RED HAT INC
Form DEFM14A
December 12, 2018
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

SCHEDULE 14A

Proxy Statement Pursuant to Section 14(a) of the

Securities Exchange Act of 1934

(Amendment No.)

Filed by the Registrant Filed by a Party other than the Registrant

Check the appropriate box:

Preliminary Proxy Statement

Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))

Definitive Proxy Statement

Definitive Additional Materials

Soliciting Material under §240.14a-12

RED HAT, INC.

(Name of Registrant as Specified In Its Charter)

N/A

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

Payment of Filing Fee (Check the appropriate box):

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(3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (set forth the amount on which the filing fee is calculated and state how it was determined):

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Table of Contents

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Table of Contents

MERGER PROPOSAL YOUR VOTE IS VERY IMPORTANT

December 12, 2018

Dear Red Hat Stockholders,

It is my pleasure to invite you to a special meeting of stockholders, which we refer to as the special meeting, of Red Hat, Inc., which we refer to as Red Hat, to be held at 100 East Davie Street, Raleigh, North Carolina 27601 on January 16, 2019, at 9:00 a.m., Eastern time. I hope that you will be able to attend.

At the special meeting, you will be asked to consider and vote on a proposal to adopt the Agreement and Plan of Merger (as it may be amended from time to time), dated as of October 28, 2018, which we refer to as the merger agreement, by and among Red Hat, International Business Machines Corporation, which we refer to as IBM, and Socrates Acquisition Corp., which we refer to as Sub, a wholly-owned subsidiary of IBM. Pursuant to the terms of the merger agreement, Sub will merge with and into Red Hat, with Red Hat surviving the merger as a wholly-owned subsidiary of IBM, which we refer to as the merger. You also will be asked to consider and vote on (i) a proposal to approve, by means of a non-binding, advisory vote, compensation that will or may become payable to the named executive officers of Red Hat in connection with the merger and (ii) a proposal to approve one or more adjournments of the special meeting to a later date or dates, if necessary or appropriate, to solicit additional proxies if there are insufficient votes to adopt the merger agreement at the then-scheduled date and time of the special meeting.

If the merger is completed, you will be entitled to receive $190.00 in cash, without interest, for each share of our common stock, par value $0.0001, which we refer to as Red Hat common stock, you own (unless you have properly exercised your appraisal rights with respect to such shares), which represents a premium of (i) approximately 62.8% to Red Hat s closing stock price on October 26, 2018, the last trading day prior to the announcement of the merger, (ii) approximately 51.7% to the volume weighted average stock price of Red Hat common stock during the 30 days ended October 26, 2018 and (iii) approximately 7.8% to the highest closing stock price of Red Hat common stock during the 52-week period ended October 26, 2018.

The receipt of cash in exchange for shares of Red Hat common stock pursuant to the merger will generally be a taxable transaction to U.S. holders (as defined in the accompanying proxy statement) for United States federal income tax purposes. For a more complete description, see the section entitled Proposal 1: Adoption of the Merger Agreement The Merger U.S. Federal Income Tax Consequences of the Merger beginning on page 79 of the accompanying proxy statement.

The Red Hat Board of Directors, after considering the reasons more fully described in this proxy statement and after consultation with independent legal and financial advisors, unanimously determined that the terms of the merger agreement, the merger and the other transactions contemplated by the merger agreement are fair to and in the best interests of Red Hat and its stockholders, and adopted, approved and declared advisable the execution, delivery and performance of the merger agreement, the merger and the other transactions contemplated by the merger agreement. The Red Hat Board of Directors recommends that you vote:

(i) FOR the proposal to adopt the merger agreement, thereby approving the merger and the other transactions contemplated by the merger agreement;

(ii) FOR the proposal to approve, by means of a non-binding, advisory vote, compensation that will or may become payable to the named executive officers of Red Hat in connection with the merger; and

(iii) FOR the proposal to approve one or more adjournments of the special meeting to a later date or dates, if necessary or appropriate, to solicit additional proxies if there are insufficient votes to adopt the merger agreement at the then-scheduled date and time of the special meeting.

Table of Contents

The enclosed proxy statement provides detailed information about the special meeting, the merger agreement and the merger. A copy of the merger agreement is attached as Annex A to the proxy statement. The proxy statement also describes the actions and determinations of our Board of Directors in connection with its evaluation of the merger agreement and the merger. We encourage you to read the proxy statement and its annexes, including the merger agreement, carefully and in their entirety. You may also obtain more information about Red Hat from documents we file with the U.S. Securities and Exchange Commission, which we refer to as the SEC, from time to time.

Whether or not you plan to attend the special meeting in person, please complete, sign, date and return, as promptly as possible, the enclosed proxy card in the accompanying prepaid reply envelope or grant your proxy electronically over the Internet or by telephone. If you attend the special meeting and vote in person by ballot, your vote will revoke any proxy that you have previously submitted. If you hold your shares in street name, you should instruct your broker, bank or other nominee how to vote in accordance with the voting instruction form you will receive from your broker, bank or other nominee.

Your vote is very important, regardless of the number of shares that you own. We cannot complete the merger unless the proposal to adopt the merger agreement is approved by the affirmative vote of a majority of the shares of Red Hat common stock outstanding and entitled to vote thereon. The failure of any stockholder to vote in person by ballot at the special meeting, to submit a signed proxy card or to grant a proxy electronically over the Internet or by telephone will have the same effect as a vote AGAINST the proposal to adopt the merger agreement. If you hold your shares in street name, the failure to instruct your broker, bank or other nominee on how to vote your shares will have the same effect as a vote AGAINST the proposal to adopt the merger agreement.

If you have any questions or need assistance voting your shares of Red Hat common stock, please contact Innisfree M&A Incorporated, our proxy solicitor, by calling (888) 750-5835 toll-free.

On behalf of our Board of Directors, I thank you for your support and appreciate your consideration of this matter.

Sincerely,

James M. Whitehurst
President and Chief Executive Officer

Neither the SEC nor any state securities regulatory agency has approved or disapproved of the transactions described in this document, including the merger, or determined if the information contained in this document is accurate or adequate. Any representation to the contrary is a criminal offense.

The accompanying proxy statement is dated December 12, 2018 and, together with the enclosed form of proxy card, is first being mailed to Red Hat stockholders on or about December 13, 2018.

Table of Contents

NOTICE OF SPECIAL MEETING OF STOCKHOLDERS

TO BE HELD ON JANUARY 16, 2019

NOTICE IS HEREBY GIVEN that a special meeting of stockholders, which we refer to as the special meeting, of Red Hat, Inc., which we refer to as Red Hat, will be held:

TIME AND DATE:	9:00 a.m., Eastern time, on January 16, 2019
PLACE:	100 East Davie Street, Raleigh, North Carolina 27601
ITEMS OF BUSINESS:	1. To consider and vote on the proposal to adopt the Agreement and Plan of Merger (as it may be amended from time to time), dated as of October 28, 2018, which we refer to as the merger agreement, by and among Red Hat, International Business Machines Corporation, which we refer to as IBM, and Socrates Acquisition Corp., a wholly-owned subsidiary of IBM, a copy of which is attached as Annex A to the proxy statement accompanying this notice, which proposal we refer to as the merger proposal; 2. To consider and vote on the proposal to approve, by means of a non-binding, advisory vote, compensation that will or may become payable to the named executive officers of Red Hat in connection with the merger, which proposal we refer to as the merger-related compensation proposal; and 3. To consider and vote on the proposal to approve one or more adjournments of the special meeting to a later date or dates, if necessary or appropriate, to solicit additional proxies if there are insufficient votes to adopt the merger agreement at the then-scheduled date and time of the special meeting, which proposal we refer to as the adjournment proposal.
ADJOURNMENTS AND POSTPONEMENTS:	Any action on the items of business described above may be considered at the special meeting or at any time and date to which the special meeting may be properly adjourned or postponed.
RECORD DATE:	Stockholders of record at the close of business on December 11, 2018 are entitled to notice of, and to vote at, the special meeting and at any adjournments or postponements thereof.
INSPECTION OF LIST OF STOCKHOLDERS OF RECORD:	A list of stockholders of record will be available for inspection at our corporate headquarters located at 100 East Davie Street, Raleigh, North Carolina 27601, during ordinary business hours during the 10-day period before the special meeting.
VOTING:	Whether or not you plan to attend the special meeting, we urge you to vote your shares via the toll-free telephone number or over the Internet as described in the proxy materials. You may also sign, date and mail the proxy card in the pre-paid envelope provided.

IMPORTANT INFORMATION:

Your vote is very important to us. The merger contemplated by the merger agreement, which we refer to as the merger, is conditioned on the receipt of, and we cannot consummate the merger unless the merger proposal receives, the

Table of Contents

affirmative vote of a majority of the shares of Red Hat s common stock, par value $0.0001, which we refer to as Red Hat common stock, outstanding and entitled to vote thereon.

The affirmative vote of a majority of the shares of Red Hat common stock outstanding and entitled to vote thereon, provided a quorum is present, is required to approve the merger proposal. The affirmative vote of a majority of the voting power of the shares of Red Hat common stock entitled to vote which are present, in person or by proxy, and voting at the special meeting, provided a quorum is present, is required to approve, by means of a non-binding, advisory vote, the merger-related compensation proposal. The affirmative vote of a majority of the voting power of the shares of Red Hat common stock entitled to vote which are present, in person or by proxy, at the special meeting, whether or not a quorum is present, is required to approve the adjournment proposal.

The failure of any stockholder of record to submit a signed proxy card, grant a proxy electronically over the Internet or by telephone or to vote in person by ballot at the special meeting will have the same effect as a vote **AGAINST** the merger proposal but will not have any effect on the merger-related compensation proposal or the adjournment proposal. If you hold your shares in street name, the failure to instruct your broker, bank or other nominee on how to vote your shares will have the same effect as a vote **AGAINST** the merger proposal but will not have any effect on the merger-related compensation proposal or the adjournment proposal. Abstentions will have the same effect as a vote **AGAINST** the merger proposal and the adjournment proposal, but will not have any effect on the merger-related compensation proposal.

Stockholders who do not vote in favor of the merger proposal will have the right to seek appraisal of the fair value of their shares of Red Hat common stock if they deliver a demand for appraisal before the vote is taken on the merger proposal and comply with all applicable requirements under Delaware law, which are summarized herein and reproduced in their entirety in Annex D to the accompanying proxy statement.

The Board of Directors recommends that you vote (i) FOR the merger proposal, (ii) FOR the merger-related compensation proposal and (iii) FOR the adjournment proposal.

Raleigh, North Carolina By Order of the Board of Directors,

December 12, 2018

Michael R. Cunningham

Secretary

Table of Contents

YOUR VOTE IS IMPORTANT

WHETHER OR NOT YOU PLAN TO ATTEND THE SPECIAL MEETING, WE URGE YOU TO VOTE YOUR SHARES VIA THE TOLL-FREE TELEPHONE NUMBER OR OVER THE INTERNET AS DESCRIBED IN THE PROXY MATERIALS. YOU MAY ALSO SIGN, DATE AND MAIL THE PROXY CARD IN THE PRE-PAID ENVELOPE PROVIDED. You may revoke your proxy or change your vote at any time before the special meeting. If your shares are held in the name of a broker, bank or other nominee, please follow the instructions on the voting instruction card furnished to you by such broker, bank or other nominee, which is considered the stockholder of record, in order to vote. As a beneficial owner, you have the right to direct your broker, bank or other nominee on how to vote the shares in your account. Your broker, bank or other nominee cannot vote on any of the proposals, including the proposal to adopt the merger agreement, without your instructions.

If you fail to return your proxy card, to grant your proxy electronically over the Internet or by telephone, or to vote by ballot in person at the special meeting, your shares will not be counted for purposes of determining whether a quorum is present at the special meeting. If you are a stockholder of record, voting in person by ballot at the special meeting will revoke any proxy that you previously submitted. If you hold your shares through a broker, bank or other nominee, you must obtain from the record holder a valid proxy issued in your name in order to vote in person at the special meeting.

We encourage you to read the accompanying proxy statement, including all documents incorporated by reference into the accompanying proxy statement, and annexes to the accompanying proxy statement, carefully and in their entirety. If you have any questions concerning the merger, the special meeting or the accompanying proxy statement, would like additional copies of the accompanying proxy statement or need help voting your shares of common stock, please contact our proxy solicitor:

Innisfree M&A Incorporated

501 Madison Avenue, 20th Floor

New York, New York 10022

Toll-free: (888) 750-5835

Banks & Brokers may call collect: (212) 750-5833

Table of Contents

TABLE OF CONTENTS

	Page
PROXY SUMMARY	1
Parties Involved in the Merger (page 31)	1
Certain Effects of the Merger on Red Hat (page 33)	2
Effect on Red Hat if the Merger is Not Completed (page 33)	2
Merger Consideration (page 84)	3
The Special Meeting (page 26)	3
Recommendation of Our Board of Directors and Reasons for the Merger (page 42)	5
Opinions of Red Hat s Financial Advisors (page 47)	5
Financing of the Merger (page 79)	7
Treatment of Equity Compensation (page 84)	7
Interests of the Non-Employee Directors and Executive Officers of Red Hat in the Merger (page 72)	9
Appraisal Rights (page 116)	9
U.S. Federal Income Tax Consequences of the Merger (page 79)	9
Regulatory Approvals (page 81)	10
No Solicitation (page 92)	10
Change of Recommendation (page 94)	11
Conditions to the Closing of the Merger (page 102)	12
Termination of the Merger Agreement (page 104)	12
Termination Fee (page 106)	13
Market Prices and Dividend Data (page 111)	13
QUESTIONS AND ANSWERS	15
FORWARD-LOOKING STATEMENTS	24
THE SPECIAL MEETING	26
Date, Time and Place	26
Purpose of the Special Meeting	26
Record Date; Shares Entitled to Vote; Quorum	26
Vote Required; Abstentions and Broker Non-Votes	26
Shares Held by Red Hat s Directors and Executive Officers	27
Voting of Proxies	27
Revocability of Proxies	28
Board of Directors Recommendation	28
Tabulation of Votes	29
Solicitation of Proxies	29
Anticipated Date of Completion of the Merger	29
Attending the Special Meeting	29
Assistance	30
Rights of Stockholders Who Seek Appraisal	30
PARTIES INVOLVED IN THE MERGER	31
PROPOSAL 1: ADOPTION OF THE MERGER AGREEMENT	33
THE MERGER	33
Certain Effects of the Merger on Red Hat	33
Effect on Red Hat if the Merger is Not Completed	33
Background of the Merger	33

Recommendation of Our Board of Directors and Reasons for the Merger 42
Opinions of Red Hat s Financial Advisors 47
Financial Forecast 69
Interests of the Non-Employee Directors and Executive Officers of Red Hat in the Merger 72

Table of Contents

	Page
Financing of the Merger	79
U.S. Federal Income Tax Consequences of the Merger	79
Regulatory Approvals	81
TERMS OF THE MERGER AGREEMENT	83
Structure of the Merger	83
Closing and the Effective Time of the Merger	83
Directors and Officers; Certificate of Incorporation; Bylaws	84
Merger Consideration	84
Representations and Warranties	87
Conduct of Business Pending the Merger	89
Additional Agreements	92
Other Covenants and Agreements	102
Conditions to the Closing of the Merger	102
Termination of the Merger Agreement	104
Expenses	107
Amendment and Waiver	107
Governing Law	107
Specific Performance	108
PROPOSAL 2: ADVISORY VOTE ON MERGER-RELATED EXECUTIVE COMPENSATION ARRANGEMENTS	109
The Merger-Related Compensation Proposal	109
Vote Required and Board of Directors Recommendation	109
PROPOSAL 3: ADJOURNMENT OF THE SPECIAL MEETING	110
The Adjournment Proposal	110
Vote Required and Board of Directors Recommendation	110
MARKET PRICES AND DIVIDEND DATA	111
SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT	112
Ownership by Our Directors and Executive Officers	112
Ownership of More than 5% of Our Common Stock	113
APPRAISAL RIGHTS	116
FUTURE STOCKHOLDER PROPOSALS	121
HOUSEHOLDING INFORMATION	122
WHERE YOU CAN FIND MORE INFORMATION	123
MISCELLANEOUS	125

Annexes

Annex A Agreement and Plan of Merger	A-1
Annex B Opinion of Guggenheim Securities, LLC	B-1
Annex C Opinion of Morgan Stanley & Co. LLC	C-1
Annex D Section 262 of the General Corporation Law of the State of Delaware	D-1

Table of Contents

PROXY SUMMARY

This summary highlights selected information from this proxy statement related to the merger (as defined below). This summary may not contain all of the information that is important to you. To understand the merger more fully and for a more complete description of the legal terms of the merger, you should read carefully this entire proxy statement, the annexes to this proxy statement, including the merger agreement (as defined below), and the documents incorporated by reference in this proxy statement. You may obtain the documents and information incorporated by reference in this proxy statement without charge by following the instructions under the section entitled Where You Can Find More Information beginning on page 123. The merger agreement is attached as Annex A to this proxy statement.

Except as otherwise specifically noted in this proxy statement or as the context otherwise requires, Red Hat, the Company or we, our, us and similar words in this proxy statement refer to Red Hat, Inc. including, in certain cases, its subsidiaries. Throughout this proxy statement we refer to International Business Machines Corporation, a New York corporation, as IBM and to Socrates Acquisition Corp., a Delaware corporation and wholly-owned subsidiary of IBM, as Sub . In addition, throughout this proxy statement we refer to the Agreement and Plan of Merger (as it may be amended from time to time), dated as of October 28, 2018, by and among Red Hat, IBM and Sub, as the merger agreement . All references to the merger refer to the merger of Sub with and into Red Hat with Red Hat surviving as a wholly-owned subsidiary of IBM. Red Hat, following completion of the merger, is sometimes referred to in this proxy statement as the surviving corporation .

Parties Involved in the Merger (page 31)

Red Hat, Inc.

Red Hat is a leading provider of open source software solutions, using a community-powered approach to develop and offer reliable and high-performing operating system, virtualization, management, middleware, cloud, mobile and storage technologies. Red Hat employs an open source development model, which allows Red Hat to use the collective input, resources and knowledge of a global community of contributors who can collaborate to develop, maintain and enhance software because the human-readable source code for that software is publicly available and licenses permit modification.

Red Hat s offerings are designed to provide customers with high-performing, scalable, flexible, reliable and secure infrastructure technologies that meet the information technology, which we refer to as IT, needs of enterprises and service providers. Our offerings enable our customers to optimize their IT environments to increase agility and flexibility while adding and managing hybrid cloud infrastructures and building modern applications. Hybrid cloud infrastructures enable customers to deploy their applications using off-premise (public cloud) and on-premise (private cloud, virtual or physical server) IT resources to create a hybrid cloud environment that is designed to enhance efficiency while providing increased security. Red Hat s offerings are designed to perform consistently across hybrid cloud environments to offer greater choices to our customers when deploying their applications.

Red Hat also offers a wide range of services that are designed to help customers receive additional value from Red Hat technologies.

Red Hat s corporate headquarters is located at 100 East Davie Street, Raleigh, North Carolina 27601.

Red Hat was formed in 1993 and is a corporation organized in the State of Delaware. Red Hat common stock, par value $0.0001 per share, which we refer to as Red Hat common stock, is currently listed on the New York Stock

Exchange, which we refer to as the NYSE, under the symbol RHT.

Table of Contents

Additional information about Red Hat and its subsidiaries is included in documents incorporated by reference in this proxy statement (see the section entitled Where You Can Find More Information beginning on page 123) and on its website: www.redhat.com. The information provided or accessible through Red Hat s website is not part of, or incorporated by reference in, this proxy statement.

International Business Machines Corporation

IBM focuses on the intersection of business insight and technology innovation and creates value for clients through integrated solutions and products. These integrated solutions leverage innovative technologies, deep expertise in industries and business processes, and a commitment to security and trust. IBM solutions typically create value by enabling new capabilities for clients that optimize and transform their businesses and help them engage with their customers and employees in new ways. These solutions draw from an industry-leading portfolio of consulting and IT implementation services, cloud and cognitive offerings, and enterprise systems and software, one of the world s leading research organizations all bolstered by a commitment to the secure and responsible management of data and enterprise-grade security.

IBM s corporate headquarters is located at 1 New Orchard Road, Armonk, New York 10504.

IBM was formed in 1911 as the Computing-Tabulating-Recording Company and is a corporation organized in the State of New York. IBM s common stock, par value $0.20 per share, is currently listed on the NYSE, under the symbol IBM.

Additional information about IBM and its subsidiaries is included on its website: www.IBM.com. The information provided or accessible through IBM s website is not part of, or incorporated by reference in, this proxy statement.

Socrates Acquisition Corp.

Sub is a Delaware corporation and a wholly-owned subsidiary of IBM, formed on October 25, 2018, solely for the purpose of engaging in the merger and the other transactions as contemplated under the merger agreement. Upon completion of the merger, Sub will cease to exist.

Certain Effects of the Merger on Red Hat (page 33)

Upon the terms and subject to the conditions of the merger agreement and in accordance with the applicable provisions of the Delaware General Corporation Law, which we refer to as the DGCL, on the closing date and at the time at which the merger will become effective, which we refer to as the effective time, Sub will merge with and into Red Hat, with Red Hat continuing as the surviving corporation and a wholly-owned subsidiary of IBM.

Effect on Red Hat if the Merger is Not Completed (page 33)

If the merger agreement is not adopted by Red Hat stockholders or if the merger is not completed for any other reason, Red Hat stockholders will not receive any payment for their shares of Red Hat common stock. Instead, Red Hat will remain a public company, Red Hat common stock will continue to be listed and traded on the NYSE and registered under the Securities Exchange Act of 1934, which we refer to as the Exchange Act, and Red Hat will continue to file periodic reports with the U.S. Securities and Exchange Commission, which we refer to as the SEC.

Under certain specified circumstances, Red Hat will be required to pay IBM a termination fee upon the termination of the merger agreement, as described under the section entitled Terms of the Merger Agreement Termination of the

Merger Agreement Termination Fees beginning on page 106.

Table of Contents

Merger Consideration (page 84)

If the merger is completed, at the effective time, and without any action on the part of the holder, each share of Red Hat common stock issued and outstanding immediately prior to the effective time (other than (i) shares of Red Hat common stock that are owned directly by Red Hat, including treasury stock, or owned by IBM or Sub immediately prior to the effective time, which we refer to as canceled shares, (ii) dissenting shares (as defined herein) and (iii) shares of Red Hat common stock that are owned by any direct or indirect wholly-owned subsidiary of Red Hat or IBM (other than Sub) immediately prior to the effective time, which we refer to as subsidiary converted shares), and certain equity awards, the treatment of which is described under the sections entitled Proposal 1: Adoption of the Merger Agreement The Merger Interests of the Non-Employee Directors and Executive Officers of Red Hat in the Merger Treatment of Equity Compensation and Terms of the Merger Agreement Merger Consideration Treatment of Equity Compensation beginning on pages 73 and 84, respectively, will be converted into the right to receive $190.00 per share in cash, without interest, which we refer to as the merger consideration, less any applicable withholding taxes. All shares, when so converted into the right to receive the merger consideration, will automatically be canceled and will cease to exist.

As described under the section entitled Terms of the Merger Agreement Merger Consideration Exchange Procedures beginning on page 85, no later than substantially concurrently with the effective time, IBM will deposit, or cause to be deposited, with a designated paying agent (as defined herein) funds in an amount necessary for the payment of the merger consideration.

After the merger is completed, under the terms of the merger agreement, you will have the right to receive the merger consideration, but you no longer will have any rights as a Red Hat stockholder as a result of the merger (except for the right to receive the merger consideration and except that stockholders who properly exercise and perfect their demand for appraisal will instead have such rights as granted by Section 262 of the DGCL, as described under the section entitled Appraisal Rights beginning on page 116).

The Special Meeting (page 26)

Date, Time and Place

The special meeting of our stockholders, which we refer to as the special meeting, will be held at 100 East Davie Street, Raleigh, North Carolina 27601 on January 16, 2019, at 9:00 a.m., Eastern time.

