red Hat. While we may be able to claim protection of our intellectual property under other rights, such as trade secrets or contractual rights, our Patent Promise effectively limits our ability to assert our patent rights against these third parties (even if we were to conclude that their use infringes our patents with competing offerings), unless any such third party asserts its patent rights against us. This limitation on our ability to assert our patent rights against others could harm our business and ability to compete.

We are, and may become, involved in disputes and lawsuits that could adversely affect our business.

Lawsuits or legal proceedings may be commenced against us. These disputes and proceedings may involve significant expense and divert the attention of management and other employees. If we do not prevail in these matters, we could be required to pay substantial damages or settlement costs, which could adversely affect our business, financial condition, operating results and cash flows. See Part II, Item 1, Legal Proceedings for additional information.

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

Our business is subject to federal, state and international laws regarding privacy and protection of user data. We post, on our website, our privacy policies and practices concerning the use and disclosure of user data. As Internet commerce continues to evolve, increasing regulation by federal, state or foreign agencies becomes more likely. The introduction of new offerings by us may cause new and different regulations to apply to our business. New or increased laws and regulations applying to the solicitation, collection, processing, protection, use or other treatment of information could affect our ability to use and share data, or the adoption of our cloud offerings by customers.

It is possible that these laws may be interpreted and applied in a manner that is inconsistent with our data policies and practices. If so, in addition to the possibility of fines and penalties, a governmental order could require that we change

our data policies and practices. Compliance with these regulations may involve significant costs or require changes in business practices that result in reduced revenue. Noncompliance could result in penalties being imposed on us or orders that we cease conducting the noncompliant activity.

Any failure or perceived failure by us to comply with our posted privacy policies or other federal, state or international privacy-related or data protection laws, government regulations or directives, or industry self-regulatory principles, or a requirement to change our data practices could have an adverse effect on our business, financial condition, operating results and cash flows.

If we fail to comply with our customer contracts or government contracting regulations, our business could be adversely affected.

Our contracts with our customers may include specialized performance requirements. In particular, our contracts with federal, state, provincial and local governmental customers are subject to various government certification requirements, procurements regulations, contract provisions and other requirements relating to their formation, administration and performance. Any failure by us or our channel partners to comply with the specific provisions in our customer contracts or any violation of government contracting regulations by us or our channel partners could result in the imposition of various civil and criminal penalties, which may include termination of contracts, forfeiture of profits, suspension of payments and, in the case of our government contracts, fines and suspension from future government contracting. In addition, we may be subject to *qui tam* litigation, the process by which a private individual sues or prosecutes on behalf of the government relating to government contracts and shares in the proceeds of any successful litigation or settlement, which could include claims for up to treble damages. Further, any negative publicity related to our customer contracts or any proceedings surrounding them, regardless of its accuracy, may damage our business and affect our ability to compete for new contracts. There is increased pressure for governments and their agencies, both domestically and internationally, to reduce spending. If our customer contracts are terminated, if we are suspended from government work, if we are unable to meet government certification requirements, or if our ability to compete for new contracts is adversely affected, we could suffer an adverse effect on our business, financial condition, operating results and cash flows.

We may be subject to legal liability associated with providing online services or content.

We provide offerings, such as OpenShift by Red Hat, that enable users to exchange information, advertise products and services, conduct business, and engage in various online activities. The law relating to the liability of providers of these online offerings for activities of their users is relatively unsettled and still developing both in the U.S. and internationally and may be significantly different from jurisdiction to jurisdiction. Claims could be brought against us based on the nature and content of information that we publish or to which we provide links or that may be posted online or generated by us or by third parties, including our customers. In addition, we could be subject to domestic or international actions alleging that certain content we have generated or third-party content that we have made available within our services violates applicable law.

RISKS RELATED TO FINANCIAL UNCERTAINTY

Our quarterly and annual operating results may not be a reliable indicator of our future financial performance.

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

We may not be able to meet the financial and operational challenges that we will encounter as our international operations, which represented approximately 42.8% of our total revenue for the fiscal year ended February 28, 2015, continue to expand.