Purpose

At the special meeting, we will ask our stockholders of record as of the close of business on December 11, 2018, which we refer to as the record date, to consider and vote on the following proposals:

- the adoption of the merger agreement, a copy of which is attached as Annex A to the proxy statement accompanying this notice, which we refer to as the merger proposal;

- the approval, by means of a non-binding, advisory vote, of compensation that will or may become payable to the named executive officers of Red Hat in connection with the merger, which we refer to as the merger-related compensation proposal; and

the approval of one or more adjournments of the special meeting to a later date or dates, if necessary or appropriate, to solicit additional proxies if there are insufficient votes to adopt the merger agreement at the then-scheduled date and time of the special meeting, which we refer to as the adjournment proposal.

Table of Contents

Record Date; Shares Entitled to Vote

You are entitled to vote at the special meeting if you owned shares of Red Hat common stock as of the close of business on the record date. You will have one vote at the special meeting for each share of Red Hat common stock you owned as of the close of business on the record date.

Quorum

A majority in voting power of Red Hat common stock issued and outstanding and entitled to vote at the special meeting, represented in person or by proxy, constitutes a quorum at the special meeting. As of the close of business on the record date, there were 176,759,752 shares of Red Hat common stock issued and outstanding and entitled to vote. If you submit a properly executed proxy by mail, telephone or the Internet, you will be considered a part of the quorum. In addition, abstentions will be counted for purposes of establishing a quorum. Broker non-votes will not be counted for purposes of establishing a quorum. As a result, 88,379,877 shares of Red Hat common stock must be represented in person or by proxy to have a quorum. If a quorum is not present, the special meeting will be adjourned until a quorum is obtained, subject to the terms of the merger agreement. The affirmative vote of a majority of the voting power of the shares of Red Hat common stock entitled to vote which are present, in person or by proxy, at the special meeting or the chairman of the special meeting, may adjourn the special meeting.

Required Vote

The affirmative vote of a majority of the shares of Red Hat common stock outstanding and entitled to vote thereon, provided a quorum is present, is required to approve the merger proposal, which we refer to as stockholder approval. This means that the proposal will be approved if the number of shares voted **FOR** that proposal is greater than 50% of the total number of the votes that can be cast in respect of our outstanding shares of common stock. Abstentions and broker non-votes will have the same effect as a vote **AGAINST** the merger proposal.

The affirmative vote of a majority of the voting power of the shares of Red Hat common stock entitled to vote which are present, in person or by proxy, and voting at the special meeting, provided a quorum is present, is required to approve, by means of a non-binding, advisory vote, the merger-related compensation proposal. This means that the proposal will be approved if the number of shares voted **FOR** that proposal is greater than 50% of the total number of shares of Red Hat common stock entitled to vote which are present, in person or by proxy, and vote at the special meeting, provided a quorum is present. Abstentions and broker non-votes will not have any effect on the merger-related compensation proposal.

The affirmative vote of a majority of the voting power of the shares of Red Hat common stock entitled to vote which are present, in person or by proxy, at the special meeting, whether or not a quorum is present, is required to approve the adjournment proposal. This means that the proposal will be approved if the number of shares voted **FOR** that proposal is greater than 50% of the total number of shares of Red Hat common stock entitled to vote which are present, in person or by proxy, at the special meeting, whether or not a quorum is present. Abstentions will have the same effect as a vote **AGAINST** the adjournment proposal. Broker non-votes will not have any effect on the adjournment proposal.

Share Ownership of Red Hat Directors and Executive Officers

As of the close of business on the record date, Red Hat directors and executive officers beneficially owned and were entitled to vote, in the aggregate, 898,713 shares of Red Hat common stock (excluding any shares of Red Hat common stock that would be delivered upon exercise or conversion of stock options or other equity-based awards), which

represented approximately 0.51% of the outstanding shares of Red Hat common stock on that date.

Table of Contents

It is expected that Red Hat s directors and executive officers will vote their shares **FOR** the merger proposal, **FOR** the merger related-related compensation proposal and **FOR** the adjournment proposal, although none of them has entered into any agreement requiring them to do so.

Voting of Proxies

Any Red Hat stockholder of record entitled to vote at the special meeting may submit a proxy by returning a signed proxy card by mail or voting electronically over the Internet or by telephone, or may vote in person by appearing at the special meeting. If your shares are held in a brokerage account at a brokerage firm, bank, broker-dealer, or similar organization, then you are the beneficial owner of shares held in street name, and you should instruct your broker, bank or other nominee on how you wish to vote your shares of Red Hat common stock using the instructions provided by your broker, bank or other nominee. Under applicable stock exchange rules, if you fail to instruct your broker, bank or other nominee on how to vote your shares, your broker, bank or other nominee only has discretion to vote your shares on discretionary matters. The merger proposal, the merger-related compensation proposal and the adjournment proposal are non-discretionary matters, and brokers, banks and other nominees therefore cannot vote on these proposals without your instructions. Therefore, it is important that you cast your vote or instruct your broker, bank or other nominee on how you wish to vote your shares.

If you are a stockholder of record, you may change your vote or revoke your proxy at any time before it is voted at the special meeting by submitting a new proxy electronically over the Internet or by telephone after the date of the earlier submitted proxy, signing another proxy card with a later date and returning it to us prior to the special meeting or attending the special meeting and voting in person. Proxies submitted electronically over the Internet or by telephone must be received by 11:59 pm, Eastern time, on January 15, 2019. If you hold your shares of Red Hat common stock in street name, you should contact your broker, bank or other nominee for instructions regarding how to change your vote.

Recommendation of Our Board of Directors and Reasons for the Merger (page 42)

The Board of Directors, after considering various factors described under the section entitled Proposal 1: Adoption of the Merger Agreement The Merger Recommendation of Our Board of Directors beginning on page 42 and after consultation with independent legal and financial advisors, unanimously (i) determined that the terms of the merger agreement, the merger and the other transactions contemplated by the merger agreement are fair to and in the best interests of Red Hat and its stockholders; (ii) adopted, approved and declared advisable the execution, delivery and performance of the merger agreement, the merger and the other transactions contemplated by the merger agreement; (iii) approved, authorized and declared advisable the consummation by Red Hat of the transactions contemplated by the merger agreement; (iv) resolved to recommend that Red Hat stockholders vote in favor of the adoption and approval of the merger agreement, the merger and other transactions contemplated by the merger agreement; and (v) resolved to submit the merger agreement to Red Hat stockholders for adoption at a duly held meeting of such stockholders.

The Red Hat Board of Directors unanimously recommends that you vote (i) FOR the merger proposal, (ii) FOR the merger-related compensation proposal and (iii) FOR the adjournment proposal.

Opinions of Red Hat s Financial Advisors (page 47)

Opinion of Guggenheim Securities, LLC

Red Hat retained Guggenheim Securities, LLC, which we refer to as Guggenheim Securities, as its lead financial advisor in connection with the potential sale of or another extraordinary corporate transaction involving Red Hat, including the merger. Guggenheim Securities has had a long-standing investment banking relationship

Table of Contents

with Red Hat and had been retained by Red Hat since October 2016 in connection with Red Hat s exploration and consideration of various strategic and financial alternatives. In connection with the merger, Guggenheim Securities delivered an opinion to the Red Hat Board of Directors to the effect that, as of October 28, 2018 and based on and subject to the matters considered, the procedures followed, the assumptions made and various limitations of and qualifications to the review undertaken, the merger consideration was fair, from a financial point of view, to Red Hat stockholders. The full text of Guggenheim Securities written opinion, which is attached as Annex B to this proxy statement and which you should read carefully and in its entirety, is subject to the assumptions, limitations, qualifications and other conditions contained in such opinion and is necessarily based on economic, capital markets and other conditions, and the information made available to Guggenheim Securities, as of the date of such opinion.

Guggenheim Securities opinion was provided to the Red Hat Board of Directors (in its capacity as such) for its information and assistance in connection with its evaluation of the merger consideration. Guggenheim Securities opinion and any materials provided in connection therewith did not constitute a recommendation to the Red Hat Board of Directors with respect to the merger, nor does Guggenheim Securities opinion or the summary of its underlying financial analyses elsewhere in this proxy statement constitute advice or a recommendation to any Red Hat stockholder as to how to vote or act in connection with the merger or otherwise. Guggenheim Securities opinion addresses only the fairness, from a financial point of view and as of the date of such opinion, of the merger consideration to Red Hat stockholders to the extent expressly specified in such opinion and does not address any other term, aspect or implication of the merger (including, without limitation, the form or structure of the merger), the merger agreement or any other agreement, transaction document or instrument contemplated by the merger agreement or to be entered into or amended in connection with the merger or any financing or other transactions related thereto.

For a more complete description, see the section entitled Proposal 1: Adoption of the Merger Agreement The Merger Opinions of Red Hat s Financial Advisors Opinion of Guggenheim Securities, LLC beginning on page 47.

Opinion of Morgan Stanley & Co. LLC

Red Hat retained Morgan Stanley & Co. LLC, which we refer to as Morgan Stanley, to provide it with financial advisory services in connection with the merger. Red Hat selected Morgan Stanley to act as its financial adviser based on Morgan Stanley s qualifications, expertise and reputation, and its knowledge of Red Hat s business and affairs. On October 28, 2018, Morgan Stanley rendered its oral opinion, subsequently confirmed by delivery of a written opinion dated October 28, 2018, to the effect that, as of such date, and based upon and subject to the assumptions made, procedures followed, matters considered and qualifications and limitations on the scope of review undertaken by Morgan Stanley as set forth in its written opinion, the merger consideration to be received by Red Hat stockholders pursuant to the merger agreement was fair from a financial point of view to such Red Hat stockholders.

The full text of the written opinion of Morgan Stanley dated October 28, 2018, is attached as Annex C to this proxy statement, and is incorporated by reference herein in its entirety. The opinion sets forth, among other things, the assumptions made, procedures followed, matters considered and qualifications and limitations on the scope of the review undertaken by Morgan Stanley in rendering its opinion. The summary of the opinion of Morgan Stanley set forth in this proxy statement is qualified in its entirety by reference to the full text of the opinion. You are encouraged to read Morgan Stanley s opinion and the summary of Morgan Stanley s opinion below carefully and in their entirety. Morgan Stanley s opinion was directed to the Red Hat Board of Directors, in its capacity as such, and addressed only the fairness from a financial point of view of the merger consideration to be received by Red Hat stockholders pursuant to the merger agreement as of the date of the opinion and did not address any other aspects or implications of the merger. Morgan Stanley s opinion was not intended to, and

Table of Contents

does not, constitute advice or a recommendation to any Red Hat stockholder as to how to vote at the special meeting to be held in connection with the merger or whether to take any other action with respect to the merger.

For a more complete description, see the section entitled Proposal 1: Adoption of the Merger Agreement The Merger Opinions of Red Hat s Financial Advisors Opinion of Morgan Stanley & Co. LLC beginning on page 60.

Financing of the Merger (page 79)

The merger is not conditioned on IBM s ability to obtain financing. IBM and Sub have represented to Red Hat that they will have available to them sufficient funds at the effective time to pay all amounts required to be paid by IBM and Sub pursuant to the terms of the merger agreement, including the amounts payable to the holders of Cash-Out Stock Options (as defined herein), Cash-Out Restricted Shares (as defined herein), Cash-Out RSUs (as defined herein) and Cash-Out PSUs (as defined herein) and to pay all associated fees, costs and expenses. IBM expects to finance the merger through cash on hand and proceeds from debt financing.

IBM has made available to Red Hat copies of a fully executed commitment letter, dated the date of the merger agreement, which we refer to as the commitment letter, with JPMorgan Chase Bank, N.A., Goldman Sachs Bank USA and Goldman Sachs Lending Partners LLC, which we refer to collectively as the commitment parties. Pursuant to the commitment letter, and subject to the terms and conditions set forth therein, the commitment parties have committed to provide IBM with loans under a 364-day senior unsecured bridge term loan facility in an aggregate principal amount of up to $20.0 billion, which we refer to as the bridge facility. The funding of the bridge facility provided for in the commitment letter is contingent on the satisfaction of customary conditions, including (i) the execution and delivery of definitive documentation with respect to the bridge facility in accordance with the terms sets forth in the commitment letter, and (ii) the consummation of the merger in accordance with the merger agreement.

For a more complete description, see the section entitled Proposal 1: Adoption of the Merger Agreement Financing of the Merger beginning on page 79.

Treatment of Equity Compensation (page 84)

Our executive officers and employees hold various types of compensatory awards with respect to Red Hat common stock. Our non-employee directors hold awards of restricted shares and deferred stock units, which we refer to as DSUs. The merger agreement provides for the treatment set forth below with respect to the awards described below. None of our non-employee directors or executive officers hold stock options.

Exchange Ratio. For purposes of the conversion of Red Hat equity awards described below, the Exchange Ratio is defined as a fraction, the numerator of which is the merger consideration and the denominator of which is the closing price per share of IBM common stock on the New York Stock Exchange Composite Transactions Tape on the trading day immediately preceding the date on which the merger effective time occurs.

Restricted Shares. Each restricted share award of Red Hat common stock that is held by a non-employee director, consultant or independent contractor of Red Hat or a subsidiary immediately prior to the effective time, which we refer to as a Cash-Out Restricted Share, will be converted at the effective time into the right to receive an amount in cash equal to the merger consideration multiplied by the number of shares of Red Hat common stock subject to the award. Each other restricted share award of Red Hat common stock (*i.e.*, those held by employees of Red Hat or a subsidiary immediately prior to the effective time), which we refer to as a Rollover Restricted Share, will be converted at the effective time into a restricted share award consisting of IBM common stock subject to substantially the same terms and conditions as were applicable to the Rollover Restricted Shares

7

Table of Contents

(other than any performance conditions, which will be deemed satisfied upon the effective time under the terms of the award) with respect to a number of shares of IBM common stock determined by multiplying the number of shares of Red Hat common stock subject to such Rollover Restricted Share award immediately prior to the effective time by the Exchange Ratio (rounded down to the nearest whole share).

Restricted Stock Units; Deferred Stock Units. Each restricted stock unit with respect to Red Hat common stock which is held by a non-employee director, consultant or independent contractor of Red Hat or a subsidiary immediately prior to the effective time, which, together with each DSU, we refer to as a Cash-Out RSU, will be converted at the effective time into the right to receive an amount in cash equal to the merger consideration multiplied by the number of shares of Red Hat common stock subject to the award. Each other restricted stock unit with respect to Red Hat common stock (*i.e.*, those held by employees of Red Hat or a subsidiary immediately prior to the effective time), which we refer to as a Rollover RSU, will be converted at the effective time into a restricted stock unit with respect to IBM common stock subject to substantially the same terms and conditions as were applicable to the Rollover RSUs with respect to a number of shares of IBM common stock determined by multiplying the number of shares of Red Hat common stock subject to such Rollover RSU award immediately prior to the effective time by the Exchange Ratio (rounded down to the nearest whole share).

Performance Share Units. At the effective time, each performance share unit with respect to Red Hat common stock that is held by a non-employee director, consultant or independent contractor of Red Hat or a subsidiary immediately prior to the effective time, which we refer to as a Cash-Out PSU, will be canceled and the holder thereof will be entitled to receive in consideration for such cancellation an amount in cash equal to the product of (i) the applicable PSU Share Number (as defined herein) and (ii) the merger consideration. Each other performance share unit (*i.e.*, those held by employees of Red Hat or a subsidiary immediately prior to the effective time), which we refer to as a Rollover PSU, will be converted at the effective time into a restricted share award consisting of IBM common stock subject to substantially the same terms and conditions as were applicable under such Rollover PSU (other than the performance-based vesting schedule, which will be converted into a service-based vesting schedule in accordance with the applicable award agreement), with respect to a number of shares of IBM common stock determined by multiplying the applicable PSU Share Number by the Exchange Ratio (rounded down to the nearest whole share). For purposes of the treatment of performance share units, the applicable PSU Share Number means, with respect to performance share units that were granted with performance goals relating to operating performance, either the target performance level if the effective time occurs in the first performance segment of the award, or the actual performance level based on the most recently completed fiscal quarter prior to the closing date if the effective time occurs in the second performance segment of the award. For performance share units with performance goals based on total shareholder return, the applicable PSU Share Number will be determined based on the total shareholder return represented by the merger consideration.

Stock Options. At the effective time, each option to acquire Red Hat common stock that is vested and unexercised immediately prior to the effective time, has an exercise price equal to or greater than the merger consideration or is held by a non-employee director, consultant or independent contractor of Red Hat or a subsidiary, which we refer to as a Cash-Out Stock Option, will be canceled and the holder thereof will be entitled to receive in consideration for such cancellation an amount in cash equal to the product of (i) the number of shares of Red Hat common stock that are subject to the Cash-Out Stock Option and (ii) the excess, if any, of the merger consideration over the exercise price per share of Red Hat common stock subject to the Cash-Out Stock Option. All other options to acquire Red Hat common stock (*i.e.*, options which are unvested, have an exercise price less than the merger consideration and are held by employees of Red Hat or a subsidiary immediately prior to the effective time), which we refer to as Rollover Stock Options, will be converted at the effective time into options to acquire, on substantially the same terms and conditions as were applicable under such Rollover Stock Option, the number of shares of IBM common stock (rounded down to the nearest whole share), determined by

8

Table of Contents

multiplying the number of shares of Red Hat common stock subject to such Rollover Stock Option immediately prior to the effective time by the Exchange Ratio, with an exercise price per share of IBM common stock (rounded up to the nearest whole cent) equal to (a) the exercise price per share of Red Hat common stock applicable to such Rollover Stock Option divided by (b) the Exchange Ratio.

Interests of the Non-Employee Directors and Executive Officers of Red Hat in the Merger (page 72)

Red Hat non-employee directors and executive officers may have interests in the merger that are different from, or in addition to, your interests as a stockholder. The Red Hat Board of Directors was aware of and considered these interests to the extent such interests existed at the time, among other matters, in evaluating and overseeing the negotiation of the merger agreement, in approving the merger agreement and the merger and in recommending that the merger agreement be adopted by the stockholders of Red Hat.

For a more complete description, see the section entitled Proposal 1: Adoption of the Merger Agreement The Merger Interests of the Non-Employee Directors and the Executive Officers of Red Hat in the Merger, beginning on page 72.

Appraisal Rights (page 116)

Any shares of Red Hat common stock that are issued and outstanding immediately prior to the effective time and as to which the holders thereof have not voted in favor of the merger proposal and are entitled to demand and properly demand appraisal of such shares of Red Hat common stock pursuant to Section 262 of the DGCL and, as of the effective time, have neither failed to perfect, nor effectively withdrawn or lost rights to appraisal under the DGCL, such shares we collectively refer to as the dissenting shares, will not be converted into the right to receive the merger consideration, unless and until such holder will have effectively withdrawn or lost such holder s right to appraisal under the DGCL, or if a court of competent jurisdiction determines that such holder is not entitled to the relief provided by Section 262 of the DGCL, at which time such shares of Red Hat common stock will be treated as if they had been converted into the right to receive, as of the effective time, the merger consideration, less applicable tax withholdings upon surrender of such certificates that formerly represented such shares of Red Hat common stock, and such Red Hat common stock will not be deemed dissenting shares, and such holder thereof will cease to have any other rights with respect to such Red Hat common stock. Each holder of dissenting shares will only be entitled to such consideration as may be due with respect to such dissenting shares pursuant to Section 262 of the DGCL.

To exercise your appraisal rights, you must submit a written demand for appraisal to Red Hat before the vote is taken on the merger proposal, you must not submit a blank proxy or otherwise vote in favor of the merger proposal and you must continue to hold the shares of Red Hat common stock of record through the effective time. Your failure to follow the procedures specified under the DGCL will result in the loss of your appraisal rights. The DGCL requirements for exercising appraisal rights are described in further detail in this proxy statement, and the relevant section of the DGCL regarding appraisal rights is reproduced and attached as Annex D to this proxy statement. If you hold your shares of Red Hat common stock through a broker, bank or other nominee and you wish to exercise appraisal rights, you should consult with your broker, bank or other nominee to determine the appropriate procedures for the making of a demand for appraisal by such broker, bank or other nominee. Stockholders should refer to the discussion under the section entitled Appraisal Rights beginning on page 116 and the DGCL requirements for exercising appraisal rights reproduced and attached as Annex D to this proxy statement.

U.S. Federal Income Tax Consequences of the Merger (page 79)

The exchange of Red Hat common stock for cash pursuant to the merger will be a taxable transaction for U.S. federal income tax purposes. Accordingly, a U.S. holder (as defined herein) of Red Hat common stock who

9

Table of Contents

exchanges shares of Red Hat common stock for cash in the merger generally will recognize gain or loss in an amount equal to the difference, if any, between the amount of cash received with respect to such shares and the U.S. holder s adjusted tax basis in such shares. If you are a non-U.S. holder, the merger generally will not result in tax to you under U.S. federal income tax laws unless you have certain connections with the United States.

This proxy statement contains a general discussion of U.S. federal income tax consequences of the merger. This description does not address any non-U.S. tax consequences, nor does it pertain to state, local or other tax consequences. Consequently, you are urged to contact your own tax advisor to determine the particular tax consequences to you of the merger.

Regulatory Approvals (page 81)

Red Hat and IBM have agreed to use their respective reasonable best efforts to take all actions and to do, or cause to be done, all things reasonably necessary, proper or advisable under applicable laws to consummate the merger and the other transactions contemplated by the merger agreement as soon as practicable and no later than the termination date (as defined herein), including obtaining any requisite approvals, subject to certain specified limitations under the merger agreement. These approvals include approvals under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, which we refer to as the HSR Act, and the Council Regulation 139/2004 of the European Union, which we refer to as the Council Regulation. Red Hat and IBM filed their respective HSR Act notifications on November 21, 2018. Although we expect that all required regulatory clearances and approvals will be obtained, we cannot assure you that these regulatory clearances and approvals will be timely obtained or obtained at all, or that the granting of these regulatory clearances and approvals will not involve the imposition of additional conditions on the completion of the merger, including the requirement to divest assets. In furtherance thereof, IBM has agreed to effect certain divestitures and other dispositions and take other actions, including accepting certain restrictions on its operations and assets, if necessary to obtain all approvals and authorizations under antitrust laws. These conditions or changes could result in the conditions to the closing of the merger not being satisfied.

No Solicitation (page 92)

As of the date of the merger agreement, Red Hat and its subsidiaries agreed to immediately cease any and all existing activities, discussions or negotiations with any third party with respect to any takeover proposal (as defined herein).

Under the merger agreement, Red Hat is generally not permitted to solicit or discuss takeover proposals with third parties, subject to certain exceptions.

Except as expressly permitted by the merger agreement, Red Hat will not, and will not authorize or permit any of its subsidiaries to, or any of its subsidiaries directors, officers or employees to, and it will use its reasonable best efforts to cause the company representatives (as defined herein) not to, and will not publicly announce any intention to, directly or indirectly:

- solicit, initiate or knowingly encourage, or knowingly take any other action to facilitate, any takeover proposal or any inquiries or the making of any proposal that would reasonably be expected to lead to a

10

Table of Contents

takeover proposal, except that ministerial acts that are not otherwise prohibited by the merger agreement (*e.g.*, answering unsolicited phone calls) will not (in and of themselves) be deemed to facilitate for purposes of, or otherwise constitute a violation of, the merger agreement;

enter into, continue or otherwise participate in any discussions or negotiations regarding, or furnish to any person (or any representative thereof) any information with respect to any takeover proposal; or

execute or enter into any letter of intent, memorandum of understanding, agreement in principle, acquisition agreement, merger agreement, option agreement, joint venture agreement, partnership agreement or other agreement, each of which we refer to as an acquisition agreement, relating to any takeover proposal;

Notwithstanding the foregoing, under certain circumstances prior to obtaining the requisite stockholder approval at the special meeting, Red Hat may furnish information with respect to Red Hat and its subsidiaries subject to a confidentiality agreement and participate in discussions or negotiations with the person making a *bona fide*, written, unsolicited takeover proposal received after the date of the merger agreement if the Red Hat Board of Directors determines in good faith that such proposal constitutes, or could reasonably be expected to lead to, a superior proposal (as defined herein), and which takeover proposal did not result from a breach of the merger agreement.