Our international operations accounted for approximately 42.8% of total revenue for the fiscal year ended February 28, 2015. As we expand our international operations, we may have difficulty managing and administering a globally dispersed business and we may need to expend additional funds to, among other activities, reorganize our sales force and technical support services team, outsource or supplement general and administrative functions, staff key management positions, obtain additional information technology infrastructure and successfully localize offerings for a significant number of international markets, which may adversely affect our operating results. Additional challenges associated with the conduct of our business globally that may adversely affect our operating results include:

- Fluctuations in exchange rates;
- Pricing environments;
- Longer payment cycles and less financial stability of customers;
- Economic, political, compliance and regulatory risks associated with specific countries;
- Laws and policies of the U.S. and other jurisdictions affecting trade, foreign investment, loans, and taxes;
- Difficulty selecting and monitoring channel partners;
- Lower levels of availability or use of the Internet, through which our software is often delivered;
- Difficulty protecting our intellectual property rights globally due to, among other reasons, the uncertainty of laws and enforcement in certain countries relating to the protection of intellectual property rights;
- Difficulty in staffing, developing and managing foreign operations as a result of distance, language, legal, cultural and other differences;
- Different employee/employer relationships and the existence of works councils and labor unions;
- Difficulty maintaining quality standards consistent with the our brands;

- Export and import laws and regulations that could prevent us from delivering our offerings into and from certain countries;

- Public health risks and natural disasters, particularly in areas in which we have significant operations;

- Limitations on the repatriation and investment of funds and foreign currency exchange restrictions;

- Changes in import/export duties, quotas or other trade barriers that could affect the competitive pricing of our offerings and reduce our market share in some countries; and

- Economic or political instability or terrorist acts in some international markets that could adversely affect our business in those markets or result in the loss or forfeiture of some foreign assets and the loss of sums spent developing and marketing those assets and the revenue associated with them.

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

A substantial portion of our revenue is derived from our Red Hat Enterprise Linux platform.

During our fiscal year ended February 28, 2015, a substantial portion of our subscription revenue was derived from our Red Hat Enterprise Linux offerings. Although we are continuing to develop other offerings, we expect that revenue from Red Hat Enterprise Linux will constitute a majority of our revenue for the foreseeable future. Declines and variability in demand for Red Hat Enterprise Linux could occur as a result of:

- competitive products and pricing;

- failure to release new or enhanced versions of Red Hat Enterprise Linux on a timely basis, or at all;
- technological change that we are unable to address with Red Hat Enterprise Linux; or
- future economic conditions.

Additionally, as more customers and potential customers virtualize their data centers and move computing projects to cloud environments, demand for operating systems such as Red Hat Enterprise Linux may decline. Moreover, as data centers become more virtualized and move to cloud environments, we may experience a decline in growth if we are unsuccessful in adapting our business model and offerings accordingly. Due to the concentration of our revenue from Red Hat Enterprise Linux, our business, financial condition, operating results and cash flows could be adversely affected by a decline in demand for Red Hat Enterprise Linux.

We are subject to risks of currency fluctuations and related hedging operations.

A portion of our business is conducted in currencies other than the U.S. dollar. Changes in exchange rates among other currencies and the U.S. dollar may affect our revenue, operating expenses and operating margins, which are reported in U.S. dollars. We cannot predict the impact of future exchange rate fluctuations. As we expand international operations, our exposure to exchange rate fluctuations may increase. We use financial instruments, primarily forward purchase contracts, to economically hedge currency commitments arising from trade accounts receivable, trade accounts payable and fixed purchase obligations. If these hedging activities are not successful or we change or reduce these hedging activities in the future, we may experience significant unexpected expenses from fluctuations in exchange rates. For information regarding our hedging activity, see Part I, Item 3, Quantitative and Qualitative Disclosures About Market Risk .

We may be subject to greater tax liabilities.

We are subject to income and other taxes in the U.S. and in numerous foreign jurisdictions. Our domestic and foreign tax liabilities are subject to the allocation of revenue and expenses in different jurisdictions. Additionally, the amount of taxes paid is subject to our interpretation of applicable tax laws in the jurisdictions in which we operate. Significant judgment is required in determining our worldwide provision for income taxes. In the ordinary course of our business, there are many transactions and calculations where the ultimate tax determination is uncertain. We are regularly subject to audits by tax authorities. Although we believe our tax estimates are reasonable, the final determination of tax audits and any related litigation could be materially different from our historical income tax provisions and accruals. Economic and political pressures to increase tax revenue in various jurisdictions may make resolving tax disputes more difficult. The results of an audit or litigation could adversely affect our financial statements in the period or periods for which that determination is made.