Notwithstanding anything to the contrary in the merger agreement, Red Hat and the company representatives may, in response to a *bona fide* written unsolicited takeover proposal, contact the person who made such takeover proposal solely to determine whether such person intends to provide any documents (or additional documents) containing the terms and conditions of such takeover proposal.

For a more complete description, see the section entitled Terms of the Merger Agreement Additional Agreements No Solicitation beginning on page 92.

Change of Recommendation (page 94)

As described under the section entitled The Special Meeting Board of Directors Recommendation beginning on page 28, the Red Hat Board of Directors has recommended that the holders of shares of Red Hat common stock vote **FOR** the merger proposal.

The merger agreement provides that the Red Hat Board of Directors will not (i) withhold, withdraw, qualify or modify, or propose publicly to take such actions, in a manner adverse to IBM or Sub, the recommendation of the Board of Directors to Red Hat stockholders that they vote **FOR** the adoption of the merger agreement, which we refer to as an adverse recommendation change, (ii) recommend, declare advisable or propose to recommend or declare advisable, the approval or adoption of any takeover proposal or resolve or agree to take any such action, or adopt or approve any takeover proposal, or (iii) cause or permit Red Hat to enter into any acquisition agreement constituting or related to, or which is intended to or would reasonably be expected to lead to, any takeover proposal (other than a confidentiality agreement referred to in, and in accordance with, the non-solicitation provisions of the merger agreement), or resolve or agree to take any such action.

However, prior to obtaining stockholder approval, the Red Hat Board of Directors, in certain circumstances and subject to certain limitations set forth in the merger agreement, may make an adverse recommendation change in connection with a takeover proposal that constitutes a superior proposal or in connection with an intervening event that was not known to the Red Hat Board of Directors or the consequences of which were not reasonably foreseeable as of the date of the merger agreement. If the Red Hat Board of Directors makes an adverse recommendation change

or delivers notice of a superior proposal or intervening event under the merger agreement, IBM may terminate the merger agreement and receive a termination fee from Red Hat as further described under Terms of the Merger Agreement Termination of the Merger Agreement Termination Fees beginning on page 106.

Table of Contents

Prior to obtaining stockholder approval, the Red Hat Board of Directors may also, in certain circumstances and subject to certain limitations set forth in the merger agreement, cause Red Hat to terminate the merger agreement in order to enter into a definitive agreement relating to a takeover proposal that constitutes a superior proposal, in each case, subject to specified obligations to IBM to negotiate and consider in good faith any revisions to the merger agreement proposed by IBM.

For a more complete description, see the sections entitled Terms of the Merger Agreement Additional Agreements Change of Recommendations beginning on page 94.

Conditions to the Closing of the Merger (page 102)

The following are some of the conditions that must be satisfied or waived before the merger may be consummated:

- receipt of Red Hat stockholder approval of the merger agreement and the transactions contemplated thereby;
- (i) any waiting period (and any extension thereof) applicable to the merger under the HSR Act having been terminated or having expired and (ii) any other approval or waiting period under certain other applicable antitrust laws, as set out in the merger agreement, having been obtained or terminated or having expired, in each case without the imposition, individually or in the aggregate, of a burdensome condition (as defined herein);
- (i) no order, injunction, judgment or law by certain courts of competent jurisdiction or other governmental entities being in effect that prohibits or makes illegal the consummation of the merger or imposes a burdensome condition, and (ii) no governmental entity having instituted any action or proceeding before any certain courts or other governmental entities of competent jurisdiction, which remains pending at what would otherwise be the closing date, seeking to enjoin, restrain or prohibit the consummation of the merger or impose a legal restraint (as defined herein);
- the accuracy of the representations and warranties of Red Hat, IBM and Sub in the merger agreement, subject in some instances to materiality or material adverse effect qualifiers, as of the closing date of the merger;
- the performance in all material respects by Red Hat, on the one hand, and IBM and Sub on the other hand, of their respective obligations under the merger agreement at or prior to the closing; and
- since the date of the merger agreement, no effect having occurred that would reasonably be expected to have, individually or in the aggregate, a material adverse effect, of which the existence or consequences are continuing.

Termination of the Merger Agreement (page 104)

The merger agreement may be terminated and the merger may be abandoned at any time prior to the effective time:

by the mutual written consent of IBM, Sub and Red Hat;

by either IBM or Red Hat, if:

the merger has not been consummated by 11:59 p.m., Eastern time, on October 28, 2019, which we refer to as the initial termination date, which is subject to extension for two consecutive three month periods by either party if all conditions are satisfied other than receipt of regulatory approvals and absence of legal restraints, which date, after giving effect to any extensions, we

Table of Contents

refer to as the termination date; provided that a party will not be able to terminate the merger agreement if it is in breach of the merger agreement and such breach is a principal cause of the failure of the merger to occur on or before the termination date;

an order having the effect of making the merger illegal or otherwise prohibiting consummation of the merger becomes final and non-appealable; provided that a party will not be able to terminate the merger agreement if it is in breach of the merger agreement and such breach is a principal cause of the issuance of such legal restraint; or

the requisite affirmative vote of Red Hat stockholders for the merger proposal has not been obtained at the special meeting of Red Hat stockholders or any adjournment or postponement thereof.

by IBM:

prior to the special meeting of Red Hat stockholders, if the Red Hat Board of Directors makes an adverse recommendation change or has delivered a notice of an intervening event (as defined herein) or a notice of a superior proposal (as defined herein) and IBM has delivered a notice of its intent to terminate the merger agreement and publicly and irrevocably waived its matching rights; or

if Red Hat has breached any representation or warranty or failed to perform any covenant, such that the conditions relating to the accuracy of Red Hat s representations and warranties or performance of covenants would fail to be satisfied (subject to a 30 business day cure period); provided that IBM will not be able to terminate the merger agreement if IBM or Sub is in material breach of the merger agreement or if any representation or warranty of IBM or Sub has become untrue, resulting in the failure of a closing condition.

by Red Hat:

prior to receipt of the requisite stockholder approval at the special meeting, in order to enter into a definitive written agreement providing for a superior proposal, provided that Red Hat pays a termination fee of $975 million to IBM simultaneously with, and as a condition to the validity of, such termination; or

if IBM has breached any representation or warranty or failed to perform any covenant, such that the conditions relating to the accuracy of IBM s or Sub s representations and warranties or performance of covenants would fail to be satisfied (subject to a 30 business day cure period); provided that Red Hat will not be able to terminate the merger agreement if Red Hat is in material breach of the merger agreement or if any representation or warranty of Red Hat has become untrue, resulting in the failure of a closing condition.

Termination Fee (page 106)

Under the merger agreement, Red Hat will be required to pay a termination fee of $975 million in connection with a termination of the merger agreement under specified circumstances. In no event will Red Hat be required to pay the termination fee described above on more than one occasion.

Market Prices and Dividend Data (page 111)

On October 26, 2018, the last trading day prior to the announcement of the merger, the closing price of Red Hat common stock was $116.68 per share. On December 11, 2018, the latest practicable trading day before the date of this proxy statement, the closing price of our common stock on the NYSE was $176.53 per share.

Table of Contents

We have never declared or paid any cash dividends on our common stock. Under the terms of the merger agreement, from October 28, 2018, until the effective time, Red Hat may not declare, set aside or pay any dividends on, or make any other distributions in respect of, any of its capital stock, other equity interests or voting securities without IBM s prior written consent.

Neither the SEC nor any state securities regulatory agency has approved or disapproved of the transactions described in this document, including the merger, or determined if the information contained in this document is accurate or adequate. Any representation to the contrary is a criminal offense.

Table of Contents

QUESTIONS AND ANSWERS

The following questions and answers are intended to address some commonly asked questions regarding the merger, the merger agreement and the special meeting. These questions and answers may not address all questions that may be important to you as a Red Hat stockholder. We encourage you to read carefully the more detailed information contained elsewhere in this proxy statement, the annexes to this proxy statement (including the merger agreement), and the documents we incorporate by reference in this proxy statement. You may obtain the documents and information incorporated by reference in this proxy statement without charge by following the instructions under the section entitled Where You Can Find More Information beginning on page 123. The merger agreement is attached as Annex A to this proxy statement.

Q: **Why am I receiving these proxy materials?**

A: On October 28, 2018, Red Hat entered into the merger agreement providing for the merger of Sub, with and into Red Hat, with Red Hat surviving the merger as a wholly-owned subsidiary of IBM. The Red Hat Board of Directors is furnishing this proxy statement and form of proxy card to the holders of Red Hat common stock in connection with the solicitation of proxies in favor of the proposal to adopt the merger agreement and to approve the other proposals to be voted on at the special meeting or any adjournments or postponements thereof. This proxy statement includes information that we are required to provide to you under the rules of the SEC and is designed to assist you in voting on the matters presented at the special meeting. Stockholders of record as of the close of business on December 11, 2018 may attend the special meeting and are entitled and requested to vote on the proposals described in this proxy statement.

Q: **What is included in the proxy materials?**

A: The proxy materials include the proxy statement and the annexes to the proxy statement, including the merger agreement, and a proxy card or voting instruction form.

Q: **When and where is the special meeting?**

A: The special meeting will take place on January 16, 2019, at 9:00 a.m., Eastern time, at 100 East Davie Street, Raleigh, North Carolina 27601.

Q: **What is the proposed merger and what effects will it have on Red Hat?**

A: The proposed merger is the acquisition of Red Hat by IBM through the merger of Sub with and into Red Hat pursuant to the merger agreement. If the proposal to adopt the merger agreement is approved by the requisite number of shares of Red Hat common stock and the other closing conditions under the merger agreement have been satisfied or waived, Sub will merge with and into Red Hat, with Red Hat continuing as the surviving

corporation. As a result of the merger, Red Hat will become a wholly-owned subsidiary of IBM and you will no longer own shares of Red Hat common stock. Red Hat expects to delist its common stock from the NYSE as promptly as practicable after the effective time and de-register its common stock under the Exchange Act as promptly as practicable after such delisting. Thereafter, Red Hat would no longer be a publicly-traded company.

Q: **What will I receive if the merger is completed?**

A: Upon completion of the merger, you will be entitled to receive the merger consideration of $190.00 in cash, without interest and less applicable tax withholdings, for each share of Red Hat common stock that you own, unless you have properly exercised and perfected and not withdrawn your demand for appraisal rights under the DGCL with respect to such shares. For example, if you own 100 shares of Red Hat common stock, you will receive $19,000.00 in cash, without interest and less any applicable withholding taxes, in exchange for your shares of Red Hat common stock. In no case will you own shares in the surviving corporation.

Table of Contents

Q: **Who is entitled to vote at the special meeting?**

A: If your shares of Red Hat common stock are registered in your name in the records of our transfer agent, Computershare Limited, which we refer to as Computershare, as of the close of business on the record date, you are a stockholder of record for purposes of the special meeting and are eligible to attend and vote. If you hold shares of our common stock indirectly through a broker, bank or similar institution, you are not a stockholder of record, but instead hold your shares in street name and the record owner of your shares is your broker, bank or similar institution. Instructions on how to vote shares held in street name are described under the question How do I vote my shares? below.

Q: **How many votes do I have?**

A: You will have one vote for each share of Red Hat common stock owned by you, as a stockholder of record or in street name, as of the close of business on the record date.

Q: **May I attend the special meeting and vote in person?**

A: Yes. All Red Hat stockholders as of the close of business on the record date may attend the special meeting and vote in person. All Red Hat stockholders will need to present government-issued photo identification to be admitted to the special meeting. The use of cameras, sound recording equipment, communication devices or any other similar equipment is prohibited at the special meeting without the express written permission of Red Hat. Even if you plan to attend the special meeting in person, we encourage you to complete, sign, date and return the enclosed proxy card or vote electronically over the Internet or via telephone to ensure that your shares will be represented at the special meeting. If you attend the special meeting and vote in person, your vote by ballot will revoke any proxy previously submitted. If you held your shares in street name, because you are not the stockholder of record, you may not vote your shares in person in the special meeting unless you request and obtain a valid proxy from your broker, bank or other nominee.

Q: **What am I being asked to vote on at the special meeting?**

A: You are being asked to consider and vote on the following proposals:

the adoption of the merger agreement, a copy of which is attached as Annex A to the proxy statement accompanying this notice;

the approval, by means of a non-binding, advisory vote, of compensation that will or may become payable to the named executive officers of Red Hat in connection with the merger; and

the approval of one or more adjournments of the special meeting to a later date or dates, if necessary or appropriate, to solicit additional proxies if there are insufficient votes to adopt the merger agreement at the then-scheduled date and time of the special meeting.

Q: **How does Red Hat s Board of Directors recommend that I vote?**

A: The Red Hat Board of Directors, after considering various factors described under the section entitled Proposal 1: Adoption of the Merger Agreement The Merger Recommendation of Our Board of Directors and Reasons for the Merger beginning on page 42 and after consultation with independent legal and financial advisors, unanimously (i) determined that the terms of the merger agreement, the merger and the other transactions contemplated by the merger agreement are fair to and in the best interests of Red Hat and its stockholders; (ii) adopted, approved and declared advisable the execution, delivery and performance of the merger agreement, the merger and the other transactions contemplated by the merger agreement; (iii) approved, authorized and declared advisable the consummation by Red Hat of the transactions contemplated by the merger agreement; (iv) resolved to recommend that Red Hat stockholders vote in favor of the adoption and approval of the merger agreement, the merger and other transactions contemplated by the merger agreement; and (v) resolved to submit the merger agreement to Red Hat stockholders for adoption at a duly held meeting of such stockholders.

Table of Contents

The Red Hat Board of Directors unanimously recommends that you vote

FOR the merger proposal;

FOR the merger-related compensation proposal; and

FOR the adjournment proposal.

Q: **How does the merger consideration compare to the market price of Red Hat common stock prior to the date on which the transaction was announced?**

A: The merger consideration represents a premium of (i) approximately 62.8% to Red Hat s closing stock price on October 26, 2018, the last trading day prior to the announcement of the merger, (ii) approximately 51.7% to the volume weighted average stock price of Red Hat common stock during the 30 days ended October 26, 2018 and (iii) approximately 7.8% to the highest closing stock price of Red Hat common stock during the 52-week period ended October 26, 2018.

Q: **Will Red Hat pay a quarterly dividend before the completion of the merger?**

A: Under the terms of the merger agreement, from October 28, 2018 until the effective time, Red Hat may not declare, set aside or pay any dividends on, or make any other distributions in respect of, any of its capital stock, other equity interests or voting securities. See the section entitled Terms of the Merger Agreement Conduct of Business Pending the Merger beginning on page 89.

Q: **Does IBM have the financial resources to complete the merger?**

A: IBM has secured committed debt financing from lenders providing IBM with sufficient funds, together with other sources of funds available to IBM at the effective time, to consummate the merger and pay all associated fees, costs and expenses with respect to the merger. Consummation of the merger is not conditioned on IBM or Sub obtaining financing. The funding of the bridge facility provided for in the commitment letter is contingent on the satisfaction of customary conditions, including (i) the execution and delivery of definitive documentation with respect to the bridge facility in accordance with the terms sets forth in the commitment letter, and (ii) the consummation of the merger in accordance with the merger agreement.

For a more complete description of sources of funding for the merger and related costs, see Proposal 1: Adoption of the Merger Agreement Financing of the Merger beginning on page 79.

Q: **What do I need to do now?**

A: We encourage you to read this proxy statement, the annexes to this proxy statement (including the merger agreement), and the documents we refer to in this proxy statement carefully and consider how the merger affects you. Then complete, sign, date and return, as promptly as possible, the enclosed proxy card in the accompanying reply envelope or grant your proxy electronically over the Internet or by telephone, so that your shares can be voted at the special meeting. If you hold your shares in street name, please refer to the voting instruction forms provided by your broker, bank or other nominee to vote your shares.

Q: **How do I vote my shares?**

A: *For stockholders of record*: If you are eligible to vote at the special meeting and are a stockholder of record, you may submit your proxy or cast your vote in any of four ways:

By Internet If you have Internet access, you may submit your proxy by following the instructions provided with your proxy materials and on your proxy card. Proxies submitted via Internet must be received by 11:59 p.m., Eastern time, on January 15, 2019.

Table of Contents

By Telephone You can also submit your proxy by telephone by following the instructions provided with your proxy materials and on your proxy card. Proxies submitted via telephone must be received by 11:59 p.m., Eastern time, on January 15, 2019.

By Mail You may submit your proxy by completing the proxy card enclosed with those materials, signing and dating it and returning it in the pre-paid envelope we have provided.

In Person at Our Special Meeting You can vote in person at our special meeting. In order to gain admittance, you must present valid government-issued photo identification, such as a driver s license or passport.

For holders in street name: If you hold your shares in street name and, therefore, are not a stockholder of record, you will need to follow the specific voting instructions provided to you by your broker, bank or other similar institution. If you wish to vote your shares in person at our special meeting, you must obtain a valid proxy from your broker, bank or similar institution, granting you authorization to vote your shares. In order to attend and vote your shares held in street name at our special meeting, you will need to present valid government-issued photo identification, such as a driver s license or passport, and hand in the valid proxy from your broker, bank or similar institution, along with a signed ballot that you can request at the special meeting. You will not be able to attend and vote your shares held in street name at the special meeting without valid government-issued photo identification such as a driver s license or passport, a valid proxy from your broker, bank or similar institution and a signed ballot.

If you submit your proxy by Internet, telephone or mail, and you do not subsequently revoke your proxy, your shares of Red Hat common stock will be voted in accordance with your instructions.

Even if you plan to attend the special meeting in person, you are strongly encouraged to vote your shares of Red Hat common stock by proxy. If you are a stockholder of record or if you obtain a valid proxy to vote shares which you beneficially own, you may still vote your shares of Red Hat common stock in person at the special meeting even if you have previously voted by proxy. If you are present at the special meeting and vote in person, your previous vote by proxy will not be counted.

Q: **Can I change or revoke my proxy?**

A: *For stockholders of record*: Yes. A proxy may be changed or revoked at any time prior to the vote at the special meeting by submitting a later-dated proxy (including a proxy submitted via the Internet or by telephone) or by giving written notice to our Corporate Secretary at our corporate headquarters. You may not change your vote over the Internet or by telephone after 11:59 p.m., Eastern time, on January 15, 2019. You may also attend the special meeting and vote your shares in person.

For holders in street name: Yes. You must follow the specific voting instructions provided to you by your broker, bank or other similar institution to change or revoke any instructions you have already provided to them.

Q: **How will my shares be voted if I do not provide specific instructions in the proxy card or voting instructions form that I submit?**

A: If you are a stockholder of record and if you sign, date and return your proxy card but do not provide specific voting instructions, your shares of Red Hat common stock will be voted **FOR** the merger proposal, **FOR** the merger-related compensation proposal and **FOR** the adjournment proposal.

If your shares are held in street name at a broker, bank or similar institution, your broker, bank or similar institution may under certain circumstances vote your shares on discretionary matters if you do not timely provide voting instructions in accordance with the instructions provided by them. However, if you do not provide timely instructions, your broker, bank or similar institution does not have the authority to vote on

Table of Contents

any non-discretionary proposals at the special meeting and a broker non-vote would occur, as explained in the following question and explanation.

Q: **What is broker discretionary voting ?**

A: If you hold your shares in street name, your broker, bank or other similar institution may be able to vote your shares without your instructions depending on whether the matter being voted on is discretionary or non-discretionary. Because brokers, banks and other nominee holders of record do not have discretionary voting authority with respect to any of the three proposals, if a beneficial owner of shares of Red Hat common stock held in street name does not give voting instructions to the broker, bank or other nominee with respect to any of the proposals, then those shares will not be present in person or represented by proxy at the special meeting. If there are any broker non-votes, then such broker non-votes will be counted as a vote **AGAINST** the merger proposal, but will not have any effect on the merger-related compensation proposal or the adjournment proposal. **Therefore, it is important that you instruct your broker, bank or other nominee on how you wish to vote your shares.**

Q: **I understand that a quorum is required in order to conduct business at the special meeting. What constitutes a quorum?**

A: A majority in voting power of Red Hat common stock issued and outstanding and entitled to vote at the special meeting, represented in person or by proxy, constitutes a quorum at the special meeting. As of the close of business on the record date, there were 176,759,752 shares of Red Hat common stock issued and outstanding and entitled to vote. If you submit a properly executed proxy by mail, telephone or the Internet, you will be considered a part of the quorum. In addition, abstentions will be counted for purposes of establishing a quorum. Broker non-votes will not be counted for purposes of establishing a quorum. As a result, 88,379,877 shares must be represented in person or by proxy to have a quorum. If a quorum is not present, the special meeting will be adjourned until a quorum is obtained, subject to the terms of the merger agreement. The affirmative vote of a majority of the voting power of the shares of Red Hat common stock entitled to vote which are present, in person or by proxy, at the special meeting or the chairman of the special meeting may adjourn the special meeting.

Q: **What is required to approve the proposals submitted to a vote at the annual meeting?**

A: *The merger proposal*: The affirmative vote of a majority of the shares of Red Hat common stock outstanding and entitled to vote thereon, provided a quorum is present, is required to approve the merger proposal. This means that the proposal will be approved if the number of shares voted **FOR** that proposal is greater than 50% of the total number of the votes that can be cast in respect of our outstanding shares of common stock. Abstentions and broker non-votes will have the same effect as a vote **AGAINST** the merger proposal.

The merger-related compensation proposal: The affirmative vote of a majority of the voting power of the shares of Red Hat common stock entitled to vote which are present, in person or by proxy, and voting at the special meeting, provided a quorum is present, is required to approve, by means of a non-binding, advisory vote, the merger-related compensation proposal. This means that the proposal will be approved if the number of shares voted **FOR** that

proposal is greater than 50% of the shares of Red Hat common stock entitled to vote which are present, in person or by proxy, and vote at the special meeting, provided a quorum is present. Abstentions and broker non-votes will not have any effect on the merger-related compensation proposal.

The adjournment proposal: The affirmative vote of a majority of the voting power of the shares of Red Hat common stock entitled to vote which are present, in person or by proxy, at the special meeting, whether or not a quorum is present, is required to approve the adjournment proposal. This means that the proposal will be approved if the number of shares voted **FOR** that proposal is greater than 50% of the total number of

Table of Contents

shares of Red Hat common stock entitled to vote which are present, in person or by proxy, at the special meeting, whether or not a quorum is present. Abstentions will have the same effect as a vote **AGAINST** the adjournment proposal. Broker non-votes will not have any effect on the adjournment proposal.

Q: **How can I obtain a proxy card or voting instruction form?**

A: If you lose, misplace or otherwise need to obtain a proxy card or a voting instruction form, please follow the applicable procedure below.

For stockholders of record: Please contact Computershare at 1-888-542-4427.

For holders in street name: Please contact your account representative at your broker, bank or other similar institution.

Q: **Should I send in my stock certificates now?**

A: No. After the merger is completed, under the terms of the merger agreement, you will receive shortly thereafter the letter of transmittal instructing you to send your stock certificates to the paying agent in order to receive the cash payment of the merger consideration for each share of your Red Hat common stock represented by the stock certificates. You should use the letter of transmittal to exchange your stock certificates for the cash payment to which you are entitled upon completion of the merger. Please do not send in your stock certificates now.

Q: **I do not know where my stock certificates are, how will I get the merger consideration for my shares of Red Hat common stock?**

A: If the merger is completed, the transmittal materials you will receive after the completion of the merger will include the procedures that you must follow if you cannot locate your stock certificates. This will include an affidavit that you will need to sign attesting to the loss of your stock certificates. You may also be required to post a bond as indemnity against any potential loss.

Q: **What happens if I sell or otherwise transfer my shares of Red Hat common stock after the close of business on the record date but before the special meeting?**

A: The record date is earlier than the date of the special meeting and the date the merger is expected to be completed. If you sell or transfer your shares of Red Hat common stock after the close of business on the record date but before the special meeting, unless special arrangements (such as the provision of a proxy) are made between you and the person to whom you sell or otherwise transfer your shares and each of you notifies Red Hat in writing of such special arrangements, you will transfer the right to receive the merger consideration if the merger is completed to the person to whom you sell or transfer your shares of Red Hat common stock, but you

will retain your right to vote these shares at the special meeting. Even if you sell or otherwise transfer your shares of Red Hat common stock after the close of business on the record date, we encourage you to complete, date, sign and return the enclosed proxy card or vote via the Internet or telephone.

Q: **When do you expect the merger to be completed?**

A: We are working toward completing the merger as quickly as possible and currently expect to complete the merger in the latter half of 2019. However, the exact timing of completion of the merger cannot be predicted because the completion of the merger is subject to conditions, including the adoption of the merger agreement by our stockholders and the receipt of regulatory approvals.

Table of Contents

Q: **What happens if the merger is not completed?**

A: If the merger agreement is not adopted by Red Hat stockholders or if the merger is not completed for any other reason, Red Hat stockholders will not receive any payment for their shares of Red Hat common stock. Instead, Red Hat will remain a public company, Red Hat common stock will continue to be listed and traded on the NYSE and registered under the Exchange Act, and Red Hat will continue to file periodic reports with the SEC.

Under certain specified circumstances, Red Hat will be required to pay IBM a termination fee upon the termination of the merger agreement, as described under the section entitled Terms of the Merger Agreement Termination of the Merger Agreement Termination Fees beginning on page 106.

Q: **Are there any other risks to me from the merger that I should consider?**

A: Yes. There are risks associated with all business combinations, including the merger. See the section entitled Forward-Looking Statements beginning on page 24.

Q: **Do any of Red Hat s directors or officers have interests in the merger that may differ from those of Red Hat stockholders generally?**

A: Yes. For a description of the interests of our directors and executive officers in the merger, see Proposal 1: Adoption of the Merger Agreement The Merger Interests of the Non-Employee Directors and Executive Officers of Red Hat in the Merger beginning on page 72.

Q: **What happens if the merger-related compensation proposal is not approved?**

A: Approval of the merger-related compensation proposal is not a condition to completion of the merger. The vote is an advisory vote and is not binding. Accordingly, regardless of the outcome of the advisory vote, if the merger is completed, Red Hat may still pay such compensation to its named executive officers in accordance with the terms and conditions applicable to such compensation.

Q: **What should I do if I receive more than one set of voting materials?**

A: You may receive more than one set of voting materials, including multiple copies of this proxy statement and multiple proxy cards or voting instruction cards. For example, if you hold your shares in more than one brokerage account, you will receive a separate voting instruction card for each brokerage account in which you hold shares. If you are a stockholder of record and your shares are registered in more than one name, you will receive more than one proxy card. Please complete, date, sign and return (or vote via the Internet or telephone with respect to) each proxy card and voting instruction card that you receive.

Q: **Who counts the votes?**

A: Votes are counted by Computershare, our transfer agent and registrar, and are then certified by a representative of Computershare appointed by the Red Hat Board of Directors to serve as the inspector of election at the special meeting.

Q: **Who may attend the special meeting?**

A: Red Hat stockholders who held shares of Red Hat common stock as of the close of business on December 11, 2018.

Q: **How can I obtain directions to the special meeting?**

A: Red Hat stockholders may contact Red Hat Investor Relations at (919) 754-3700 to obtain directions to the special meeting.

Table of Contents

Q: **Who pays for the expenses of this proxy solicitation?**

A: Red Hat will bear the entire cost of this proxy solicitation, including the preparation, printing, mailing and distribution of these proxy materials. We may also reimburse brokerage firms and other persons representing stockholders who hold their shares in street name for reasonable expenses incurred by them in forwarding proxy materials to such stockholders. In addition, certain directors, officers and other employees, without additional remuneration, may solicit proxies in person, or by telephone, facsimile, email and other methods of electronic communication.

Q: **Where can I find the vote results after the special meeting?**

A: We are required to publish final vote results in a Current Report on Form 8-K to be filed with the SEC within four business days after our special meeting.

Q: **Will I be subject to U.S. federal income tax upon the exchange of Red Hat common stock for cash pursuant to the merger?**

A: The exchange of Red Hat common stock for cash pursuant to the merger will be a taxable transaction for U.S. federal income tax purposes. Accordingly, a U.S. holder of Red Hat common stock who exchanges shares of Red Hat common stock for cash in the merger generally will recognize gain or loss in an amount equal to the difference, if any, between the amount of cash received with respect to such shares and the U.S. holder s adjusted tax basis in such shares. If you are a non-U.S. holder, the merger generally will not result in tax to you under U.S. federal income tax laws unless you have certain connections with the United States.

For a more complete description of the U.S. federal income tax consequences of the merger, see Proposal 1: Adoption of the Merger Agreement The Merger U.S. Federal Income Tax Consequences of the Merger beginning on page 79.

This proxy statement contains a general discussion of U.S. federal income tax consequences of the merger. This description does not address any non-U.S. tax consequences, nor does it pertain to state, local or other tax consequences. Consequently, you are urged to contact your own tax advisor to determine the particular tax consequences to you of the merger.

Q: **What will the holders of outstanding Red Hat equity awards receive in the merger?**

A: For information regarding the treatment of Red Hat s outstanding equity awards, see the section entitled Terms of the Merger Agreement Merger Consideration Treatment of Equity Compensation beginning on page 84.

Q: **Am I entitled to appraisal rights under the DGCL?**

A: If the merger is adopted by Red Hat s stockholders, stockholders who do not vote (whether in person or by proxy) in favor of the adoption of the merger agreement and who properly exercise and perfect their demand for appraisal of their shares will be entitled to appraisal rights in connection with the merger under Section 262 of the DGCL. This means that holders of Red Hat common stock are entitled to have their shares appraised by the Court of Chancery of the State of Delaware and to receive payment in cash of the fair value of the shares of Red Hat common stock, exclusive of any elements of value arising from the accomplishment or expectation of the merger, together with interest to be paid upon the amount determined to be fair value, if any, as determined by the court. Stockholders who wish to seek appraisal of their shares are in any case encouraged to seek the advice of legal counsel with respect to the exercise of appraisal rights due to the complexity of the appraisal process. Stockholders should refer to the discussion under the section entitled Appraisal Rights beginning on page 116 and the DGCL requirements for exercising appraisal rights reproduced and attached as Annex D to this proxy statement.

Table of Contents

Q: **What is householding ?**

A: Some banks, brokers and similar institutions may be participating in the practice of householding proxy materials. This means that only one copy of our proxy materials may have been sent to multiple stockholders in your household. We will promptly deliver a separate copy of the proxy materials to you if you write to us at the following address or call us at the following phone number:

Red Hat, Inc.

Attention: Investor Relations

100 East Davie Street

Raleigh, North Carolina 27601

Phone: Call (919) 754-3700 and ask to speak to Investor Relations.

To receive separate copies of the proxy materials in the future, or if you are receiving multiple copies and would like to receive only one copy for your household, you should contact your bank, broker or similar institution or you may contact us at the above address or telephone number.

Q: **How can I obtain more information about Red Hat?**

A: You can find more information about us from various sources described in the section entitled Where You Can Additional Information beginning on page 123.

Q: **Who can help answer my questions?**

A: If you have any questions concerning the merger, the special meeting or this proxy statement, would like additional copies of this proxy statement or need help voting your shares of Red Hat common stock, please contact our proxy solicitor:

Innisfree M&A Incorporated

501 Madison Avenue, 20th Floor

New York, New York 10022

Toll-free: (888) 750-5835

Banks & Brokers may call collect: (212) 750-5833

23

Table of Contents

FORWARD-LOOKING STATEMENTS

This proxy statement, and the documents to which we refer you in this proxy statement, as well as information included in oral statements or other written statements made or to be made by us or on our behalf, contain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, including, without limitation, statements relating to the completion of the merger and statements that do not directly or exclusively relate to historical facts. You can typically identify forward-looking statements by the use of forward-looking words such as may, could, should, see, will, would, estimate, project, forecast, inten anticipate, believe, target, plan, providing guidance and similar expressions and variations or negatives of these that are intended to identify information that is not historical in nature. Forward-looking statements by their nature address matters that are, to different degrees, uncertain, such as statements about the consummation of the proposed merger and the anticipated benefits thereof. These and other forward-looking statements are not guarantees of future results and are subject to risks, uncertainties and assumptions that could cause actual results to differ materially from those expressed in any forward-looking statements, including the failure to consummate the proposed merger or to make any filing or take other action required to consummate such merger in a timely matter or at all. The inclusion of such statements should not be regarded as a representation that any plans, estimates or expectations will be achieved. You should not place undue reliance on such statements.

These risks and uncertainties include, but are not limited to, the risks detailed in our filings with the SEC, including in our most recent filing on Form 10-K and subsequent periodic and interim reports, factors and matters described or incorporated by reference in this proxy statement, and the following factors:

- Red Hat may be unable to obtain stockholder approval as required for the merger;
- conditions to the closing of the merger, including obtaining required regulatory approvals, may not be satisfied or waived on a timely basis or otherwise;
- a governmental entity or a regulatory body may prohibit, delay or refuse to grant approval for the consummation of the merger and may require conditions, limitations or restrictions in connection with such approvals that can adversely affect the anticipated benefits of the proposed merger or cause the parties to abandon the proposed merger;
- the merger may involve unexpected costs, liabilities or delays;
- Red Hat s business may suffer as a result of uncertainty surrounding the merger or the potential adverse changes to business relationships (including, without limitation, customers and partners) resulting from the proposed merger;
- legal proceedings may be initiated related to the merger and the outcome of any legal proceedings related to the merger may be adverse to Red Hat;

Red Hat may be adversely affected by other general industry, economic, business and/or competitive factors;

there may be unforeseen events, changes or other circumstances that could give rise to the termination of the merger agreement or affect the ability to recognize benefits of the merger;

risks that the proposed merger may disrupt current plans and operations and present potential difficulties in employment retention as a result of the merger;

the risk that the merger may be terminated in certain circumstances that require us to pay IBM a termination fee of $975 million;

risks related to diverting management s attention from the Red Hat s ongoing business operations;

the fact that Red Hat stockholders would forgo the opportunity to realize the potential long-term value of the successful execution of Red Hat s current strategy as an independent company; and

Table of Contents

there may be other risks to consummation of the merger, including the risk that the merger will not be consummated within the expected time period or at all which may affect Red Hat s business and the price of Red Hat common stock.

Consequences of material differences in results as compared with those anticipated in the forward-looking statements could include, among other things, business disruption, operational problems, financial loss, legal liability to third parties and similar risks, any of which could have a material adverse effect on Red Hat s financial condition, results of operations, credit rating or liquidity.

There can be no assurance that the merger will be completed, or if it is completed, that it will close within the anticipated time period or that the expected benefits of the merger will be realized. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date on which such statements were made.

All of the forward-looking statements we make in this proxy statement are qualified by the information contained or incorporated by reference herein, including, but not limited to, (i) the information contained under this heading and (ii) the information in our consolidated financial statements and notes thereto included in our most recent filing on Form 10-K and subsequent periodic and interim report filings (see the section entitled Where You Can Find More Information beginning on page 123).

Except as required by applicable law, we undertake no obligation to publicly update forward-looking statements, whether as a result of new information, future events or otherwise. Red Hat stockholders are advised, however, to consult any future disclosures we make on related subjects as may be detailed in our other filings made from time to time with the SEC.

Table of Contents

THE SPECIAL MEETING

The enclosed proxy is solicited on behalf of the Board of Directors for use at the special meeting of stockholders or at any adjournments or postponements thereof.

Date, Time and Place

We will hold the special meeting on January 16, 2019, at 9:00 a.m., Eastern time, at 100 East Davie Street, Raleigh, North Carolina 27601.

Purpose of the Special Meeting

At the special meeting, we will ask our stockholders of record as of the close of business on the record date to consider and vote on the following proposals:

Proposal 1 Adoption of the Merger Agreement. To consider and vote on the merger proposal;

Proposal 2 Approval, by Means of a Non-Binding, Advisory Vote, of Certain Compensatory Arrangements with Named Executive Officers. To consider and vote on the merger-related compensation proposal; and

Proposal 3 Adjournment of the Special Meeting. To consider and vote on the adjournment proposal.

Record Date; Shares Entitled to Vote; Quorum

Only stockholders of record as of the close of business on December 11, 2018 are entitled to notice of the special meeting and to vote at the special meeting or at any adjournments or postponements thereof. A list of stockholders entitled to vote at the special meeting will be available in Red Hat s corporate headquarters located at 100 East Davie Street, Raleigh, North Carolina 27601, during regular business hours for a period of at least 10 days before the special meeting and at the place of the special meeting during the special meeting.

A majority in voting power of Red Hat common stock issued and outstanding and entitled to vote at the special meeting, represented in person or by proxy, constitutes a quorum at the special meeting. As of the close of business on the record date for the special meeting, there were 176,759,752 shares of Red Hat common stock issued and outstanding and entitled to vote. If you submit a properly executed proxy by mail, telephone or the Internet, you will be considered a part of the quorum. In addition, abstentions will be counted for purposes of establishing a quorum. Broker non-votes will not be counted for purposes of establishing a quorum. As a result, 88,379,877 shares must be represented in person or by proxy to have a quorum. If a quorum is not present, the special meeting will be adjourned until a quorum is obtained, subject to the terms of the merger agreement. The affirmative vote of a majority of the voting power of the shares of Red Hat common stock entitled to vote which are present, in person or by proxy, at the special meeting or the chairman of the special meeting may adjourn the special meeting.

Vote Required; Abstentions and Broker Non-Votes

The affirmative vote of a majority of the shares of Red Hat common stock outstanding and entitled to vote thereon, provided a quorum is present, is required to approve the merger proposal. This means that the proposal will be approved if the number of shares voted **FOR** that proposal is greater than 50% of the total number of the votes that can be cast in respect of our outstanding shares of common stock. Abstentions and broker non-votes will have the same effect as a vote **AGAINST** the merger proposal.

The affirmative vote of a majority of the voting power of the shares of Red Hat common stock entitled to vote which are present, in person or by proxy, and voting at the special meeting, provided a quorum is present, is

Table of Contents

required to approve, by means of a non-binding, advisory vote, the merger-related compensation proposal. This means that the proposal will be approved if the number of shares voted **FOR** that proposal is greater than 50% of the total number of shares of Red Hat common stock entitled to vote which are present, in person or by proxy, and vote at the special meeting, provided a quorum is present. Abstentions and broker non-votes will not have any effect on the merger-related compensation proposal.

The affirmative vote of a majority of the voting power of the shares of Red Hat common stock entitled to vote which are present, in person or by proxy, at the special meeting, whether or not a quorum is present, is required to approve the adjournment proposal. This means that the proposal will be approved if the number of shares voted **FOR** that proposal is greater than 50% of the total number of shares of Red Hat common stock entitled to vote which are present, in person or by proxy, at the special meeting, whether or not a quorum is present. Abstentions will have the same effect as a vote **AGAINST** the adjournment proposal. Broker non-votes will not have any effect on the adjournment proposal.

Broker non-votes are shares held by a broker, bank or other nominee that are present in person or represented by proxy at the special meeting, but with respect to which the broker, bank or other nominee is not instructed by the beneficial owner of such shares on how to vote on a particular proposal and the broker does not have discretionary voting power on such proposal. Because brokers, banks and other nominee holders of record do not have discretionary voting authority with respect to any of the three proposals, if a beneficial owner of shares of Red Hat common stock held in street name does not give voting instructions to the broker, bank or other nominee with respect to any of the proposals, then those shares will not be present in person or represented by proxy at the special meeting. If there are any broker non-votes, then such broker non-votes will be counted as a vote **AGAINST** the merger proposal, but will have no effect on the merger-related compensation proposal and the adjournment proposal.

Shares Held by Red Hat s Directors and Executive Officers

As of the close of business on the record date, Red Hat directors and executive officers beneficially owned and were entitled to vote, in the aggregate, 898,713 shares of Red Hat common stock (excluding any shares of Red Hat common stock that would be delivered upon exercise or conversion of stock options or other equity-based awards), which represented approximately 0.51% of the outstanding shares of Red Hat common stock on that date. It is expected that Red Hat s directors and executive officers will vote their shares **FOR** the merger proposal, **FOR** the merger-related compensation proposal and **FOR** the adjournment proposal, although none of them has entered into any agreement requiring them to do so.

Voting of Proxies

If your shares are registered in your name with our transfer agent, Computershare, you may cause your shares to be voted by returning a signed proxy card, or you may vote in person at the special meeting. Additionally, you may submit electronically over the Internet or by phone a proxy authorizing the voting of your shares by following the instructions on your proxy card. You must have the enclosed proxy card available, and follow the instructions on the proxy card, in order to submit a proxy electronically over the Internet or by telephone. Based on your proxy cards or Internet and telephone proxies, the proxy holders will vote your shares according to your directions.

If you plan to attend the special meeting and wish to vote in person, you will be given a ballot at the meeting. If your shares are registered in your name, you are encouraged to vote by proxy even if you plan to attend the special meeting in person. If you attend the special meeting and vote in person, your vote by ballot will revoke any proxy previously submitted.

Voting instructions are included on your proxy card. All shares represented by properly executed proxies received in time for the special meeting will be voted at the special meeting in accordance with the instructions

Table of Contents

of the stockholder. Properly executed proxies that do not contain voting instructions will be voted (i) **FOR** the merger proposal, (ii) **FOR** the merger-related compensation proposal and (iii) **FOR** the adjournment proposal. No proxy that is specifically marked against the merger proposal will be voted in favor of the merger-related compensation, unless it is specifically marked **FOR** the approval of such proposal.

If your shares are held in street name through a broker, bank or other nominee, you may vote through your broker, bank or other nominee by completing and returning the voting form provided by your broker, bank or other nominee, or by the Internet or telephone through your broker, bank or other nominee if such a service is provided. To vote via the Internet or telephone through your broker, bank or other nominee, you should follow the instructions on the voting form provided by your broker, bank or other nominee. Under applicable stock exchange rules, brokers, banks or other nominees have the discretion to vote your shares on discretionary matters if you fail to instruct your broker, bank or other nominee on how to vote your shares with respect to such matters. The merger proposal, merger-related compensation proposal and the adjournment proposal are non-discretionary matters, and brokers, banks and other nominees therefore cannot vote on these proposals without your instructions. If you do not return your broker s, bank s or other nominee s voting form, do not vote via the Internet or telephone through your broker, bank or other nominee, if applicable, or do not attend the special meeting and vote in person with a proxy from your broker, bank or other nominee, such actions will have the same effect as if you voted **AGAINST** the merger proposal but will not have any effect on the adjournment proposal or the merger-related compensation proposal.

Revocability of Proxies

If you are a stockholder of record, you may change your vote or revoke your proxy at any time before it is voted at the special meeting by:

- submitting a new proxy electronically over the Internet or by telephone after the date of the earlier submitted proxy;
- delivering a written notice of revocation to our Corporate Secretary;
- signing another proxy card with a later date and returning it to us prior to the special meeting; or
- attending the special meeting and voting in person.

Please note that to be effective, your new proxy card, Internet or telephonic voting instructions or written notice of revocation must be received by our Corporate Secretary prior to the special meeting and, in the case of Internet or telephonic voting instructions, must be received before 11:59 p.m., Eastern time, on January 15, 2019. If you have submitted a proxy, your appearance at the special meeting, in the absence of voting in person or submitting an additional proxy or revocation, will not have the effect of revoking your prior proxy.

If you hold your shares of Red Hat common stock in street name, you should contact your broker, bank or other nominee for instructions regarding how to change your vote. You may also vote in person at the special meeting if you obtain a valid proxy from your broker, bank or other nominee. Any adjournment of the special meeting for the purpose of soliciting additional proxies will allow Red Hat stockholders who have already sent in their proxies to revoke them at any time prior to their use at the special meeting, as adjourned.

Board of Directors Recommendation

The Board of Directors, after considering various factors described under the section entitled Proposal 1: Adoption of the Merger Agreement The Merger Recommendation of Our Board of Directors beginning on page 42 and after consultation with independent legal and financial advisors, unanimously (i) determined that the terms of the merger agreement, the merger and the other transactions contemplated by the merger agreement are fair to and in the best interests of Red Hat and its stockholders; (ii) adopted, approved and declared advisable the execution, delivery and performance of the merger agreement, the merger and the other transactions

Table of Contents

contemplated by the merger agreement; (iii) approved, authorized and declared advisable the consummation by Red Hat of the transactions contemplated by the merger agreement; (iv) resolved to recommend that Red Hat stockholders vote in favor of the adoption and approval of the merger agreement, the merger and other transactions contemplated by the merger agreement; and (v) resolved to submit the merger agreement to Red Hat stockholders for adoption at a duly held meeting of such stockholders.

The Red Hat Board of Directors unanimously recommends that you vote (i) FOR the merger proposal, (ii) FOR the merger-related compensation proposal and (iii) FOR the adjournment proposal.

Tabulation of Votes

All votes will be tabulated by a representative of Computershare, who will act as the inspector of election appointed for the special meeting and will separately tabulate affirmative and negative votes, abstentions and broker non-votes.

Solicitation of Proxies

The expense of soliciting proxies in the enclosed form will be borne by Red Hat. We have retained Innisfree M&A Incorporated, a proxy solicitation firm, to solicit proxies in connection with the special meeting at a cost of approximately $50,000 and an additional success fee of $25,000 if the merger proposal is approved by our stockholders plus expenses. We have also agreed to indemnify Innisfree M&A Incorporated against losses arising out of its provision of these services as requested by Red Hat. In addition, we may reimburse brokers, banks and other custodians, nominees and fiduciaries representing beneficial owners of shares for their expenses in forwarding soliciting materials to such beneficial owners. Proxies may also be solicited by certain of our directors, officers and employees, personally or by telephone, facsimile or other means of communication. No additional compensation will be paid for such services.

Anticipated Date of Completion of the Merger

Assuming timely satisfaction of necessary closing conditions, including the approval by our stockholders of the merger proposal, we anticipate that the merger will be consummated during the latter half of 2019.

Attending the Special Meeting

Red Hat stockholders as of the close of business on the record date may attend the special meeting in person. All Red Hat stockholders should bring valid government-issued photo identification, such as a driver s license or passport.

If you hold your shares in street name and wish to vote your shares in person at our special meeting, you must obtain a valid proxy from your broker, bank or similar institution, granting you authorization to vote your shares. In order to attend and vote your shares held in street name at our special meeting, you will need to present valid government-issued photo identification, such as a driver s license or passport, and hand in the valid proxy from your broker, bank or similar institution, along with a signed ballot that you can request at the special meeting. You will not be able to attend and vote your shares held in street name at the special meeting without valid government-issued photo identification, such as a driver s license or passport, a valid proxy from your broker, bank or similar institution and a signed ballot.

The use of cameras, sound recording equipment, communication devices or any other similar equipment is prohibited at the special meeting without the express written permission of Red Hat.

Even if you plan to attend the special meeting in person, we encourage you to complete, sign, date and return the enclosed proxy card or vote electronically over the Internet or via telephone to ensure that your shares

Table of Contents

will be represented at the special meeting. If you attend the special meeting and vote in person, your vote by ballot will revoke any proxy previously submitted. If you hold your shares in street name, because you are not the stockholder of record, you may not vote your shares in person at the special meeting unless you follow the procedures set forth above.

Assistance

If you need assistance in completing your proxy card or have questions regarding Red Hat s special meeting, please contact Innisfree M&A Incorporated by mail at 501 Madison Avenue, 20th Floor, New York, New York 10022 or by telephone. Stockholders may call toll-free at (888) 750-5834 and banks and brokers may call collect: (212) 750-5833.

Rights of Stockholders Who Seek Appraisal

If the merger proposal is approved by Red Hat stockholders, stockholders who do not vote (whether in person or by proxy) in favor of the adoption of the merger agreement and who properly exercise and perfect their demand for appraisal of their shares will be entitled to appraisal rights in connection with the merger under Section 262 of the DGCL. This means that holders of Red Hat common stock are entitled to have their shares appraised by the Court of Chancery of the State of Delaware and to receive payment in cash of the fair value of the shares of Red Hat common stock, exclusive of any elements of value arising from the accomplishment or expectation of the merger, together with interest to be paid upon the amount determined to be fair value, if any, as determined by the court. Stockholders who wish to seek appraisal of their shares are in any case encouraged to seek the advice of legal counsel with respect to the exercise of appraisal rights due to the complexity of the appraisal process.