We earn a significant amount of our operating income from outside the U.S., and any repatriation of funds currently held in foreign jurisdictions may result in higher effective tax rates for the company. In addition, there have been proposals to change U.S. tax laws that would significantly impact how U.S. multinational corporations are taxed on foreign earnings. Although we cannot predict whether or in what form this proposed legislation may pass, if enacted it could adversely affect our tax expense and cash flows.

Because we recognize revenue from subscriptions for our service over the term of the subscription, downturns or upturns in sales may not be immediately reflected in our operating results.

We generally recognize subscription revenue from customers ratably over the term of their subscription agreements, which are generally 12 to 36 months. As a result, much of the revenue we report in each quarter is deferred revenue from subscription agreements entered into during previous quarters. Consequently, a decline in subscriptions in any one quarter will not necessarily be fully reflected in the revenue in that quarter and will negatively affect our revenue in future quarters. In addition, we may be unable to adjust our cost structure to reflect this reduced revenue. Accordingly, the effect of significant downturns in sales and market acceptance of our service, and potential changes in our rate of renewals, may not be fully reflected in our operating results until future periods. Our subscription model also makes it difficult for us to rapidly increase our revenue through

additional sales in any period, as revenue from new customers must be recognized over the applicable subscription term.

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

Under generally accepted accounting principles, we review our amortizable intangible assets for impairment when events or changes in circumstances indicate the carrying value may not be recoverable. Goodwill is required to be tested for impairment at least annually. Factors that may be considered a change in circumstances indicating that the carrying value of our goodwill or amortizable intangible assets may not be recoverable include a decline in stock price and market capitalization, reduced future cash flow estimates and slower growth rates in our industry. We may be required to record a significant charge to earnings in our financial statements during the period in which any impairment of our goodwill or amortizable intangible assets is determined, which could adversely affect our operating results.

We may be exposed to potential risks if we do not have an effective system of disclosure controls or internal controls.

We must comply, on an on-going basis, with the requirements of the Sarbanes-Oxley Act of 2002, including those provisions that establish the requirements for both management and auditors of public companies with respect to reporting on internal control over financial reporting. We cannot be certain that measures we have taken, and will take, will be sufficient or timely completed to meet these requirements on an on-going basis, or that we will be able to implement and maintain adequate disclosure controls and controls over our financial processes and reporting in the future, particularly in light of our rapid growth, international expansion and changes in our offerings, which are expected to result in on-going changes to our control systems and areas of potential risk.

If we fail to maintain an effective system of disclosure controls or internal control over financial reporting, including satisfaction of the requirements of the Sarbanes-Oxley Act, we may not be able to accurately or timely report on our financial results or adequately identify and reduce fraud. As a result, the financial condition of our business could be adversely affected; current and potential future stockholders could lose confidence in us and/or our reported financial results, which may cause a negative effect on our trading price; and we could be exposed to litigation or regulatory proceedings, which may be costly or divert management attention.

Changes in accounting principles and guidance, or their interpretation, could result in unfavorable accounting charges or effects, including changes to previously filed financial statements, which could cause our stock to decline.

We prepare our consolidated financial statements in accordance with accounting principles generally accepted in the U.S. These principles are subject to interpretation by the Securities and Exchange Commission and various bodies formed to interpret and create appropriate accounting principles and guidance. A change in these principles or guidance, or in their interpretations, may have a significant effect on our reported results and may retroactively affect previously reported results.

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

We maintain an investment portfolio of various holdings, types and maturities. Our portfolio as of February 28, 2015 consisted primarily of money market funds, U.S. government and agency securities, European sovereign and agency securities with a rating of AA or higher, certificates of deposit, and corporate securities. Although we follow an established investment policy and seek to minimize the risks associated with our investments by investing primarily in investment grade, highly liquid securities and by limiting the amounts

invested with any one institution, type of security or issuer, we cannot give assurances that the assets in our investment portfolio will not lose value or become impaired, or that our interest income will not decline.

A significant part of our investment portfolio consists of U.S. government and agency securities. If global credit and equity markets experience prolonged periods of decline, or if there is a default or downgrade of U.S. government or agency debt, our investment portfolio may be adversely impacted and we could determine that some of our investments have experienced an other-than-temporary decline in fair value, requiring impairment charges that could adversely affect our financial condition and operating results.