Stockholders considering seeking appraisal should be aware that the fair value of their shares as determined pursuant to Section 262 of the DGCL could be more than, the same as or less than $190.00 per share consideration payable pursuant to the merger agreement if they did not seek appraisal of their shares.

To exercise your appraisal rights, you must submit a written demand for appraisal to Red Hat before the vote is taken on the merger proposal, you must not submit a blank proxy or otherwise vote in favor of the merger proposal and you must continue to hold the shares of Red Hat common stock of record through the effective time. Your failure to follow the procedures specified under the DGCL will result in the loss of your appraisal rights. The DGCL requirements for exercising appraisal rights are described in further detail in this proxy statement, and the relevant section of the DGCL regarding appraisal rights is reproduced and attached as Annex D to this proxy statement. If you hold your shares of Red Hat common stock through a broker, bank or other nominee and you wish to exercise appraisal rights, you should consult with your broker, bank or other nominee to determine the appropriate procedures for the making of a demand for appraisal by such broker, bank or other nominee. Stockholders should refer to the discussion under the section entitled Appraisal Rights beginning on page 116 and the DGCL requirements for exercising appraisal rights reproduced and attached as Annex D to this proxy statement.

Table of Contents

PARTIES INVOLVED IN THE MERGER

Red Hat, Inc.

Red Hat is a leading provider of open source software solutions, using a community-powered approach to develop and offer reliable and high-performing operating system, virtualization, management, middleware, cloud, mobile and storage technologies. Red Hat employs an open source development model, which allows Red Hat to use the collective input, resources and knowledge of a global community of contributors who can collaborate to develop, maintain and enhance software because the human-readable source code for that software is publicly available and licenses permit modification.

Red Hat s offerings are designed to provide customers with high-performing, scalable, flexible, reliable and secure infrastructure technologies that meet the information technology, which we refer to as IT, needs of enterprises and service providers. Our offerings enable our customers to optimize their IT environments to increase agility and flexibility while adding and managing hybrid cloud infrastructures and building modern applications. Hybrid cloud infrastructures enable customers to deploy their applications using off-premise (public cloud) and on-premise (private cloud, virtual or physical server) IT resources to create a hybrid cloud environment that is designed to enhance efficiency while providing increased security. Red Hat s offerings are designed to perform consistently across hybrid cloud environments to offer greater choices to our customers when deploying their applications.

Red Hat also offers a wide range of services that are designed to help customers receive additional value from Red Hat technologies.

Red Hat s corporate headquarters is located at 100 East Davie Street, Raleigh, North Carolina 27601.

Red Hat was formed in 1993 and is a corporation organized in the State of Delaware. Red Hat common stock is currently listed on the NYSE under the symbol RHT.

Additional information about Red Hat and its subsidiaries is included in documents incorporated by reference in this proxy statement (see the section entitled Where You Can Find More Information beginning on page 123) and on its website: www.redhat.com. The information provided or accessible through Red Hat s website is not part of, or incorporated by reference in, this proxy statement.

International Business Machines Corporation

IBM focuses on the intersection of business insight and technology innovation and creates value for clients through integrated solutions and products. These integrated solutions leverage innovative technologies, deep expertise in industries and business processes, and a commitment to security and trust. IBM solutions typically create value by enabling new capabilities for clients that optimize and transform their businesses and help them engage with their customers and employees in new ways. These solutions draw from an industry-leading portfolio of consulting and IT implementation services, cloud and cognitive offerings, and enterprise systems and software, one of the world s leading research organizations all bolstered by a commitment to the secure and responsible management of data and enterprise-grade security.

IBM s corporate headquarters is located at 1 New Orchard Road, Armonk, New York 10504.

IBM was formed in 1911 as the Computing-Tabulating-Recording Company and is a corporation organized in the State of New York. IBM s common stock, par value $0.20 per share, is currently listed on the NYSE, under the symbol

IBM.

Additional information about IBM and its subsidiaries is included on its website: www.IBM.com. The information provided or accessible through IBM s website is not part of, or incorporated by reference in, this proxy statement.

Table of Contents

Socrates Acquisition Corp.

Sub is a Delaware corporation and a wholly-owned subsidiary of IBM, formed on October 25, 2018, solely for the purpose of engaging in the merger and the other transactions as contemplated under the merger agreement. Upon completion of the merger, Sub will cease to exist.

Table of Contents

PROPOSAL 1: ADOPTION OF THE MERGER AGREEMENT

THE MERGER

This discussion of the merger is qualified in its entirety by reference to the merger agreement, which is attached to this proxy statement as Annex A and incorporated into this proxy statement by reference. You should read the entire merger agreement carefully as it is the legal document that governs the merger.

Certain Effects of the Merger on Red Hat

Upon the terms and subject to the conditions of the merger agreement and in accordance with the applicable provisions of the DGCL, on the closing date and at the effective time, Sub will merge with and into Red Hat, with Red Hat continuing as the surviving corporation and a wholly-owned subsidiary of IBM. Red Hat expects to delist its common stock from the NYSE as promptly as practicable after the effective time and de-register its common stock under the Exchange Act as promptly as practicable after such delisting. Thereafter, Red Hat would no longer be a publicly-traded company. If the merger is completed, you will not own any shares of the capital stock of the surviving corporation, and instead will only be entitled to receive the merger consideration, as described under the section entitled Terms of the Merger Agreement Merger Consideration beginning on page 84.

The effective time will occur upon the filing of a certificate of merger with the Secretary of State of the State of Delaware (or at such later time as Red Hat and IBM may agree and specify in the certificate of merger).

Effect on Red Hat if the Merger is Not Completed

If the merger agreement is not adopted by Red Hat stockholders or if the merger is not completed for any other reason, Red Hat stockholders will not receive any payment for their shares of Red Hat common stock. Instead, Red Hat will remain a public company, Red Hat common stock will continue to be listed and traded on the NYSE and registered under the Exchange Act and Red Hat will continue to file periodic reports with the SEC.

Furthermore, if the merger is not consummated, and depending on the circumstances that caused the merger not to be consummated, it is likely that the price of Red Hat common stock will decline significantly. If that were to occur, it is uncertain when, if ever, the price of Red Hat common stock would return to the price at which it trades as of the date of this proxy statement.

Accordingly, if the merger is not consummated, there can be no assurance as to the effect of these risks and opportunities on the future value of your shares of Red Hat common stock. If the merger is not consummated, the Board of Directors will continue to evaluate and review Red Hat s business operations, properties and capitalization, among other things, make such changes as are deemed appropriate and continue to seek to enhance stockholder value. If the merger agreement is not adopted by Red Hat stockholders or if the merger is not consummated for any other reason, there can be no assurance that any other transaction acceptable to Red Hat or its stockholders will be offered or that Red Hat s business, prospects or results of operations will not be adversely impacted.

Under certain specified circumstances, Red Hat will be required to pay IBM a termination fee upon the termination of the merger agreement, as described under the section entitled Terms of the Merger Agreement Termination of the Merger Agreement Termination Fees beginning on page 106.

Background of the Merger

As part of Red Hat s strategic planning process, the Red Hat Board of Directors regularly reviews and discusses with Red Hat s senior management the company s performance, business strategy and competitive

position in the industries in which it operates. In addition, the Red Hat Board of Directors and Red Hat s senior management regularly review and evaluate various strategic alternatives, including acquisitions, dispositions, major commercial partnerships and other strategic transactions, as part of ongoing efforts to strengthen Red Hat s overall business and enhance stockholder value.

As part of this ongoing process, the Red Hat Board of Directors has considered and implemented actions to enhance stockholder value, including executing a number of strategic acquisitions, including, among others, CoreOS, Inc. on January 30, 2018, Permabit Technology Corporation on July 31, 2017 and Codenvy S.A. on June 1, 2017. In the course of Red Hat s strategic planning process, representatives of Red Hat have, in the ordinary course and from time to time, discussed with various companies in the software and technology industries potential commercial partnerships that might expand their respective businesses, improve their respective customer offerings and create value for Red Hat stockholders.

Since October 2016, Guggenheim Securities has rendered advice to Red Hat regarding various strategic and financial matters. During the course of Guggenheim Securities engagement, representatives of Guggenheim Securities interacted, on Red Hat s behalf, with various companies in the software and technology industries, including IBM, and offered general perspectives on the technology landscape and operating environment for Red Hat s offerings including hybrid multi-cloud solutions. During the period from October 2017 to December 2017, representatives of Guggenheim Securities met with representatives of IBM to discuss Red Hat, including regarding a potential commercial partnership and other strategic alternatives.

During this time period, certain members of Red Hat s senior management also met with representatives of IBM to discuss expanding the commercial partnership between the two parties. Thereafter, and until IBM and Red Hat announced the expansion of that partnership on May 8, 2018, representatives of both Red Hat and IBM were in contact regarding the implementation of the expanded commercial partnership.

In February 2018, James M. Whitehurst, Chief Executive Officer of Red Hat met the Chief Executive Officer of Party A, a technology company offering software, services, and other solutions, at a meeting of CEOs for the purposes of professional and leadership development. During the course of the discussion, the Chief Executive Officer of Party A indicated a possible interest in an acquisition of Red Hat through a transaction structured to maintain Red Hat s independence, potentially with Red Hat remaining a separate public company in which Party A would have a significant stake.

On March 22, 2018, representatives of Guggenheim Securities met with representatives of Party A (including its Chief Executive Officer) to discuss Red Hat, including regarding a potential commercial partnership and other strategic alternatives.

During the spring of 2018, representatives of Red Hat, including Paul Cormier, Executive Vice President and President, Products and Technologies, met with representatives of Party B, a technology company that specializes in Internet-related services and products, on several occasions to discuss a potential commercial partnership in the software industry.

On April 11, 2018, Mr. Whitehurst met with Ginni Rometty, Chairman, President and Chief Executive Officer of IBM, at Mrs. Rometty s invitation, to discuss the strategic landscape in which Red Hat and IBM operate, as well as ways in which the two companies could expand upon the commercial partnership that IBM and Red Hat planned to announce in May 2018.

On May 8, 2018, Red Hat and IBM announced an expansion of their existing commercial partnership in order to fuel hybrid cloud adoption in the enterprise.

On May 31, 2018, Mr. Whitehurst and Mr. Cormier met with representatives of Party A, as they had from time to time in the past, regarding commercial relationships and other potential strategic opportunities. During

Table of Contents

the course of these discussions, Party A reiterated an interest in pursuing an acquisition of Red Hat through a transaction structured to maintain Red Hat s independence, potentially with Red Hat remaining a separate public company in which Party A would have a significant stake. Thereafter, Mr. Whitehurst and the Chief Executive Officer of Party A planned to continue discussions later that summer. On August 1, 2018, Mr. Whitehurst contacted the Chief Executive Officer of Party A to discuss whether Party A was interested in continuing the discussion of commercial and strategic opportunities. The Chief Executive Officer of Party A indicated that Party A remained interested in pursuing a transaction with Red Hat and the two CEOs should continue the discussion about this opportunity towards the end of the year.

Thereafter, Mr. Cormier remained in contact with other representatives of Party A for purposes of discussing certain other commercial matters. Following these discussions, on September 19, 2018, Mr. Cormier and a representative of Party A agreed to schedule a meeting between senior executives of Party A (including its Chief Executive Officer) and Red Hat (including Messrs. Cormier and Whitehurst) to discuss with more specificity Party A s interest in pursuing a strategic transaction with Red Hat. This meeting was scheduled to occur and did occur on October 10, 2018.

On September 23, 2018, representatives of Guggenheim Securities met with a senior executive of IBM at the senior executive s request to discuss the businesses and prospects of each of IBM and Red Hat generally and more specifically, IBM s interest in potentially pursuing a strategic transaction with Red Hat.

On September 25, 2018, Mrs. Rometty contacted Mr. Whitehurst to schedule a meeting on the morning of September 27, 2018 when both would be in New York City, NY.

Also, on September 25, 2018, representatives of Guggenheim Securities met with the Chairman of Party A to discuss Party A s and Red Hat s commercial relationship and the potential for a strategic transaction between Party A and Red Hat.

On September 27, 2018, Mrs. Rometty and Mr. Whitehurst met in New York City, NY. At that meeting, Mrs. Rometty provided Mr. Whitehurst with a written proposal outlining IBM s offer to acquire 100% of the equity securities of Red Hat at a price of $185 per share in cash, with the goal to preserve the independent brand and culture of Red Hat, including the goal of retaining substantially all of Red Hat s management team. Mrs. Rometty indicated that IBM was willing to work diligently to announce a transaction in approximately three weeks.

On September 30, 2018, the Red Hat Board of Directors held a special meeting to discuss IBM s proposal. Representatives of Red Hat s senior management and representatives of Guggenheim Securities and Skadden, Arps, Slate, Meagher & Flom LLP, Red Hat s external legal counsel, which we refer to as Skadden, were present during the meeting. Representatives of Skadden discussed with the Red Hat Board of Directors their fiduciary duties in considering IBM s offer and strategic alternatives. The Red Hat Board of Directors discussed, among other things, their initial views on IBM s offer, including the price offered relative to Red Hat s market valuation and recent trading history and the need to compare the value of IBM s offer to the value reflected in Red Hat s stand-alone business prospects to determine, among other things, whether any strategic third party transaction should be pursued at that time. The Red Hat Board of Directors sought the advice of Guggenheim Securities regarding IBM s offer and also potential additional counterparties that might be able to offer a compelling value in excess of the price offered by IBM. Representatives of Guggenheim Securities discussed with the Red Hat Board of Directors the industrial logic for IBM to pursue an acquisition of Red Hat and compared the industrial logic for a company like IBM to the logic that might be applicable to other potential counterparties. The Red Hat Board of Directors requested Guggenheim Securities and management to develop a list of potentially interested parties and an assessment of the parties strategic rationale for potentially acquiring Red Hat. Following discussion among the Red Hat Board of Directors, the Red Hat Board of Directors concluded that the initial offer from IBM was inadequate. However, the Red Hat Board of

Directors authorized further exploration of a transaction with IBM and also authorized Red Hat s senior management to engage in limited, price-confirmatory due diligence discussions with IBM in order to provide IBM with information necessary to enable IBM to

Table of Contents

increase its offer price. The Red Hat Board of Directors also directed Red Hat management to review with the Red Hat Board of Directors management s view of Red Hat s stand-alone business prospects.

On October 1, 2018, Mr. Whitehurst called Mrs. Rometty to inform her that the Red Hat Board of Directors had evaluated IBM s proposal, but that IBM would need to present a more compelling price in order for the Red Hat Board of Directors to consider a transaction with IBM. Mr. Whitehurst also indicated that Red Hat was willing to provide limited, price-confirmatory due diligence to IBM to enable IBM to put forward a more compelling offer price. During the course of the discussion, Mrs. Rometty indicated that IBM would require that Red Hat enter into an exclusivity agreement prohibiting Red Hat from discussing or pursuing a strategic transaction with a third party for an agreed upon period, in consideration for IBM s evaluation of the transaction. On the same day, James Kavanaugh, Chief Financial Officer of IBM, called Eric Shander, Chief Financial Officer of Red Hat to discuss the scope of IBM s confirmatory due diligence process and the appropriate next steps required to facilitate information sharing, including execution of a confidentiality agreement.

Also, on October 1, 2018, a representative of Red Hat sent a draft confidentiality agreement, which we refer to as the confidentiality agreement, to a representative of IBM, which was negotiated over the ensuing days by representatives of Red Hat, IBM, Skadden and Paul, Weiss, Rifkind, Wharton, & Garrison LLP, counsel to IBM, which we refer to as Paul Weiss. On October 3, 2018, Red Hat and IBM executed the confidentiality agreement.

That same day, Paul Weiss, on behalf of IBM, provided Skadden with a draft exclusivity agreement, which provided for an exclusivity period of four weeks.

In the evening on October 1, 2018, the Red Hat Board of Directors held a special meeting, with certain members of Red Hat s senior management, Guggenheim Securities and Skadden in attendance, to continue its discussions regarding a potential transaction with IBM. During the meeting, Mr. Whitehurst and Mr. Shander reported on the discussions with Mrs. Rometty and Mr. Kavanaugh, including IBM s request for exclusivity. The Red Hat Board of Directors discussed and evaluated the benefits of contacting Party A in advance of a previously scheduled meeting with Party A on October 10, 2018, as well other third parties. Following discussion among the Red Hat Board of Directors, the Red Hat Board of Directors directed Mr. Whitehurst to call the Chief Executive Officer of Party A to inform the Chief Executive Officer of Party A that Red Hat was in the process of reviewing a potential business combination with another counterparty. The Red Hat Board of Directors also concluded that an exclusivity arrangement between IBM and Red Hat was premature under the circumstances.

On October 2, 2018, Mr. Whitehurst, at the direction of the Red Hat Board of Directors, called the Chief Executive Officer of Party A. Mr. Whitehurst informed the Chief Executive Officer of Party A that, since Red Hat s discussions with Party A, Red Hat had continued to evaluate commercial and strategic alternatives and that Red Hat was in discussions regarding a potential business combination transaction with another counterparty. Mr. Whitehurst encouraged the Chief Executive Officer of Party A to prepare any proposals for potential strategic opportunities for the previously scheduled meeting on October 10, 2018.

Also, on October 2, 2018, an executive of Party A contacted representatives of Guggenheim Securities to determine whether Red Hat had established a formal sale process. Representatives of Guggenheim Securities informed the executive of Party A that Red Hat was considering a potential business combination transaction.

On October 3, 2018, a representative of Party B contacted Mr. Cormier of Red Hat to arrange a meeting, as they had from time to time in the past.

On October 4, 2018, Mr. Kavanaugh sent a written confirmatory due diligence list to Mr. Shander.

On October 5, 2018, Mr. Cormier met with senior executives from Party B. Mr. Cormier and the executives from Party B discussed the commercial relationship between Party B and Red Hat and other potential strategic opportunities as they had discussed from time to time in the past. One of the senior executives of Party B requested that Red Hat notify Party B if Red Hat was to ever explore other strategic opportunities.

Table of Contents

On October 7, 2018, a member of the board of Party B contacted representatives of Guggenheim Securities to determine whether Red Hat had established a formal sale process. Representatives of Guggenheim Securities informed the board member of Party B that Red Hat was considering a potential business combination transaction. The board member of Party B asked that Red Hat afford Party B sufficient time to assess its interest in pursuing a strategic transaction with Red Hat and indicated that Party B would revert promptly.

On October 8, 2018, the Red Hat Board of Directors held a special meeting with certain representatives of Red Hat s senior management, Guggenheim Securities and Skadden in attendance. Mr. Shander reviewed with the Red Hat Board of Directors Red Hat s historical performance and, in response to the Red Hat Board of Directors request to understand Red Hat management s view of Red Hat s stand-alone business prospects, presented three long-term forecasts, including the methodology used to create the forecasts, the assumptions underlying each forecast and the perceived challenges and risks associated with Red Hat s ability to meet such forecasts, including, among other things, the challenges of maintaining high rates of growth in the rapidly evolving technology sector. Representatives of Guggenheim Securities then discussed with the Red Hat Board of Directors matters relating to, among other things, the competitive landscape in which Red Hat operates and a preliminary review of the financial aspects of IBM s proposal, including trading multiples of peer companies, recent M&A activity in the technology and software sectors, the increased competitive and pricing pressures that Red Hat could expect to confront as enterprises moved to public, private and hybrid cloud solutions and preliminary financial analyses with respect to Red Hat based on the forecasts. Thereafter, Skadden reviewed the current regulatory environment and provided a preliminary assessment of the regulatory considerations associated with completing a transaction with either IBM or Party A. Finally, the Red Hat Board of Directors discussed and considered whether Red Hat should engage a second financial advisor. Following discussion among the directors the Red Hat Board of Directors directed Mr. Whitehurst to contact Morgan Stanley.

Also, on October 8, 2018, Mr. Whitehurst contacted Morgan Stanley to discuss engaging Morgan Stanley to act as a financial advisor in connection with a potential transaction. Red Hat retained Morgan Stanley as its financial advisor based on Morgan Stanley s qualifications, expertise and reputation, its knowledge of and involvement in recent transactions in the software industry and its knowledge of Red Hat s business and affairs.

On October 10, 2018, Red Hat senior management met with representatives from Party A. During that meeting Party A presented the high-level framework of a possible expanded commercial partnership arrangement with Red Hat. Party A indicated that it was not prepared to pursue a strategic transaction with Red Hat, citing concerns about securing regulatory approvals of a strategic transaction in the US and Europe.

On October 11, 2018, senior management from Red Hat and IBM met at the offices of Paul Weiss in New York City, NY for business due diligence sessions.

Also, on October 11, 2018, representatives from Morgan Stanley had two separate conversations with senior executives at Party B to inform the senior executives at Party B that Red Hat was in discussions regarding a potential business combination transaction with another counterparty and to ascertain Party B s interest in pursuing an acquisition.

Also, on October 11, 2018, senior executives of Party B discussed with representatives of Guggenheim Securities the process regarding a potential acquisition of Red Hat.

On October 12, 2018, the Red Hat Board of Directors held a special meeting with certain members of Red Hat s senior management, Guggenheim Securities, Morgan Stanley and Skadden in attendance. During the meeting, Mr. Whitehurst provided an update regarding the status of discussions with Party A and Party B. Thereafter, the Red Hat Board of Directors discussed whether to contact Party C, a technology company that specializes in Internet-related

services and products, to ascertain whether Party C might be interested in a strategic transaction. Following the discussion, the Red Hat Board of Directors determined that it would be in the best interests of Red Hat for Mr. Whitehurst to contact Party C regarding its interest in a potential strategic transaction and directed Mr. Whitehurst to contact Party C.

Also, on October 12, 2018, at the direction of the Red Hat Board of Directors, Mr. Whitehurst contacted a senior executive of Party C. Mr. Whitehurst informed the senior executive of Party C that Red Hat was in discussions regarding a potential business combination transaction. That same day, a senior executive of Party C called Morgan Stanley to discuss the situation and understand the process for a potential acquisition of Red Hat.

On October 13, 2018, a senior executive of Party B discussed with representatives of Morgan Stanley, the process regarding a potential acquisition of Red Hat. Morgan Stanley advised Party B that if they were interested in pursuing an acquisition, they would need to meet Red Hat management promptly and should they submit any proposal it would need to be in excess of the 52 week high of $176.27 in order for it to be considered by the Red Hat Board of Directors.

Also, on October 13, 2018, a senior executive from Party C spoke with Morgan Stanley and indicated that Party C was working quickly to evaluate the viability of a potential acquisition of Red Hat. Morgan Stanley advised Party C that if they were interested in pursuing an acquisition, they would need to meet Red Hat management promptly and should they submit any proposal it would need to be in excess of the 52 week high of $176.27 in order for it to be considered by the Red Hat Board of Directors.

On October 14, 2018, representatives of Morgan Stanley sent to a senior executive of Party C a document outlining the strategic rationale of a potential acquisition of Red Hat by Party C.

On October 15, 2018, representatives of Red Hat and IBM met telephonically to discuss additional price confirmatory due diligence matters.

On October 16, 2018, the CEO of Party B contacted Mr. Whitehurst to express interest in exploring a strategic transaction between Red Hat and Party B and requested an in-person meeting with representatives of Red Hat management later that week.

Also, on October 16, 2018, the Red Hat Board of Directors held a special meeting with certain representatives of Red Hat s senior management, Guggenheim Securities, Morgan Stanley and Skadden in attendance. During the meeting, Mr. Whitehurst provided an update regarding the status of discussions with Party B, Party C and IBM. Representatives of Morgan Stanley then reviewed with the Red Hat Board of Directors the potential accretive effects of the transaction on IBM, and Morgan Stanley s preliminary assessment of IBM s capability and willingness to pay more than its then current offer of $185 per share. Thereafter, representatives of Guggenheim Securities discussed with the Red Hat Board of Directors the potential strategic benefits to IBM of acquiring Red Hat, including the realization by incumbent technology providers, such as IBM, that Kubernetes-based orchestration platforms such as Red Hat s OpenShift are a key element of the emerging hybrid multi-cloud architecture and infrastructure.