Future fluctuations and uncertainty in economic and market conditions could adversely affect the market value of our investments, and we could record additional impairment charges and lose some or all of the principal value of investments in our portfolio. A total loss of an investment or a significant decline in the value of our investment portfolio could adversely affect our financial condition and operating results. For information regarding the sensitivity of and risks associated with the market value of portfolio investments and interest rates, see Part I, Item 3, Quantitative and Qualitative Disclosures About Market Risk .

Our investments in private companies are subject to risk of loss of investment capital. Some of these investments may have been made to further our strategic objectives and support our key business initiatives. Our investments in private companies are inherently risky because the markets for the technologies they have under development are typically in the early stages and may never materialize. We could lose the value of our entire investment in these companies.

Epidemics, geo-political events, Internet and power outages or natural disasters could adversely affect our business, financial condition, operating results and cash flows.

The occurrence of one or more epidemics, geo-political events (such as civil unrest or terrorist attacks), Internet and power outages or natural disasters in a country in which we operate or in which technology industry suppliers or our customers are located, could adversely affect our business, financial condition, operating results and cash flows. Such events could result in physical damage to, or the complete loss of, one or more of our facilities, the lack of an adequate work force in a market, the inability of our customers to access our offerings, the inability of our associates to reach or have transportation to our facilities directly affected by such events, the evacuation of the populace from areas in which our facilities are located, changes in the purchasing patterns of our customers, the temporary or long-term disruption in the supply of computer hardware and related components, the disruption or delay in the manufacture and transport of goods globally, the disruption of utility services to our facilities or to suppliers, partners or customers, or disruption in our communications with our customers.

RISKS RELATED TO THE CONVERTIBLE NOTES

The convertible notes are effectively subordinated to any secured debt we incur in the future and to any liabilities of our subsidiaries.

In October 2014, we issued $805.0 million of 0.25% Convertible Senior Notes due 2019 (the convertible notes). The convertible notes will rank senior in right of payment to any of our indebtedness that is expressly subordinated in right of payment to the convertible notes; equal in right of payment to any of our existing and future indebtedness and other liabilities that are not so subordinated; effectively junior in right of payment to any of our secured indebtedness to the extent of the value of the assets securing such indebtedness; and structurally junior to all existing and future indebtedness and other liabilities of our subsidiaries (including trade payables). In the event of our bankruptcy, liquidation, reorganization or other winding up, our assets that secure debt ranking senior in right of payment to the convertible notes will be available to pay obligations on the convertible notes only after the secured debt has been

repaid in full from these assets, and the assets of our subsidiaries will be available to pay obligations on the convertible notes only after all claims senior to the convertible notes have

been repaid in full. There may not be sufficient assets remaining to pay amounts due on any or all of the convertible notes then outstanding.

We may still incur substantially more debt or take other actions that could diminish our ability to make payments on the convertible notes.

We and our subsidiaries may be able to incur substantial additional debt in the future, subject to the restrictions contained in our future debt instruments, some of which may be secured debt. We are not restricted under the terms of the indenture governing the convertible notes from incurring additional debt, securing existing or future debt, recapitalizing our debt or taking a number of other actions that are not limited by the terms of the indenture governing the convertible notes that could have the effect of diminishing our ability to make payments on the convertible notes when due.

We may not have the ability to raise the funds necessary to settle conversions of the convertible notes in cash, repay the convertible notes at maturity or repurchase the convertible notes upon a fundamental change, and our future debt may contain limitations on our ability to pay cash upon conversion or repurchase of the convertible notes.

Holders of the convertible notes will have the right to require us to repurchase all or a portion of their convertible notes upon the occurrence of a fundamental change at a repurchase price equal to 100% of the principal amount of the convertible notes to be repurchased, plus accrued and unpaid interest, if any. In addition, upon conversion of the convertible notes, unless we elect to deliver solely shares of our common stock to settle such conversion (other than paying cash in lieu of delivering any fractional share), we will be required to make cash payments in respect of the convertible notes being converted. However, we may not have enough available cash or be able to obtain financing at the time we are required to make repurchases of the convertible notes surrendered therefor or pay cash with respect to the convertible notes being converted or at their maturity.