On October 17, 2018, a senior executive from Party C called Mr. Whitehurst to share Party C s interest in pursuing an acquisition. Separately, a senior executive from Party C called representatives of Morgan Stanley to schedule an in-person meeting with representatives of Red Hat senior management later that week.

Also, on October 17, 2018, a representative of Red Hat sent a draft mutual confidentiality agreement, which we refer to as the Party B confidentiality agreement, to Party B. The Party B confidentiality agreement was negotiated over the ensuing days by representatives of Red Hat, Party B, Skadden and Party s B counsel. On October 18, 2018, Red Hat and Party B executed the Party B confidentiality agreement.

Also, on October 18, 2018, executives of Red Hat and Party B met to discuss a possible transaction. Representatives of Red Hat provided Party B with an overview of Red Hat s products, go-to-market strategy and certain financial information. Party B received information that was substantially similar to the information previously provided to

IBM.

Also, on October 17, 2018, a representative of Morgan Stanley sent a draft mutual confidentiality agreement, which we refer to as the Party C confidentiality agreement, to a senior executive of Party C. The Party C

confidentiality agreement was negotiated over the ensuing days by representatives of Red Hat, Party C and Skadden. On October 19, 2018, Red Hat and Party C executed the Party C confidentiality agreement. Thereafter, executives of Red Hat and Party C met to discuss a possible transaction. Representatives of Red Hat provided Party C with an overview of Red Hat s products, go-to-market strategy and certain financial information. Party C received information that was substantially similar to the information previously provided to IBM.

Also, on October 19, 2018, Mrs. Rometty contacted Mr. Whitehurst to present a revised proposal to acquire all outstanding shares of Red Hat common stock at a price of $190.00 per share in cash. The offer was conditioned upon IBM and Red Hat finalizing and announcing the transaction early in the week of October 29, 2018 and entering into an exclusivity agreement through the end of that week.

That same day, Paul Weiss, on behalf of IBM, provided Skadden with a revised draft of the exclusivity agreement, which provided for an exclusivity period through 11:59 p.m. on Friday, November 2, 2018.

Also, on October 18 and October 19, 2018, Morgan Stanley had various conversations with representatives of Party B and Party C to reiterate the necessary timing of any proposal by Party B or Party C if they were to be considered by the Red Hat Board of Directors in light of Red Hat s ongoing discussions with other parties.

On October 20, 2018, a senior executive of Party C contacted Mr. Whitehurst and indicated that Party C would not pursue an acquisition of Red Hat.

Also, on October 20, 2018, a senior executive of Party C also contacted representatives of Morgan Stanley to confirm that Party C would not pursue an acquisition of Red Hat. Party C stated it was not in a position to submit a proposal that exceeded the 52 week high of $176.27.

That same day, a representative of Party B contacted Mr. Cormier and indicated that Party B would decline to make a proposal to acquire Red Hat; however, Party B remained interested in exploring a commercial partnership with a minority equity investment in Red Hat. Separately, a senior executive from Party B contacted Morgan Stanley and indicated that Party B would decline to make a proposal to acquire Red Hat. Party B stated it was not in a position to submit a proposal that exceeded the 52 week high of $176.27.

On October 21, 2018, the Red Hat Board of Directors held a special meeting with certain representatives of Red Hat s senior management, Guggenheim Securities, Morgan Stanley and Skadden in attendance. During the meeting, Mr. Whitehurst and Mr. Cormier provided an update regarding the status of discussions with Party B and Party C. Thereafter, Mr. Whitehurst reviewed with the Red Hat Board of Directors Red Hat management s view of Red Hat s stand-alone business prospects. Representatives of Skadden then provided an update regarding the preliminary antitrust analysis of a potential transaction with IBM and the likely timeline for completing such a transaction. Following discussion among the Red Hat Board of Directors, Mr. Whitehurst recommended that Red Hat pursue the negotiation of a transaction with IBM at $190 per share and grant IBM exclusivity for a limited duration through the morning of October 29, 2018. After further discussion, the Red Hat Board of Directors decided to work towards a definitive agreement on terms and conditions which maximized value for Red Hat s stockholders.

Following the special meeting, on October 21, 2018, Skadden, on behalf of Red Hat provided Paul Weiss with a revised draft of the exclusivity agreement. Red Hat and IBM executed the exclusivity agreement on October 21, 2018, which provided for an exclusivity period through 7:30 a.m. on October 29, 2018. Later that day, Paul Weiss, on behalf of IBM, provided Skadden with a draft merger agreement, which included, among other provisions, a proposed termination fee in an amount to equal 4% of Red Hat s fully diluted equity value payable by Red Hat in connection with accepting a superior proposal from a third party and no termination fee payable by IBM in the event that the

parties could not complete the transaction due to a failure to obtain antitrust and competition approvals.

During the week of October 22, 2018, certain members of Red Hat s senior management held a series of diligence calls with IBM and its representatives relating to various aspects of Red Hat s business.

Table of Contents

On October 22, 2018, a senior executive of IBM indicated to Mr. Whitehurst that IBM expected certain members of Red Hat s management team to execute a holder agreement, containing restrictive covenants, including a non-compete and non-solicit. On October 23, 2018, a representative of IBM provided a draft of the holder agreement to Mr. Shander.

On October 23, 2018, Skadden, on behalf of Red Hat, provided Paul Weiss with a revised draft of the merger agreement, which included a termination fee payable by Red Hat equal to 2.5% of Red Hat s fully diluted equity value and a regulatory termination fee, in an amount equal to 6% of Red Hat s fully diluted equity value, payable by IBM in the event that the parties could not complete the transaction due to a failure to obtain antitrust and competition approvals.

On October 24, 2018, Paul Weiss, on behalf of IBM, provided Skadden with a revised draft of the merger agreement. Late in the evening on October 24, 2018, representatives of Skadden and Paul Weiss discussed the merger agreement. The revised draft merger agreement did not include a regulatory termination fee and proposed a termination fee equal to 3.75% payable by Red Hat of Red Hat s fully diluted equity value.

On October 25, 2018, Skadden, on behalf of Red Hat, provided Paul Weiss with a revised draft of the merger agreement, which included a termination fee payable by Red Hat equal to 2.5% of Red Hat s fully diluted equity value and a regulatory termination fee payable by IBM, in an amount equal to 6% of Red Hat s fully diluted equity value.

Also, on October 25, 2018, a senior executive of IBM provided Red Hat with a summary proposal outlining the key terms of retention arrangements with key executives of Red Hat.

On October 25, 2018, the Red Hat Board of Directors held a special meeting with certain representatives of Red Hat s senior management, Guggenheim Securities, Morgan Stanley and Skadden in attendance. During the meeting, Mr. Whitehurst provided an update regarding the status of discussions with IBM. Thereafter, Skadden again discussed with the Red Hat Board of Directors the fiduciary duties of directors in connection with evaluating Red Hat s other strategic alternatives. Skadden also provided the Red Hat Board of Directors with an update on the antitrust analysis of a potential transaction with IBM, including anticipated timing and areas of risk. Thereafter, representatives of Skadden reviewed the key terms of the proposed merger agreement relating to deal certainty and the parties required efforts to obtain applicable regulatory approvals, including certain open issues between the parties, including whether IBM would be required to pay a regulatory termination fee in the event that the parties could not complete the transaction due to a failure to obtain antitrust and competition approvals and the size of the termination fee payable by Red Hat in connection with accepting a superior proposal from a third party. Thereafter, Mr. Whitehurst reviewed with the Red Hat Board of Directors the proposed provisions regarding employee retention and the amount of retention awards available, as well as the retention arrangements offered by IBM to certain executive officers, which were conditional upon the closing of the merger, in consideration for such executive officer entering into the holder agreements requested by IBM. Representatives of Guggenheim Securities then discussed with the Red Hat Board of Directors matters relating to, among other things, the price per share offered by IBM compared to certain precedent transactions based upon certain valuation metrics and delivered a presentation to the Red Hat Board of Directors regarding preliminary financial analyses with respect to Red Hat based on the forecasts. Representatives of Morgan Stanley also discussed with the Red Hat Board of Directors matters relating to the premium offered by IBM compared with premiums paid in other software transactions during the past five years and delivered a presentation to the Red Hat Board of Directors regarding preliminary financial analyses with respect to Red Hat based on the forecasts.

On October 25, 2018, Mr. Whitehurst and Mrs. Rometty spoke to discuss the terms of the proposed transaction, including the regulatory termination fee and other key provisions. During this call, Mrs. Rometty indicated that IBM was unwilling to proceed with any transaction on terms that provided for a regulatory termination fee and informed

Mr. Whitehurst that if the Red Hat Board of Directors ultimately insisted on the inclusion of a regulatory termination fee IBM would terminate discussions.

On October 26, 2018, Paul Weiss, on behalf of IBM, provided Skadden with a revised draft of the merger agreement. The revised draft merger agreement did not include a regulatory termination fee and proposed a termination fee equal to 3.75% of Red Hat s fully diluted equity value.

Table of Contents

Late in the evening on October 26, 2018, Skadden, on behalf of Red Hat, provided Paul Weiss with a revised draft of the merger agreement. The revised draft of the merger agreement indicated that the regulatory termination fee payable by IBM remained an open issue between the principals and proposed a termination fee equal to 2.5% of Red Hat s fully diluted equity value. In the morning of October 27, 2018, representatives of Skadden and Paul Weiss discussed the merger agreement.

On October 27, 2018, the Red Hat Board of Directors held a special meeting with certain representatives of Red Hat s senior management, Guggenheim Securities, Morgan Stanley and Skadden in attendance. Representatives of Skadden reviewed with the Red Hat Board of Directors the current status of discussions regarding the inclusion of a regulatory termination fee, the parties required efforts to obtain applicable regulatory approvals, and a clear market provision, which would prohibit IBM from acquiring any assets or business, if such acquisition would reasonably be expected to increase the risk of not obtaining, or the risk of materially delaying the obtaining of, regulatory approvals. Thereafter, the Red Hat Board of Directors considered the terms of the proposed merger agreement relating to deal certainty, including the reasonable likelihood of the consummation of the transactions contemplated by the merger agreement in light of the conditions in the merger agreement and the fact that the proposed merger agreement required that IBM use its reasonable best efforts to take certain actions necessary to obtain regulatory clearance and satisfy the regulatory conditions, including the fact that IBM agreed to accept potential structural and behavioral remedies in order to obtain regulatory approval up to a level of a material adverse effect on Red Hat or IBM (measured on a scale relative to the size of Red Hat). In light of the totality of the terms then available for the Red Hat Board of Directors consideration and Mrs. Rometty s statement that IBM would not proceed with a transaction that provided for a regulatory termination fee, the Red Hat Board concluded that the proposed merger agreement offered a sufficiently high level of transaction certainty such that the Red Hat Board of Directors need not risk the substantial benefits of the transaction by conditioning the transaction on the inclusion of a regulatory termination fee, which was likely unobtainable from IBM, and concluded that a regulatory termination fee was not required. Mr. Whitehurst then reviewed with the Red Hat Board of Directors the status of the retention arrangements and holders agreements for certain executive officers of Red Hat.

During the day on October 27, 2018 and into October 28, 2018, representatives of the parties further negotiated, and reached resolution on, the remaining open points of the merger agreement, which included issues with respect to the parties required efforts to obtain applicable regulatory approvals, the size of the termination fee and obligations under the interim operating covenants, including Red Hat s ability to make certain grants of equity awards prior to closing.

During the morning of October 28, 2018, the Red Hat Board of Directors met to consider IBM s offer and the terms of the merger agreement. Representatives of Red Hat senior management and representatives of Guggenheim Securities, Morgan Stanley and Skadden also were in attendance. Representatives of Skadden discussed with the Red Hat Board of Directors the fiduciary duties of directors in connection with evaluating Red Hat s strategic alternatives and the terms of the merger agreement, including, among other things, the parties respective termination rights (including Red Hat s right to terminate the merger agreement to enter into an alternative acquisition agreement with respect to a superior proposal), the termination fee, the obligations of the parties to obtain applicable regulatory approvals, the definition of a material adverse effect and the applicable closing conditions. Also at this meeting, Guggenheim Securities reviewed with the Red Hat Board of Directors Guggenheim Securities financial analysis of the merger consideration, as more fully described below under the section entitled Proposal 1: Adoption of the Merger Agreement The Merger Opinions of Red Hat s Financial Advisors Opinion of Guggenheim Securities, LLC beginning on page 47, and rendered an oral opinion, confirmed by delivery of a written opinion dated October 28, 2018, to the Red Hat Board of Directors to the effect that, as of that date and based on and subject to the matters considered, the procedures followed, the assumptions made and various limitations of and qualifications to the review undertaken, the merger consideration was fair, from a financial point of view, to Red Hat stockholders. Representatives of Morgan Stanley then reviewed with the Red Hat Board of Directors Morgan Stanley s financial analysis of the merger consideration, as

more fully described below under the section entitled Proposal 1: Adoption of the Merger Agreement The Merger Opinions of Red Hat s Financial Advisors Opinion of Morgan Stanley & Co. LLC beginning on page 60, and rendered to the Red Hat Board of Directors its oral opinion that, as of October 28, 2018 and based upon and subject to the

Table of Contents

assumptions made, procedures followed, matters considered and qualifications and limitations on the scope of review undertaken by Morgan Stanley as set forth in its written opinion, the merger consideration to be received by Red Hat stockholders pursuant to the merger agreement was fair, from a financial point of view, to such Red Hat stockholders (such opinion was subsequently confirmed by delivery of a written opinion dated October 28, 2018 following the meeting). After discussing the proposed transaction and considering the presentations by Skadden, Guggenheim Securities and Morgan Stanley, the Red Hat Board of Directors unanimously (i) determined that the terms of the merger agreement, the merger and the other transactions contemplated by the merger agreement are fair to and in the best interests of Red Hat and its stockholders; (ii) adopted, approved and declared advisable the execution, delivery and performance of the merger agreement, the merger and the other transactions contemplated by the merger agreement; (iii) approved, authorized and declared advisable the consummation by Red Hat of the transactions contemplated by the merger agreement; (iv) resolved to recommend that Red Hat stockholders vote in favor of the adoption and approval of the merger agreement, the merger and other transactions contemplated by the merger agreement; and (v) resolved to submit the merger agreement to Red Hat stockholders for adoption at a duly held meeting of such stockholders. In connection with the execution of the merger agreement, certain of Red Hat s executive officers entered into retention arrangements with IBM and new restrictive covenant agreements with IBM.

On October 28, 2018, Red Hat and IBM issued a joint press release announcing the execution of the merger agreement.

Recommendation of Our Board of Directors and Reasons for the Merger

Recommendation of the Red Hat Board of Directors to Adopt the Merger Agreement, thereby Approving the Transactions Contemplated by the Merger Agreement.

On October 28, 2018, the Red Hat Board of Directors, after considering various factors described below, and after consultation with independent legal and financial advisors, unanimously (i) determined that the terms of the merger agreement, the merger and the other transactions contemplated by the merger agreement are fair to and in the best interests of Red Hat and its stockholders; (ii) adopted, approved and declared advisable the execution, delivery and performance of the merger agreement, the merger and the other transactions contemplated by the merger agreement; (iii) approved, authorized and declared advisable the consummation by Red Hat of the transactions contemplated by the merger agreement; (iv) resolved to recommend that Red Hat stockholders vote in favor of the adoption and approval of the merger agreement, the merger and other transactions contemplated by the merger agreement; and (v) resolved to submit the merger agreement to Red Hat stockholders for adoption at a duly held meeting of such stockholders.

The Red Hat Board of Directors unanimously recommends that you vote FOR the proposal to adopt the merger agreement, thereby approving the transactions contemplated by the merger agreement, including the merger.

Reasons for the Merger

In recommending that Red Hat s stockholders vote in favor of the merger proposal, the Red Hat Board of Directors considered a number of potentially positive factors, including, but not limited to, the following (which factors are not necessarily presented in order of relative importance):

Premium to Market Price. The fact that the merger consideration of $190.00 per share in cash to be received by the holders of shares of Red Hat common stock in the merger represents a significant premium over the market price at which shares of Red Hat common stock traded prior to the announcement of the execution of the merger agreement, including the fact that the merger consideration represents a premium of:

approximately 62.8% over the closing stock price on October 26, 2018, the last trading day prior to the announcement of the transaction;

Table of Contents

approximately 51.7% over the volume weighted average stock price of shares of Red Hat common stock during the 30 days ended October 26, 2018; and

approximately 7.8% over the highest closing stock price of shares of Red Hat common stock during the 52-week period ended October 26, 2018.

Form of Consideration. The fact that the proposed merger consideration is all cash, which provides stockholders certainty of value and liquidity for their shares of Red Hat common stock while eliminating long term business and execution risks.

Opinion of Guggenheim Securities, LLC. The opinion of Guggenheim Securities, dated October 28, 2018, to the Red Hat Board of Directors as to the fairness, from a financial point of view and as of the date of the opinion, of the merger consideration to the holders of Red Hat common stock, which opinion was based on and subject to the matters considered, the procedures followed, the assumptions made and various limitations of and qualifications to the review undertaken as more fully described below in the section entitled Proposal 1: Adoption of the Merger Agreement The Merger Opinions of Red Hat s Financial Advisors Opinion of Guggenheim Securities, LLC beginning on page 47.

Opinion of Morgan Stanley & Co. LLC. The opinion of Morgan Stanley to the Red Hat Board of Directors on October 28, 2018, which was subsequently confirmed in writing on such date, that, as of such date and based upon and subject to the assumptions made, procedures followed, matters considered and qualifications and limitations on the scope of review undertaken by Morgan Stanley as set forth in its written opinion, the merger consideration to be received by Red Hat stockholders pursuant to the merger agreement was fair, from a financial point of view, to such Red Hat stockholders as more fully described below in the section entitled Proposal 1: Adoption of the Merger Agreement The Merger Opinions of Red Hat s Financial Advisors Opinion of Morgan Stanley & Co. LLC beginning on page 60.

Fair Value. The Red Hat Board of Directors believed that the merger represents fair value for the shares of Red Hat common stock, taking into account the Red Hat Board of Directors familiarity with Red Hat s current and historical financial condition, results of operations, business, competitive position and prospects, as well as Red Hat s future business plan and potential long-term value.

Loss of Opportunity. The Red Hat Board of Directors considered the possibility that, if it declined to adopt the merger agreement, there may not be another opportunity for Red Hat s stockholders to receive a comparably priced transaction.

Market Check. In addition to continuing then ongoing discussions with Party A, after receipt of IBM s merger proposal, the Red Hat Board of Directors, with the assistance of Guggenheim Securities and Morgan Stanley, considered other parties that would be most likely to have an interest in acquiring Red Hat. After considering advice that Party A, Party B and Party C were the most likely of the strategic buyers considered to have a strategic interest in, and be willing to pay a competitive price for, Red Hat, the Red Hat Board of

Directors solicited the interest of Party A, Party B and Party C. The Red Hat Board of Directors considered the fact that, following discussions with each of Party A, Party B and Party C, Party A was only willing to pursue a commercial partnership arrangement with Red Hat on terms to be developed by Party A and Red Hat, Party B only offered to explore a commercial partnership with an investment in Red Hat and that none of the parties contacted were willing to pursue a strategic transaction with Red Hat at a price more favorable than the price offered by IBM.

Arms-Length Negotiations. The fact that the Red Hat Board of Directors and Red Hat s senior management, in coordination with Red Hat s outside legal and financial advisors, vigorously negotiated on an arms-length basis with IBM with respect to price and other terms and conditions of the merger agreement, including obtaining a price increase by IBM from its initial price of $185.00 per share to a price of $190.00 per share as well as the stated position of IBM that the agreed price was the highest price per share to which IBM was willing to agree. In addition, the Red Hat Board of Directors noted that as to matters related to retention arrangements for key executives, arrangements were not discussed with IBM until after discussions with Party A, Party B and Party C ceased, IBM increased its

Table of Contents

price per share to a price of $190.00 per share and substantially all terms of the merger agreement were agreed.

Review of Strategic Alternatives. The Red Hat Board of Directors considered, after a thorough review of Red Hat s long-term strategic goals and opportunities, competitive environment and short- and long-term performance in light of Red Hat s strategic plan, and discussions with Red Hat s senior management and Red Hat s outside legal and financial advisors, the challenges and risks of continuing as a stand-alone public company and the potential strategic alternatives available to Red Hat including the potential commercial partnerships proposed by Party A and Party B. Following such review, the Red Hat Board of Directors determined that the value offered to Red Hat s stockholders pursuant to the merger agreement is more favorable to Red Hat s stockholders than the alternative of remaining an independent public company and pursuing Red Hat s long-term plan (taking into account the potential risks, rewards and uncertainties associated therewith) and/or exploring the terms and scope of any potential commercial partnership with either Party A or Party B.

Risks Inherent in Red Hat s Business Plan. The Red Hat Board of Directors considered Red Hat s short-term and long-term financial projections and the perceived challenges and risks associated with Red Hat s ability to meet such projections, including the challenges of maintaining high rates of growth in the rapidly evolving technology sector, as well as the risks and uncertainties described in the risk factors and forward looking statements sections of Red Hat s disclosures filed with the SEC, including the fact that Red Hat s actual financial results in future periods could differ materially and adversely from the projected results.

Board Carefully Studied the Transaction. The fact that the Red Hat Board of Directors met, along with Red Hat s financial and legal advisors, to evaluate and discuss the material terms and conditions of, and other matters related to, the merger, in person and telephonically nine times between September 27, 2018, the date that representatives of IBM first proposed a business transaction to representatives of Red Hat, and October 28, 2018, the date the merger agreement was signed.

Best Value Reasonably Available. The Red Hat Board of Directors considered, after a thorough review of the process conducted, that $190.00 per share in cash and the terms of the merger agreement offer the best value reasonably attainable for holders of Red Hat common stock.

Terms of the Merger Agreement. The Red Hat Board of Directors considered that the provisions of the merger agreement, including the respective representations, warranties and covenants and termination rights of the parties and termination fees payable by Red Hat, are reasonable and customary. The Red Hat Board of Directors also believed that the terms of the merger agreement include the most favorable terms reasonably attainable from IBM.

Conditions to the Consummation of the Merger; Likelihood of Closing. The Red Hat Board of Directors considered the reasonable likelihood of the consummation of the transactions contemplated by the merger agreement in light of the conditions in the merger agreement to the obligations of IBM, as well as Red Hat s ability to seek specific performance to prevent breaches of the merger agreement, including to cause the

merger to be consummated if all of the conditions to IBM s obligations to effect the merger closing have been satisfied or waived.

Regulatory Approvals. The Red Hat Board of Directors considered the fact that the merger agreement requires that IBM use its reasonable best efforts to take certain actions necessary to obtain regulatory clearance and satisfy the regulatory conditions, including the fact that IBM agreed to accept potential structural and behavioral remedies in order to obtain regulatory approval, including IBM s commitment to divest certain assets or businesses of Red Hat and other additional remedies on Red Hat or IBM, unless such additional remedies would result in, or would reasonably be expected to result in a material adverse effect on Red Hat or IBM (measured on a scale relative to the size of Red Hat). The Red Hat Board of Directors also considered the fact that actions taken to maintain Red Hat as an open and neutral platform would not be taken into account when determining whether a remedy would result in a material adverse effect. For a more complete description of IBM s obligations to obtain required regulatory approvals, see the section below entitled Terms of the Merger Agreement Additional Agreements Efforts to Complete the Merger beginning on page 97. The merger agreement also provides an appropriate termination date by which time

Table of Contents

it is reasonable to expect that the regulatory conditions are likely to be satisfied. For a more complete description of the termination date, see the section below entitled Terms of the Merger Agreement Termination of the Merger Agreement Termination beginning on page 104.

No Financing Condition. The Red Hat Board of Directors considered IBM s representations and covenants contained in the merger agreement relating to IBM s financing commitments and the fact that the merger is not subject to a financing condition. The Red Hat Board of Directors also considered the delivery by IBM of a debt commitment letter by banks of international reputation and reviewed the terms and conditions thereof.

Ability to Respond to Certain Unsolicited Takeover Proposals. The Red Hat Board of Directors considered the fact that, while the merger agreement restricts Red Hat s ability to actively solicit competing bids to acquire it, the Red Hat Board of Directors has rights, under certain circumstances, to engage in discussions with, and provide information to, third parties submitting written unsolicited takeover proposals and to terminate the merger agreement in order to enter into an alternative acquisition agreement that the Red Hat Board of Directors determines to be a superior proposal, provided that Red Hat concurrently pays a $975,000,000 termination fee. The Board further considered that the timing of the merger would provide ample opportunity for such third parties to submit proposals, that other companies in the cloud and/or technology industry, including Party A, Party B and Party C, have significant resources which would make them highly capable of submitting such a proposal if they so chose and that the terms of the merger agreement, including the size of the termination fee, would be unlikely to deter such third parties from submitting such proposals.

Change of Recommendation. The Red Hat Board of Directors considered the fact that it has the right to make an adverse recommendation change to Red Hat stockholders if a superior proposal is available or an intervening event has occurred, provided that Red Hat pays a $975,000,000 termination fee if IBM terminates the merger agreement.

Retention of Key Employees. The Red Hat Board of Directors belief that a retention plan for certain employees of Red Hat that Red Hat would be permitted to implement in connection with the merger would help assure the continuity of management, and increase the likelihood of the successful operation of Red Hat during the period prior to closing.

Appraisal Rights. The Red Hat Board of Directors considered the availability of appraisal rights with respect to the merger for Red Hat stockholders who properly exercise their rights under the DGCL, which would give these stockholders the ability to seek and be paid a judicially determined appraisal of the fair value of their shares at the completion of the merger.

Recommendation of Senior Management. The Red Hat Board of Directors considered the recommendation of Red Hat s senior management in favor of the merger.

Distinct Unit. The Red Hat Board of Directors considered that it was the intention of the parties that, following the effective time, Red Hat would remain an open and neutral platform, partnering broadly with information technology participants and continuing to support the open source community and the joint statement of the parties that Red Hat will join IBM s Hybrid Cloud team as a distinct unit, preserving the independence and neutrality of Red Hat s open source development heritage and commitment, current product portfolio and go-to-market strategy, and unique development culture and will continue to be led by Mr. Whitehurst and Red Hat s current management team. In addition, the Red Hat Board of Directors also considered IBM s statement in the joint press release that IBM remained committed to Red Hat s open governance, open source contributions, participation in the open source community and development model, and fostering Red Hat s widespread developer ecosystem. The Red Hat Board of Directors also considered the impact of such statements on Red Hat s employees, customers and partners prior to closing of the merger.

The Red Hat Board of Directors also considered and balanced against the potentially positive factors a number of uncertainties, risks and other potentially negative factors in its deliberations concerning the merger

Table of Contents

and the other transactions contemplated by the merger agreement, including, but not limited to, the following (not necessarily in order of relative importance):

No Stockholder Participation in Future Growth or Earnings. The fact that Red Hat s stockholders will lose the opportunity to realize the potential long-term value of the successful execution of Red Hat s current strategy as an independent public company.

Impact of Announcement on Red Hat. The fact that the announcement and pendency of the merger, or the failure to complete the merger, may result in significant costs to Red Hat and cause substantial harm to Red Hat s relationships with its employees (including making it more difficult to attract and retain key personnel and the possible loss of key management and other personnel) and its customers, partners, providers and suppliers.

Diversion of Management Attention. The Red Hat Board of Directors considered the substantial time and effort of management required to consummate the merger, which could disrupt Red Hat s business operations and may divert employees attention away from Red Hat s day-to-day operations.

Tax Treatment. The fact that the all-cash transaction would be taxable to holders of Red Hat common stock for U.S. federal income tax purposes.

Closing Certainty. The fact that there can be no assurance that all conditions to the parties obligations to consummate the merger will be satisfied, including approval by the holders of Red Hat common stock and the approval of certain regulatory authorities.

Pre-Closing Covenants. The Red Hat Board of Directors considered the restrictions on Red Hat s conduct of business prior to completion of the merger contained in the merger agreement, which could delay or prevent Red Hat from undertaking business opportunities that may arise or taking other actions with respect to its operations during the pendency of the merger without IBM s consent.

No Solicitation. The Red Hat Board of Directors considered the restrictions in the merger agreement on Red Hat s ability to actively solicit competing bids to acquire it.

Termination Fee. The Red Hat Board of Directors considered the termination fee of $975,000,000 that could become payable to IBM under specified circumstances, including upon the termination of the merger agreement in order to enter into an alternative acquisition agreement with respect to a superior proposal and concluded that the termination fee is reasonable in amount, consistent with or below fees in comparable transactions and will not unduly deter any other party that might be interested in acquiring Red Hat.

No Reverse Termination Fee. The Red Hat Board of Directors considered the fact that if the merger is not completed as a result of regulatory impediments, IBM will not be obligated to pay any reverse termination fee to Red Hat.

Loss of Key Personnel. The Red Hat Board of Directors considered the risk that, despite retention efforts prior to consummation of the merger, Red Hat may lose personnel.

Timing of Closing. The Red Hat Board of Directors considered the amount of time it could take from the date of its deliberations and the special meeting to complete the transactions, including that an extended period of time may exacerbate the impact of other risks considered by the Red Hat Board of Directors described herein.

After taking into account all of the factors set forth above, as well as others, the Red Hat Board of Directors concluded that the risks, uncertainties, restrictions and potentially negative factors associated with the merger were outweighed by the potential benefits of the merger to Red Hat s stockholders.

The foregoing discussion of factors considered by the Red Hat Board of Directors is not intended to be exhaustive, but summarizes the material factors considered by the Red Hat Board of Directors. In light of the variety of factors considered in connection with their evaluation of the merger agreement and the merger, the

Table of Contents

Red Hat Board of Directors did not find it practicable to, and did not, quantify or otherwise assign relative weights to the specific factors considered in reaching their determinations and recommendations. Moreover, each member of the Red Hat Board of Directors applied his or her own personal business judgment to the process and may have given different weight to different factors. The Red Hat Board of Directors did not undertake to make any specific determination as to whether any factor, or any particular aspect of any factor, supported or did not support their ultimate determinations. The Red Hat Board of Directors based their recommendations on the totality of the information presented, including thorough discussions with, and questioning of, Red Hat s senior management and the Red Hat Board of Directors financial advisors and outside legal counsel. It should be noted that this explanation of the reasoning of the Red Hat Board of Directors and certain information presented in this section is forward-looking in nature and should be read in light of the factors set forth in Forward-Looking Statements beginning on page 24.

Opinions of Red Hat s Financial Advisors

Opinion of Guggenheim Securities, LLC

Overview

Red Hat retained Guggenheim Securities as its lead financial advisor in connection with the potential sale of or another extraordinary corporate transaction involving Red Hat, including the merger. In selecting Guggenheim Securities as its lead financial advisor, Red Hat considered that, among other things, Guggenheim Securities has had a long-standing investment banking relationship with Red Hat and had been retained by Red Hat since October 2016 in connection with Red Hat s exploration and consideration of various strategic and financial alternatives. Guggenheim Securities is an internationally recognized investment banking, financial advisory and securities firm whose senior professionals have substantial experience advising companies in, among other industries, the technology and software sectors. Guggenheim Securities, as part of its investment banking, financial advisory and capital markets businesses, is regularly engaged in the valuation and financial assessment of businesses and securities in connection with mergers and acquisitions, recapitalizations, spin-offs/split-offs, restructurings, securities offerings in both the private and public capital markets and valuations for corporate and other purposes.

At the October 28, 2018 meeting of the Red Hat Board of Directors, Guggenheim Securities rendered an oral opinion, which was confirmed by delivery of a written opinion, to the Red Hat Board of Directors to the effect that, as of October 28, 2018 and based on and subject to the matters considered, the procedures followed, the assumptions made and various limitations of and qualifications to the review undertaken, the merger consideration was fair, from a financial point of view, to Red Hat stockholders.

This description of Guggenheim Securities opinion is qualified in its entirety by the full text of the written opinion, which is attached as Annex B to this proxy statement and which you should read carefully and in its entirety. Guggenheim Securities written opinion sets forth the matters considered, the procedures followed, the assumptions made and various limitations of and qualifications to the review undertaken by Guggenheim Securities. Guggenheim Securities written opinion, which was authorized for issuance by the Fairness Opinion and Valuation Committee of Guggenheim Securities, is necessarily based on economic, capital markets and other conditions, and the information made available to Guggenheim Securities, as of the date of such opinion. Guggenheim Securities has no responsibility for updating or revising its opinion based on facts, circumstances or events occurring after the date of the rendering of the opinion.

In reading the discussion of Guggenheim Securities opinion set forth below, you should be aware that such opinion (and, as applicable, any materials provided in connection therewith or the summary of Guggenheim Securities

underlying financial analyses elsewhere in this proxy statement):

was provided to the Red Hat Board of Directors (in its capacity as such) for its information and assistance in connection with its evaluation of the merger consideration;

did not constitute a recommendation to the Red Hat Board of Directors with respect to the merger;

Table of Contents

does not constitute advice or a recommendation to any Red Hat stockholder as to how to vote or act in connection with the merger or otherwise;

did not address Red Hat s underlying business or financial decision to pursue the merger, the relative merits of the merger as compared to any alternative business or financial strategies that might exist for Red Hat, the financing or funding of the merger by IBM or the effects of any other transaction in which Red Hat might engage;

addressed only the fairness, from a financial point of view and as of the date of such opinion, of the merger consideration to Red Hat stockholders to the extent expressly specified in such opinion;

expressed no view or opinion as to (i) any other term, aspect or implication of (A) the merger (including, without limitation, the form or structure of the merger) or the merger agreement or (B) any other agreement, transaction document or instrument contemplated by the merger agreement or to be entered into or amended in connection with the merger or (ii) the fairness, financial or otherwise, of the merger to, or of any consideration to be paid to or received by, the holders of any class of securities (other than as expressly specified in such opinion), creditors or other constituencies of Red Hat;

(i) did not address the individual circumstances of specific holders of Red Hat s securities (including convertible notes, stock options and warrants) with respect to rights or aspects which may distinguish such holders or Red Hat s securities (including convertible notes, stock options and warrants) held by such holders, (ii) did not address, take into consideration or give effect to any rights, preferences, restrictions or limitations or other attributes of any such securities (including convertible notes, stock options and warrants) and (iii) did not in any way address proportionate allocation or relative fairness; and

expressed no view or opinion as to the fairness, financial or otherwise, of the amount or nature of any compensation payable to or to be received by any of Red Hat s directors, officers or employees, or any class of such persons, in connection with the merger relative to the merger consideration.

In the course of performing its reviews and analyses for rendering its opinion, Guggenheim Securities:

reviewed a draft of the merger agreement dated October 27, 2018;

reviewed certain publicly available business and financial information regarding Red Hat;

reviewed certain non-public business and financial information regarding Red Hat s business and prospects (including Red Hat management s forecasts (as defined herein) for Red Hat for the fiscal years ending February 28, 2019 through February 29, 2024 and Red Hat management s illustrative extrapolations thereof through the fiscal year ending February 28, 2034, with such forecasts and illustrative extrapolations reflecting three alternative scenarios (for more detail regarding the forecasts, see the section entitled Proposal

1: Adoption of the Merger Agreement The Merger Financial Forecast)), all as prepared and approved for Guggenheim Securities use by Red Hat s senior management;

discussed with Red Hat s senior management their strategic and financial rationale for the merger as well as their views of Red Hat s business, operations, historical and projected financial results and future prospects and the commercial, competitive and regulatory dynamics in the technology and software sectors;

reviewed the historical prices, trading multiples and trading activity of Red Hat common stock;

compared the financial performance of Red Hat and the trading multiples and trading activity of Red Hat common stock with corresponding data for certain other publicly-traded companies that Guggenheim Securities deemed relevant in evaluating Red Hat;

reviewed the valuation and financial metrics of certain mergers and acquisitions that Guggenheim Securities deemed relevant in evaluating the merger;

Table of Contents

performed discounted cash flow analyses based on the forecasts; and

conducted such other studies, analyses, inquiries and investigations as Guggenheim Securities deemed appropriate.

With respect to the information used in arriving at its opinion, Guggenheim Securities noted that:

Guggenheim Securities relied upon and assumed the accuracy, completeness and reasonableness of all industry, business, financial, legal, regulatory, tax, accounting, actuarial and other information (including, without limitation, the forecasts, any other estimates and any other forward-looking information) provided by or discussed with Red Hat or obtained from public sources, data suppliers and other third parties.

Guggenheim Securities (i) did not assume any responsibility, obligation or liability for the accuracy, completeness, reasonableness, achievability or independent verification of, and Guggenheim Securities did not independently verify, any such information (including, without limitation, the forecasts, any other estimates and any other forward-looking information), (ii) expressed no view, opinion, representation, guaranty or warranty (in each case, express or implied) regarding the reasonableness or achievability of the forecasts, such other estimates and such other forward-looking information or the assumptions upon which they are based and (iii) relied upon the assurances of Red Hat s senior management that they were unaware of any facts or circumstances that would make such information (including, without limitation, the forecasts, such other estimates and such other forward-looking information) incomplete, inaccurate or misleading.

Specifically, with respect to (i) the forecasts, any other estimates and any other forward-looking information provided by or discussed with Red Hat, (A) Guggenheim Securities was advised by Red Hat s senior management, and Guggenheim Securities assumed, that the forecasts, such other estimates and such other forward-looking information utilized in its analyses had been reasonably prepared on bases reflecting the best then-currently available estimates and judgments of Red Hat s senior management as to the expected future performance of Red Hat and (B) Guggenheim Securities assumed that the forecasts, such other estimates and such other forward-looking information had been reviewed by the Red Hat Board of Directors with the understanding that such information would be used and relied upon by Guggenheim Securities in connection with rendering its opinion and (ii) any forecasts, other estimates and/or other forward-looking information obtained by Guggenheim Securities from public sources, data suppliers and other third parties, Guggenheim Securities assumed that such information was reasonable and reliable. Furthermore, in assessing and utilizing the forecasts for purposes of its financial analyses and opinion, Guggenheim Securities took into account its various discussions with the Red Hat Board of Directors and senior management regarding the risks and uncertainties of achieving the forecasts, including the three alternative scenarios described therein, in light of (i) the current and prospective industry conditions and competitive dynamics facing Red Hat, (ii) Red Hat s recent financial performance, (iii) the key commercial, operational and financial drivers of the scenarios described in the forecasts and (iv) various other facts and circumstances regarding the forecasts.

Guggenheim Securities also noted certain other considerations with respect to its engagement and the rendering of its opinion:

During the course of its engagement, Guggenheim Securities assisted the Red Hat Board of Directors and senior management in connection with their discussions with certain potential strategic acquirors, and Guggenheim Securities considered the nature and outcome of such discussions in rendering its opinion.

Guggenheim Securities did not perform or obtain any independent appraisal of the assets or liabilities (including any contingent, derivative or off-balance sheet assets and liabilities) of Red Hat or any other entity or the solvency or fair value of Red Hat or any other entity, nor was Guggenheim Securities furnished with any such appraisals.

Table of Contents

Guggenheim Securities professionals are not legal, regulatory, tax, consulting, accounting, appraisal or actuarial experts and Guggenheim Securities opinion should not be construed as constituting advice with respect to such matters; accordingly, Guggenheim Securities relied on the assessments of Red Hat s senior management and Red Hat s other professional advisors with respect to such matters. Guggenheim Securities did not express any view or render any opinion regarding the tax consequences of the merger to Red Hat or its securityholders.

Guggenheim Securities further assumed that:

In all respects meaningful to its analyses, (i) the final executed form of the merger agreement would not differ from the draft that Guggenheim Securities reviewed, (ii) each of Red Hat, IBM and Merger Sub will comply with all terms and provisions of the merger agreement and (iii) the representations and warranties of each of Red Hat, IBM and Merger Sub contained in the merger agreement were true and correct and all conditions to the obligations of each party to the merger agreement to consummate the merger will be satisfied without any waiver, amendment or modification thereof; and

The merger will be consummated in a timely manner in accordance with the terms of the merger agreement and in compliance with all applicable laws, documents and other requirements, without any delays, limitations, restrictions, conditions, divestiture or other requirements, waivers, amendments or modifications (regulatory, tax-related or otherwise) that would have an effect on Red Hat or the merger in any way meaningful to Guggenheim Securities analyses or opinion.

Guggenheim Securities did not express any view or opinion as to the price or range of prices at which the shares of common stock or other securities or financial instruments of or relating to Red Hat may trade or otherwise be transferable at any time, including subsequent to the announcement or consummation of the merger.

Summary of Financial Analyses

Overview of Financial Analyses

This Summary of Financial Analyses presents a summary of the principal financial analyses performed by Guggenheim Securities and presented to the Red Hat Board of Directors in connection with Guggenheim Securities rendering of its opinion. Such presentation to the Red Hat Board of Directors was supplemented by Guggenheim Securities oral discussion, the nature and substance of which may not be fully described herein.

Some of the financial analyses summarized below include summary data and information presented in tabular format. In order to understand fully such financial analyses, the summary data and tables must be read together with the full text of the summary. Considering the summary data and tables alone could create a misleading or incomplete view of Guggenheim Securities financial analyses.

The preparation of a fairness opinion is a complex process and involves various judgments and determinations as to the most appropriate and relevant financial analyses and the application of those methods to the particular circumstances involved. A fairness opinion therefore is not readily susceptible to partial analysis or summary description, and taking portions of the financial analyses set forth below, without considering such analyses as a

whole, would in Guggenheim Securities view create an incomplete and misleading picture of the processes underlying the financial analyses considered in rendering Guggenheim Securities opinion.

In arriving at its opinion, Guggenheim Securities:

based its financial analyses on various assumptions, including assumptions concerning general business, economic and capital markets conditions and industry-specific and company-specific factors, all of which are beyond the control of Red Hat and Guggenheim Securities;

did not form a view or opinion as to whether any individual analysis or factor, whether positive or negative, considered in isolation, supported or failed to support its opinion;

Table of Contents

considered the results of all of its financial analyses and did not attribute any particular weight to any one analysis or factor; and

ultimately arrived at its opinion based on the results of all of its financial analyses assessed as a whole and believes that the totality of the factors considered and the various financial analyses performed by Guggenheim Securities in connection with its opinion operated collectively to support its determination as to the fairness, from a financial point of view and as of the date of such opinion, of the merger consideration to the extent expressly specified in such opinion.

With respect to the financial analyses performed by Guggenheim Securities in connection with rendering its opinion:

Such financial analyses, particularly those based on estimates and projections, are not necessarily indicative of actual values or actual future results, which may be significantly more or less favorable than suggested by these analyses.

None of the selected precedent merger and acquisition transactions used in the selected precedent merger and acquisition transactions analysis described below is identical or directly comparable to the merger, and none of the selected publicly-traded companies used in the selected publicly-traded companies analysis described below is identical or directly comparable to Red Hat. However, such transactions and companies were selected by Guggenheim Securities, among other reasons, because they involved target companies or represented publicly-traded companies which may be considered broadly similar, for purposes of Guggenheim Securities financial analyses, to Red Hat based on Guggenheim Securities familiarity with the technology and software sectors.

In any event, selected precedent merger and acquisition transactions analysis and selected publicly-traded companies analysis are not mathematical. Rather, such analyses involve complex considerations and judgments concerning the differences in business, financial, operating and capital markets-related characteristics and other factors regarding the selected precedent merger and acquisition transactions to which the merger was compared and the selected publicly-traded companies to which Red Hat was compared.

Such financial analyses do not purport to be appraisals or to reflect the prices at which any securities may trade at the present time or at any time in the future.

Certain Definitions

Throughout this Summary of Financial Analyses, the following financial terms and miscellaneous abbreviations are used in connection with Guggenheim Securities various financial analyses:

CY: means the calendar year ended December 31.

EBITDA: means the relevant company s operating earnings before interest, taxes, depreciation and amortization.

EBITDA multiple: represents the relevant company s enterprise value divided by its historical or projected EBITDA.

Enterprise value: represents the relevant company s net equity value (as defined below) plus (i) the principal or face amount of total debt and non-convertible preferred stock, (ii) the estimated net present value of any deemed-repatriation transition tax liabilities pursuant to the Tax Cuts and Jobs Act of 2017 and (iii) the estimated fair market value (as available) or book value of any non-controlling/minority interests less (iv) cash, cash equivalents and short- and long-term marketable investments, (v) the estimated fair market value (as available) or book value of any non-consolidated investments and (vi) the estimated net present value of any tax-related net operating losses.

FY: means Red Hat s fiscal year ending February 28/29.

FY1: means the fiscal year immediately following the fiscal year in which the relevant transaction was announced.

Table of Contents

FY2: means the second fiscal year immediately following the fiscal year in which the relevant transaction was announced.

LFCF: means the relevant company s levered free cash flow, defined as after-tax levered operating cash flow minus capital expenditures.

NA: means not available.

Net equity value: represents the relevant company s (i) gross equity value as calculated (A) based on outstanding common stock plus shares issuable upon the conversion or exercise of all in-the-money convertible securities, stock options and/or stock warrants times (B) the relevant company s stock price less (ii) the cash proceeds from the assumed exercise of all in-the-money stock options and stock warrants. For Red Hat, the in-the-money value of its convertible notes was fully hedged by Red Hat s purchase of call options with respect to the number of shares of Red Hat common stock underlying the convertible notes and the cash take-out value of its outstanding warrants was estimated using a Black-Scholes model.

NM: means not meaningful (in Guggenheim Securities professional judgment).

Pre-SBC: means the relevant financial metric unburdened by the deduction for SBC (as defined below).

Post-SBC: means the relevant financial metric burdened by the deduction for SBC.

SBC: means stock-based compensation.

VWAP: means volume-weighted average share price over the indicated period of time.

Recap of Implied Merger Financial Metrics

Based on the all-cash merger consideration of $190.00 per share of Red Hat common stock, Guggenheim Securities calculated various implied merger-related premia (relative to Red Hat s stock prices as of October 26, 2018, the last trading day prior to the announcement of the merger) and merger-implied multiples as outlined in the table below. With respect to such merger-implied multiples, each of revenue, EBITDA and LFCF were based on the base case forecast (as defined herein) as reflected in, or derived from, the forecasts for Red Hat as provided and approved for Guggenheim Securities use by Red Hat s senior management.

Table of Contents

Merger-Implied Premia and Merger-Implied Multiples

Merger Consideration per Share of Red Hat Common Stock		**$ 190.00**
	Red Hat Stock Price @ 10/26/18	
Acquisition Premium/(Discount) Relative to Red Hat s:		
Closing Stock Price	$ 116.68	62.8%
VWAPs:		
5-Day	120.30	57.9
10-Day	121.88	55.9
20-Day	124.42	52.7
60-Day	135.40	40.3
Past Year s High Closing Stock Price	176.27	7.8
Past Year s Low Closing Stock Price	116.68	62.8
Transaction Enterprise Value / Revenue for Red Hat:		
FY19E		10.1x
FY20E		8.6
FY21E		7.4
Transaction Enterprise Value / EBITDA (Pre-SBC) for Red Hat:		
FY19E		39.0x
FY20E		33.2
FY21E		27.9
Transaction Enterprise Value / EBITDA (Post-SBC) for Red Hat:		
FY19E		51.4x
FY20E		43.4
FY21E		35.8
Transaction Net Equity Value / LFCF (Pre-SBC) for Red Hat:		
FY19E		36.1x
FY20E		30.0
FY21E		25.1
Transaction Net Equity Value / LFCF (Post-SBC) for Red Hat:		
FY19E		46.0x
FY20E		37.6
FY21E		31.0

Red Hat Change-of-Control Financial Analyses

Recap of Red Hat Change-of-Control Financial Analyses. In evaluating Red Hat in connection with rendering its opinion, Guggenheim Securities performed various financial analyses which are summarized in the table below and

described in more detail elsewhere herein, including discounted cash flow analyses and selected precedent merger and acquisition transactions analysis. Solely for informational reference purposes, Guggenheim Securities also performed selected publicly-traded companies analysis and reviewed the historical trading price range for Red Hat common stock and Wall Street equity research analysts price targets for Red Hat common stock. Guggenheim Securities change-of-control financial analyses were rounded to the nearest $0.50 (with the exception of Red Hat s stock price range during the past year and Wall Street equity research analysts price targets, both of which were as reported).