In addition, our ability to repurchase or to pay cash upon conversions of the convertible notes may be limited by law, regulatory authority or agreements governing our future indebtedness and is dependent on our future performance, which is subject to economic, financial, competitive and other factors beyond our control. Our failure to repurchase the convertible notes at a time when the repurchase is required by the indenture or to pay any cash payable on future conversions of the convertible notes as required by the indenture would constitute a default under the indenture. A fundamental change under the indenture or a default under the indenture could also lead to a default under agreements governing our future indebtedness. If the repayment of the related indebtedness were to be accelerated after any applicable notice or grace periods, we may not have sufficient funds to repay the indebtedness and repurchase the convertible notes or make cash payments upon conversions thereof.

The conditional conversion feature of the convertible notes, if triggered, may adversely affect our financial condition and operating results.

In the event the conditional conversion feature of the convertible notes is triggered, holders of the convertible notes will be entitled to convert the convertible notes at any time during specified periods at their option. If one or more holders elect to convert their convertible notes, unless we elect to satisfy our conversion obligation by delivering solely shares of our common stock (other than paying cash in lieu of delivering any fractional share), we would be required to settle a portion or all of our conversion obligation through the payment of cash, which could adversely affect our liquidity. In addition, even if holders do not elect to convert their convertible notes, we could be required under applicable accounting rules to reclassify all or a portion of the outstanding principal of the convertible notes as a current rather than long-term liability, which would result in a material reduction of our net working capital.

The accounting method for convertible debt securities that may be settled in cash, such as the convertible notes, could have a material effect on our reported financial results.

Accounting Standards Codification Subtopic 470-20, Debt with Conversion and Other Options (ASC 470-20), requires an entity to separately account for the liability and equity components of convertible debt instruments (such as the convertible notes) that may be settled entirely or partially in cash upon conversion in a manner that reflects the issuer s non-convertible debt interest rate. Accordingly, the equity component of the convertible notes is required to be included in the additional paid-in capital section of stockholders equity on our consolidated balance sheet, and the value of the equity component is treated as original issue discount for purposes of accounting for the debt component of the convertible notes. As a result, we are required to recognize a greater amount of non-cash interest expense in our consolidated income statements in the current and future periods presented as a result of the amortization of the discounted carrying value of the convertible notes to their principal amount over the term of the convertible notes. We will report lower net income (or greater net losses) in our consolidated financial results because ASC 470-20 will require interest to include both the current period s amortization of the original issue discount and the instrument s non-convertible interest rate. This could adversely affect our reported or future consolidated financial results, the trading price of our common stock and the trading price of the convertible notes.

In addition, under certain circumstances, in calculating earnings per share, convertible debt instruments (such as the convertible notes) that may be settled entirely or partly in cash are currently accounted for utilizing the treasury stock method, the effect of which is that the shares of common stock issuable upon conversion of the convertible notes, if any, are not included in the calculation of diluted earnings per share except to the extent that the conversion value of the convertible notes exceeds their principal amount. Under the treasury stock method, diluted earnings per share is calculated as if the number of shares of common stock that would be necessary to settle such excess, if we elected to settle such excess in shares, were issued. We cannot be sure that the accounting standards in the future will continue to permit the use of the treasury stock method. If we are unable to use the treasury stock method in accounting for the shares issuable upon conversion of the convertible notes, if any, then our diluted consolidated earnings per share would be adversely affected.

The convertible note hedge and warrant transactions may affect the value of our common stock.

In connection with the sale of the convertible notes, we entered into convertible note hedge transactions with institutions that we refer to as the option counterparties. We also entered into warrant transactions with the option counterparties pursuant to which we sold warrants for the purchase of our common stock. The convertible note hedge transactions are expected to offset the potential dilution to our common stock upon any conversion of convertible notes and/or offset any cash payments we are required to make in excess of the principal amount upon conversion of any convertible notes. The warrant transactions could separately have a dilutive effect to the extent that the market price per share of our common stock exceeds the strike price of the relevant warrants, unless, subject to certain conditions, we elect to settle the warrants in cash.

The option counterparties or their respective affiliates may modify their hedge positions by entering into or unwinding various derivatives with respect to our common stock and/or purchasing or selling our common stock or other securities of ours in secondary market transactions prior to the maturity of the convertible notes (and are likely to do so during any observation period related to a conversion of convertible notes or following any repurchase of convertible notes by us in connection with any fundamental change repurchase date or otherwise). This activity could suppress or inflate the market price of our common stock.

We do not make any representation or prediction as to the direction or magnitude of any potential effect that the transactions described above may have on the price of the convertible notes or our common stock. In addition, we do

not make any representation that the option counterparties or their respective affiliates will engage in these transactions or that these transactions, once commenced, will not be discontinued without notice.

Table of Contents

We are subject to counterparty risk with respect to the convertible note hedge transactions.

The option counterparties are financial institutions or affiliates of financial institutions, and we will be subject to the risk that these option counterparties may default under the convertible note hedge transactions. Our exposure to the credit risk of the option counterparties will not be secured by any collateral. If one or more of the option counterparties to one or more of our convertible note hedge transactions becomes subject to insolvency proceedings, we will become an unsecured creditor in those proceedings with a claim equal to our exposure at the time under those transactions. Our exposure will depend on many factors but, generally, the increase in our exposure will be correlated to the increase in the market price of our common stock and in the volatility of the market price of our common stock. In addition, upon a default by one of the option counterparties, we may suffer dilution with respect to our common stock as well as adverse financial consequences. We can provide no assurances as to the financial stability or viability of any of the option counterparties.

RISKS RELATED TO OWNERSHIP OF OUR COMMON STOCK

Our stock price has been volatile historically and may continue to be volatile.

The trading price of our common stock has been and may continue to be subject to wide fluctuations. Our stock price may fluctuate in response to a number of events and factors, such as quarterly variations in operating results, announcements of technological innovations or new offerings by us or our competitors, announcements relating to strategic decisions, announcements related to key personnel, customer purchase delays, service disruptions, changes in financial estimates and recommendations by securities analysts, the operating and stock price performance of other companies that investors may deem comparable to us, news reports relating to trends in our markets, general economic conditions and other risks listed herein.

The sale of our common stock by significant stockholders may cause the price of our common stock to decrease.

Several of our stockholders own significant portions of our common stock. If these stockholders were to sell all or a portion of their holdings of our common stock, then the market price of our common stock could be negatively impacted. The effect of such sales, or of significant portions of our stock being offered or made available for sale, could result in strong downward pressure on our stock price. Investors should be aware that they could experience significant short-term volatility in our stock if such stockholders decide to sell all or a portion of their holdings of our common stock at once or within a short period of time.

We may issue additional shares of our common stock or instruments convertible into shares of our common stock and thereby materially and adversely affect the market price of our common stock.

We are not restricted from issuing additional shares of our common stock or other instruments convertible into, or exchangeable or exercisable for, shares of our common stock. If we issue additional shares of our common stock or instruments convertible into shares of our common stock, it may materially and adversely affect the market price of our common stock.

In addition, a substantial number of shares of our common stock is reserved for instruments issued under our equity compensation plans, including for the issuance upon the exercise of stock options and the vesting of performance share units, restricted stock, restricted stock units and deferred stock units, upon conversion of the convertible notes, and in relation to the convertible note hedge and warrant transactions entered into in connection with the convertible notes. We may not be able to predict the size of future issuances or the effect, if any, that they may have on the market price for our common stock. The issuance and sale of substantial amounts of common stock, or the perception that

such issuances and sales may occur, could adversely affect the market price of our common stock and impair our ability to raise capital through the sale of equity or equity-linked securities.

We do not currently expect to pay dividends on our common stock, so any returns may be limited to changes in the value of our common stock.

We have never declared or paid any cash dividends on our common stock. We currently anticipate that we will retain future earnings for the development, operation and expansion of our business and do not anticipate declaring or paying any cash dividends for the foreseeable future. In addition, our ability to pay cash dividends on our common stock may be prohibited or limited by the terms of any future debt financing arrangement. Any return to stockholders will therefore be limited to the increase, if any, of our stock price.

Conversion of the convertible notes may dilute the ownership interest of existing stockholders, including holders who had previously converted their convertible notes, or may otherwise depress the price of our common stock.

The conversion of the convertible notes into shares of our common stock, to the extent that we choose not to deliver all cash for the conversion value, will dilute the ownership interests of existing stockholders. Any sales in the public market of the common stock issuable upon conversion of the convertible notes could adversely affect prevailing market prices of our common stock. In addition, the existence of the convertible notes may encourage short selling by market participants due to this dilution or may facilitate trading strategies involving the convertible notes and our common stock.

Provisions of our certificate of incorporation, by-laws, Delaware law and the convertible notes may have anti-takeover effects that could prevent a change in control even if the change in control would be beneficial to our stockholders.

Provisions of our certificate of incorporation, by-laws and Delaware law could make it more difficult for a third party to acquire us, even if doing so would be beneficial to our stockholders. These provisions include:

- our Board of Directors has the right to elect directors to fill a vacancy created by the expansion of the Board of Directors or the resignation, death or removal of a director, which prevents stockholders from being able to fill vacancies on our Board of Directors;

- stockholders must provide advance notice to nominate individuals for election to the Board of Directors or to propose matters that can be acted upon at a stockholders meeting; such provisions may discourage or deter a potential acquirer from conducting a solicitation of proxies to elect the acquirer s own slate of directors or otherwise attempting to obtain control of our company; and

- our Board of Directors may issue, without stockholder approval, shares of undesignated preferred stock; the ability to issue undesignated preferred stock makes it possible for our Board of Directors to issue preferred stock with voting or other rights or preferences that could impede the success of any attempt to acquire us.

Further, as a Delaware corporation, we are also subject to certain Delaware law anti-takeover provisions. Under Delaware law, a corporation may not engage in a business combination with any holder of 15% or more of its capital stock unless the holder has held the stock for three years or, among other things, the Board of Directors has approved the transaction. Our Board of Directors could rely on Delaware law to prevent or delay an acquisition of us. Additionally, certain provisions of the convertible notes could make it more difficult or more expensive for a third

party to acquire us or could also have the effect of delaying or reducing the likelihood of a change in control of us even if such acquisition or change of control may be favorable to our stockholders.

Table of Contents

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS
Issuer Purchases of Equity Securities

The table below sets forth information regarding the Company s purchases of its common stock during its third fiscal quarter ended November 30, 2015:

Issuer Purchases of Equity Securities

Period	Total Number of Shares Purchased (1)	Weighted Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (2)	Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs (2)
September 1, 2015 September 30, 2015		$		$ 429.9 million
October 1, 2015 October 31, 2015	767,325	$ 77.68	409,400	$ 398.2 million
November 1, 2015 November 30, 2015	577,800	$ 80.40	577,800	$ 351.7 million
Total	1,345,125		987,200	

(1) During the three months ended November 30, 2015, the Company withheld an aggregate of 357,925 shares of its common stock (with a weighted average share price of $77.89) from employees to satisfy minimum tax withholding obligations relating to the vesting of share awards. These shares were not withheld pursuant to the program described in Note (2) below.

(2) On March 25, 2015, the Company announced that its Board of Directors has authorized the repurchase of up to $500.0 million of Red Hat s common stock from time to time on the open market or in privately negotiated transactions. The program commenced on April 1, 2015, and will expire on the earlier of (i) March 31, 2017, or (ii) a determination by the Board, Chief Executive Officer or Chief Financial Officer to discontinue the program.

Table of Contents

ITEM 6. EXHIBITS

(a) List of Exhibits

Exhibit No.	Exhibit
31.1	Certification of the registrant s Chief Executive Officer pursuant to Rule 13a-14(a)/Rule 15d-14(a) under the Securities Exchange Act of 1934, as amended, 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 15d-14(a) under the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification of the registrant s principal executive officer and principal financial officer pursuant to 18 U.S.C. Section 1350
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema
101.CAL	XBRL Taxonomy Extension Calculation Linkbase
101.DEF	XBRL Taxonomy Extension Definition Linkbase
101.LAB	XBRL Taxonomy Extension Label Linkbase
101.PRE	XBRL Taxonomy Extension Presentation Linkbase

SIGNATURES

Pursuant to the requirements 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.

Date: January 8, 2016 By: /S/ JAMES M. WHITEHURST

James M. Whitehurst

President and Chief Executive Officer

(Duly Authorized Officer on Behalf of the Registrant)

RED HAT, INC.

Date: January 8, 2016 By: /S/ FRANK A. CALDERONI

Frank A. Calderoni

Executive Vice President, Operations and

Chief Financial Officer

(Principal Financial Officer)