In assessing and utilizing the risk forecast, the base case forecast and the outperform forecast for purposes of its financial analyses and opinion, Guggenheim Securities took into account its various discussions with the Red

Table of Contents

Hat Board of Directors and senior management regarding the risks and uncertainties of achieving the risk forecast, the base case forecast and the outperform forecast, respectively, in light of (i) the current and prospective industry conditions and competitive dynamics facing Red Hat, (ii) Red Hat s recent financial performance, (iii) the key commercial, operational and financial drivers of the risk forecast, the base case forecast and the outperform forecast, respectively, and (iv) various other facts and circumstances regarding the risk forecast, the base case forecast and the outperform forecast. For more detail regarding the forecasts, see the section entitled Proposal 1: Adoption of the Merger Agreement The Merger Financial Forecast.

Recap of Red Hat Change-of-Control Financial Analyses

Merger Consideration per Share of Red Hat Common Stock	**$190.00**

	Reference Range for Red Hat on a Change-of-Control Basis	
Financial Analyses	**Low**	**High**
Discounted Cash Flow Analyses:		
Based on the Base Case Forecast	$ 108.00	$ 140.00
Based on the Risk Forecast	82.50	107.00
Based on the Outperform Forecast	134.00	179.50
Selected Precedent M&A Transactions Analysis Based on Red Hat Revenue for FY20E The Base Case Forecast	$ 146.50	$ 207.50
For Informational Reference Purposes		
Selected Publicly-Traded Companies Analysis		
Based on Red Hat Revenue for FY20E The Base Case Forecast	$ 105.00	$ 136.00
Based on Red Hat LFCF (Pre-SBC) for FY20E The Base Case Forecast	116.00	140.50
Red Hat s Stock Price Range During Past Year	$ 116.68	$ 176.27
Wall Street Equity Research Price Targets	$ 125.00	$ 186.00

Red Hat Discounted Cash Flow (DCF) Analyses. Guggenheim Securities performed stand-alone discounted cash flow analyses of Red Hat based on projected after-tax unlevered free cash flows (after deduction of SBC) for Red Hat and an estimate of its terminal/continuing value at the end of the projection horizon. In performing its discounted cash flow analyses with respect to Red Hat:

Guggenheim Securities utilized Red Hat management s forecasts for Red Hat for the fiscal years ending February 28, 2019 through February 29, 2024 and Red Hat management s illustrative extrapolations thereof through the fiscal year ending February 28, 2034 (with such forecasts and illustrative extrapolations reflecting three alternative scenarios), as provided and approved for Guggenheim Securities use by Red Hat s senior management. Guggenheim Securities notes the previous description of and caveats regarding the forecasts for Red Hat in Guggenheim Securities section entitled Recap of Red Hat Change-of-Control

Financial Analyses. For more detail regarding the forecasts, see the section entitled Proposal 1: Adoption of the Merger Agreement The Merger Financial Forecast beginning on page 69.

Guggenheim Securities used a discount rate range of 9.25% 11.00% based on its estimate of Red Hat s weighted average cost of capital.

In estimating Red Hat s terminal/continuing value, Guggenheim Securities used a reference range of perpetual growth rates of Red Hat s terminal year (*i.e.*, FY34E) normalized after-tax unlevered free cash flow of 1.50% 2.50%, which range was selected based on Guggenheim Securities professional

Table of Contents

judgment and experience. The terminal/continuing values implied by the foregoing perpetual growth rate reference range were cross-checked for reasonableness by reference to Red Hat s implied terminal year (*i.e.*, FY34E) EBITDA (Post-SBC) multiples (*i.e.*, 8.0x 11.3x with a midpoint of approximately 9.4x). Guggenheim Securities discounted cash flow analyses resulted in overall per share reference ranges (rounded to the nearest $0.50) for purposes of evaluating Red Hat common stock on a stand-alone intrinsic-value basis as outlined in the table below:

Recap of Red Hat Stand-Alone DCF Analyses

	Low	High
The Base Case Forecast	$ 108.00	$ 140.00
The Risk Forecast	82.50	107.00
The Outperform Forecast	134.00	179.50

Guggenheim Securities noted that the all-cash merger consideration of $190.00 per share of Red Hat common stock exceeded the foregoing stand-alone DCF-based reference ranges for Red Hat, which in Guggenheim Securities view supported its assessment of the financial fairness of the merger consideration.

Red Hat Selected Precedent Merger and Acquisition Transactions Analysis. Guggenheim Securities reviewed and analyzed certain financial metrics associated with selected precedent merger and acquisition transactions that Guggenheim Securities deemed relevant for purposes of this analysis. Guggenheim Securities characterized these selected precedent merger and acquisition transactions as Enterprise SaaS transactions or Enterprise Cloud/Infrastructure transactions based on the business characteristics of the relevant target companies. Guggenheim Securities calculated, among other things and to the extent publicly available, certain implied change-of-control transaction multiples for the selected precedent merger and acquisition transactions (based on Wall Street equity research consensus estimates, each company s most recent publicly available financial filings and certain other publicly available information), which are summarized in the table below:

Red Hat Selected Precedent Merger and Acquisition (M&A) Transactions Analysis

Date			Transaction Enterprise Value / Revenue	
Announced	**Acquiror**	**Target Company**	**FY1**	**FY2**
Enterprise SaaS Precedent M&A Transactions				
1/30/18	SAP SE	Callidus Software, Inc.	6.4x	NA
7/28/16	Oracle Corporation	NetSuite, Inc.	7.6	6.2x
6/13/16	Microsoft Corporation	LinkedIn Corporation	5.9	5.0
6/1/16	salesforce.com, inc.	Demandware, Inc.	7.4	6.0
5/31/16	Vista Equity Partners LLC	Marketo, Inc.	4.9	3.9
9/18/14	SAP SE	Concur Technologies, Inc.	9.2	7.4
12/20/13	Oracle Corporation	Responsys, Inc.	6.5	5.3
6/4/13	salesforce.com, inc.	ExactTarget, Inc.	5.5	NA
8/27/12	IBM	Kenexa Corp	3.1	2.6
5/22/12	SAP SE	Ariba, Inc.	7.0	5.7

2/9/12	Oracle Corporation	Taleo Corporation	4.4	3.8
12/3/11	SAP SE	SuccessFactors, Inc.	8.3	7.0
10/24/11	Oracle Corporation	Rightnow Technologies, Inc.	6.0	5.1

Table of Contents

Date Announced	Acquiror	Target Company	Transaction Enterprise Value / Revenue FY1	FY2
Enterprise Cloud/Infrastructure Precedent M&A Transactions				
6/4/18	Microsoft Corporation	GitHub, Inc.	25.0x	16.7x
10/3/18	Cloudera, Inc.	Hortonworks, Inc.	4.7	3.8
3/20/18	salesforce.com, inc.	MuleSoft, Inc.	11.8	9.0
10/21/15	Silver Lake Partners & Thoma Bravo, LLC	SolarWinds, Inc.	7.2	6.4
4/7/15	The Permira Funds & Canada Pension Plan Investment Board	Informatica Corporation	3.9	3.5
7/23/13	Cisco Systems, Inc.	Sourcefire, Inc.	7.0	6.1
5/6/13	Private investor group led by Bain Capital Partners, LLC, Golden Gate Private Equity, Inc., Insight Venture Partners and GIC Special Investments Pte. Ltd.	BMC Software, Inc.	2.7	2.6
Statistical Summary				
Enterprise SaaS Precedent M&A Transactions:				
High			9.2x	7.4x
Mean			6.4	5.3
Median			6.5	5.5
Low			3.1	2.6
Enterprise Cloud/Infrastructure Precedent M&A Transactions:				
High			25.0x	16.7x
Mean			8.9	6.9
Median			7.0	6.1
Low			2.7	2.6
IBM/Red Hat Merger			**8.6x**	**7.4x**

In performing its selected precedent merger and acquisition transactions analysis with respect to Red Hat:

Guggenheim Securities used Red Hat s projected revenue for FY20E the base case forecast because, in the assessment of Red Hat management, the base case forecast reflected the most likely standalone financial forecast of Red Hat s business and because the differences between the three cases were not material for FY20; and

Guggenheim Securities selected a reference range of transaction multiples for purposes of evaluating Red Hat on a change-of-control basis based on a transaction enterprise value / FY1 revenue multiple range of 6.5x 9.5x based on Red Hat s projected revenue for FY20E the base case forecast (which equates to an implied enterprise value / FY2 revenue multiple range of 5.5x 8.1x based on Red Hat s projected revenue for FY21E the base case forecast).

Guggenheim Securities selected precedent merger and acquisition transactions analysis resulted in an overall reference range of $146.50 $207.50 per share (rounded to the nearest $0.50) for purposes of evaluating Red Hat common stock on a change-of-control basis.

In connection with its selected precedent merger and acquisition transactions analysis with respect to Red Hat, Guggenheim Securities noted the following factors which in its view supported its assessment of the financial fairness of the merger consideration:

The merger-implied enterprise value / FY1 revenue multiple (*i.e.*, 8.6x) and the merger-implied enterprise value / FY2 revenue multiple (*i.e.*, 7.4x) for Red Hat were toward the upper end of the

Table of Contents

observed transaction enterprise value / FY1 revenue multiples and the observed transaction enterprise value / FY2 revenue multiples, respectively, based on Guggenheim Securities selected precedent merger and acquisition transactions analysis; and

The all-cash merger consideration of $190.00 per share of Red Hat common stock was toward the upper end of the foregoing change-of-control transaction reference range (*i.e.*, $146.50 $207.50 per share) based on Guggenheim Securities selected precedent merger and acquisition transactions analysis.

Other Financial Reviews and Analyses Solely for Informational Reference Purposes

In order to provide certain context for the financial analyses in connection with its opinion as described above, Guggenheim Securities undertook various additional financial reviews and analyses as summarized below solely for informational reference purposes. As a general matter, Guggenheim Securities did not consider such additional financial reviews and analyses to be determinative methodologies for purposes of its opinion.

Premia/(Discounts) Paid in Selected Precedent Merger and Acquisition Transactions. Guggenheim Securities reviewed, based on publicly available information, the implied premia/(discounts) paid or proposed to be paid in connection with the selected precedent merger and acquisition transactions listed above in Guggenheim Securities section entitled Red Hat Selected Precedent Merger and Acquisition Transactions Analysis. Guggenheim Securities noted that such precedent M&A transaction-related premia/(discounts) ranged from (i) 1.9% 64.2% based on the target company s unaffected spot closing stock price and (ii) (4.1%) 70.9% based on the target company s unaffected 20-day VWAP. Guggenheim Securities further noted that, in connection with the merger, the merger-implied premia (based on the all-cash merger consideration of $190.00 per share of Red Hat common stock) were 62.8% versus Red Hat s spot closing stock price of $116.68 on October 26, 2018 (the last trading day prior to the announcement of the merger) and 52.7% based on Red Hat s 20-day VWAP of $124.42 as of such date, thereby ranking the merger-implied premia at the upper end of the transaction-related premia observed in such selected precedent merger and acquisition transactions.

Table of Contents

Red Hat Selected Publicly-Traded Companies Analysis. Guggenheim Securities reviewed and analyzed Red Hat s historical stock price performance, trading metrics and historical and projected/forecasted financial performance compared to corresponding data for selected publicly-traded companies that Guggenheim Securities deemed relevant for purposes of this analysis. Guggenheim Securities characterized these selected publicly-traded companies as Public Cloud Platforms, Private/Hybrid Cloud Providers, SaaS and Incumbent Technology Providers based on the business characteristics of the relevant companies. Guggenheim Securities calculated, among other things, various public market trading multiples for Red Hat and the selected publicly-traded companies (in the case of the selected publicly-traded companies, based on Wall Street equity research consensus estimates and each company s most recent publicly available financial filings), which are summarized in the table below:

Red Hat Selected Publicly-Traded Companies Analysis

	Trading Enterprise Value / Revenue CY19E	Trading Net Equity Value / LFCF (Pre-SBC) CY19E
Public Cloud Platforms		
Amazon.com, Inc.	3.0x	30.7x
Microsoft Corporation	6.2	22.4
Alphabet, Inc.	4.1	23.8
Private/Hybrid Cloud Providers		
VMware, Inc.	5.3x	16.9x
ServiceNow, Inc.	9.2	34.6
Citrix Systems, Inc.	4.6	13.7
Pivotal Software, Inc.	5.8	NM
New Relic, Inc.	8.7	NM
SaaS		
Adobe, Inc.	11.5x	26.9x
salesforce.com, inc.	6.7	32.4
Workday, Inc.	8.2	NM
Incumbent Technology Providers		
Cisco Systems, Inc.	3.7x	14.2x
Oracle Corporation	4.8	12.5
SAP SE	4.3	25.2
IBM	1.6	9.7
Hewlett Packard Enterprise Co.	0.9	12.9
Red Hat		
Trading Basis (FY20E The Base Case Forecast)	**5.1x**	**19.3x**
Merger Basis (FY20E The Base Case Forecast)	**8.6**	**30.0**

In performing its selected publicly-traded companies analysis with respect to Red Hat:

Guggenheim Securities used Red Hat s projected revenue for FY20E the base case forecast and Red Hat s projected LFCF (Pre-SBC) for FY20E the base case forecast because, in the assessment of Red Hat management, the base case forecast reflected the most likely standalone financial forecast of Red Hat s business and because the differences between the three cases were not material for FY20; and

Table of Contents

Guggenheim Securities selected reference ranges of trading multiples for purposes of evaluating Red Hat on a stand-alone public market trading basis as follows: (i) trading enterprise value / forward revenue multiple range of 4.5x 6.0x based on Red Hat s projected revenue for FY20E the base case forecast and (ii) trading net equity value / forward LFCF (Pre-SBC) multiple range of 18.0x 22.0x based on Red Hat s projected LFCF (Pre-SBC) for FY20E the base case forecast.

Guggenheim Securities selected publicly-traded companies analysis resulted in an overall reference range of $105.00 $140.50 per share (rounded to the nearest $0.50) for purposes of evaluating Red Hat common stock on a stand-alone public market trading basis, as compared to Red Hat s spot closing stock price of $116.68 on October 26, 2018 (the last trading day prior to the announcement of the merger) and Red Hat s 20-day VWAP of $124.42 as of such date. Guggenheim Securities noted that the foregoing evaluation of Red Hat common stock did not reflect any acquisition premium that typically is paid in connection with change-of-control transactions such as the merger.

Red Hat Stock Price Trading History. Guggenheim Securities reviewed Red Hat s stock price trading history from October 26, 2013 through October 26, 2018 (the last trading day prior to the announcement of the merger). Among other things, Guggenheim Securities noted that the all-cash merger consideration of $190.00 per share of Red Hat common stock exceeded Red Hat s all-time high spot closing stock price of $176.27 on June 18, 2018 and exceeded Red Hat s spot closing stock price of $116.68 on October 26, 2018 and Red Hat s 20-day VWAP of $124.42 as of such date.

Red Hat Wall Street Equity Research Analyst Stock Price Targets. Guggenheim Securities reviewed selected Wall Street equity research analyst stock price targets for Red Hat as published prior to October 26, 2018 (the last trading day prior to the announcement of the merger). Guggenheim Securities noted that such Wall Street equity research analyst stock price targets for Red Hat common stock ranged from $125.00 to $186.00 per share, with the average price target being $159.62. For comparison purposes, Guggenheim Securities noted that the all-cash merger consideration was $190.00 per share of Red Hat common stock, Red Hat s spot closing stock price was $116.68 on October 26, 2018 and Red Hat s 20-day VWAP was $124.42 as of such date.

Other Considerations

Except as described in the summary above, Red Hat did not provide specific instructions to, or place any limitations on, Guggenheim Securities with respect to the procedures to be followed or factors to be considered in performing its financial analyses or providing its opinion. The type and amount of consideration payable in the merger were determined through negotiations between Red Hat and IBM and were approved by the Red Hat Board of Directors. The decision to enter into the merger agreement was solely that of the Red Hat Board of Directors. Guggenheim Securities opinion was just one of the many factors taken into consideration by the Red Hat Board of Directors. Consequently, Guggenheim Securities financial analyses should not be viewed as determinative of the decision of the Red Hat Board of Directors with respect to the fairness, from a financial point of view, of the merger consideration to Red Hat stockholders.

Pursuant to the terms of Guggenheim Securities engagement, Red Hat has agreed to pay Guggenheim Securities a cash transaction fee (based on a percentage of the aggregate value associated with the merger) upon consummation of the merger, which cash transaction fee currently is estimated to be approximately $79.5 million. Red Hat has previously paid Guggenheim Securities a cash milestone fee of approximately $11.9 million that became payable upon delivery of Guggenheim Securities opinion and which will be credited against the foregoing cash transaction fee. In addition, Red Hat has agreed to reimburse Guggenheim Securities for certain expenses and to indemnify Guggenheim Securities against certain liabilities arising out of its engagement.

During the two years prior to the rendering of its opinion, Guggenheim Securities had previously been engaged by each of Red Hat and IBM to provide financial advisory or investment banking services in connection

Table of Contents

with matters unrelated to the merger, for which Guggenheim Securities received compensation. Specifically, during the past two years Guggenheim Securities was engaged as a consultant to Red Hat with respect to various strategic and financial alternatives and received agreed upon fees (including, among other matters, in respect of Red Hat s acquisition of CoreOS, Inc. in 2018). In addition, Guggenheim Securities acted as financial advisor to IBM in connection with its acquisition of Promontory Financial Group, LLC, which closed in November 2016 and for which Guggenheim Securities received an agreed upon fee. Guggenheim Securities may seek to provide Red Hat, IBM and their respective affiliates with certain financial advisory and investment banking services unrelated to the merger in the future, for which services Guggenheim Securities would expect to receive compensation.

Guggenheim Securities and its affiliates and related entities engage in a wide range of financial services activities for its and their own accounts and the accounts of customers, including but not limited to: asset, investment and wealth management; insurance services; investment banking, corporate finance, mergers and acquisitions and restructuring; merchant banking; fixed income and equity sales, trading and research; and derivatives, foreign exchange and futures. In the ordinary course of these activities, Guggenheim Securities and its affiliates and related entities may (i) provide such financial services to Red Hat, IBM, other participants in the merger and their respective affiliates, for which services Guggenheim Securities and its affiliates and related entities may have received, and may in the future receive, compensation and (ii) directly and indirectly hold long and short positions, trade and otherwise conduct such activities in or with respect to loans, debt and equity securities and derivative products of or relating to Red Hat, IBM, other participants in the merger and their respective affiliates. Furthermore, Guggenheim Securities and its affiliates and related entities and its or their respective directors, officers, employees, consultants and agents may have investments in Red Hat, IBM, other participants in the merger and their respective affiliates.

Consistent with applicable legal and regulatory guidelines, Guggenheim Securities has adopted certain policies and procedures to establish and maintain the independence of its research departments and personnel. As a result, Guggenheim Securities research analysts may hold views, make statements or investment recommendations and publish research reports with respect to Red Hat, IBM, other participants in the merger and their respective affiliates and the merger that differ from the views of Guggenheim Securities investment banking personnel.

Opinion of Morgan Stanley & Co. LLC

Morgan Stanley was retained by Red Hat to act as its financial advisor in connection with the merger and to provide financial advisory services in connection with the merger. Red Hat selected Morgan Stanley to act as its financial advisor based on Morgan Stanley s qualifications, expertise and reputation, and its knowledge and understanding of Red Hat s business and affairs. On October 28, 2018, Morgan Stanley rendered its oral opinion, subsequently confirmed by delivery of a written opinion dated October 28, 2018, to the effect that, as of such date, and based upon and subject to the assumptions made, procedures followed, matters considered and qualifications and limitations on the scope of review undertaken by Morgan Stanley as set forth in its written opinion, the merger consideration to be received by Red Hat stockholders pursuant to the merger agreement was fair from a financial point of view to such Red Hat stockholders.

The full text of the written opinion of Morgan Stanley dated October 28, 2018, is attached as Annex C to this proxy statement, and is incorporated by reference herein in its entirety. The opinion sets forth, among other things, the assumptions made, procedures followed, matters considered and qualifications and limitations on the scope of the review undertaken by Morgan Stanley in rendering its opinion. The summary of the opinion of Morgan Stanley set forth in this proxy statement is qualified in its entirety by reference to the full text of the opinion. You are encouraged to read Morgan Stanley s opinion and the summary of Morgan Stanley s opinion below carefully and in their entirety. Morgan Stanley s opinion was directed to the Red Hat Board of Directors, in its capacity as such, and addressed only the fairness from a

60

Table of Contents

financial point of view of the merger consideration to be received by Red Hat stockholders pursuant to the merger agreement as of the date of the opinion and did not address any other aspects or implications of the merger. Morgan Stanley s opinion was not intended to, and does not, constitute advice or a recommendation to any Red Hat stockholder as to how to vote at the special meeting to be held in connection with the merger or whether to take any other action with respect to the merger.

For purposes of rendering its opinion, Morgan Stanley, among other things:

- reviewed certain publicly available financial statements and other business and financial information of Red Hat;
- reviewed certain internal financial statements and other financial and operating data concerning Red Hat;
- reviewed certain financial projections prepared by the management of Red Hat;
- discussed the past and current operations and financial condition and the prospects of Red Hat with senior executives of Red Hat;
- reviewed the reported prices and trading activity for Red Hat common stock;
- compared the financial performance of Red Hat and the prices and trading activity of Red Hat common stock with that of certain other publicly-traded companies comparable with Red Hat, and their securities;
- reviewed the financial terms, to the extent publicly available, of certain comparable acquisition transactions;
- participated in discussions and negotiations among representatives of Red Hat and IBM and their financial and legal advisors;
- reviewed the merger agreement, the draft commitment letters from certain lenders substantially in the form of the drafts dated October 26, 2018 and certain related documents; and
- performed such other analyses, reviewed such other information and considered such other factors as Morgan Stanley deemed appropriate.

In arriving at its opinion, Morgan Stanley assumed and relied upon, without independent verification, the accuracy and completeness of the information that was publicly available or supplied or otherwise made available to it by Red Hat, and formed a substantial basis for its opinion. With respect to the financial projections, Morgan Stanley assumed that they had been reasonably prepared on bases reflecting the best then-currently available estimates and judgments

of the management of Red Hat of the future financial performance of Red Hat. In addition, Morgan Stanley assumed that the merger will be consummated in accordance with the terms set forth in the merger agreement without any waiver, amendment or delay of any terms or conditions, including, among other things, that IBM will obtain financing in accordance with the terms set forth in the commitment letter, and that the definitive merger agreement would not differ in any material respect from the draft thereof furnished to it, except as would not be material to Morgan Stanley s opinion. Morgan Stanley assumed that in connection with the receipt of all the necessary governmental, regulatory or other approvals and consents required for the merger, no delays, limitations, conditions or restrictions will be imposed that would have a material adverse effect on the contemplated benefits expected to be derived in the merger. Morgan Stanley is not a legal, tax, regulatory or actuarial advisor. Morgan Stanley is a financial advisor only and relied upon, without independent verification, the assessment of Red Hat and its legal, tax, or regulatory advisors with respect to legal, tax, or regulatory matters. Morgan Stanley expressed no opinion with respect to the fairness of the amount or nature of the compensation to any of Red Hat s officers, directors or employees, or any class of such persons, relative to the merger consideration to be received by Red Hat stockholders in the merger. Morgan Stanley did not make any independent valuation or appraisal of the assets or liabilities of Red Hat, nor was it furnished with any such valuations or appraisals. Morgan Stanley s opinion was necessarily based on financial, economic, market and

Table of Contents

other conditions as in effect on, and the information made available to Morgan Stanley as of, October 28, 2018. Events occurring after such date may affect Morgan Stanley s opinion and the assumptions used in preparing it, and Morgan Stanley did not assume any obligation to update, revise or reaffirm its opinion.

Summary of Financial Analyses

The following is a summary of the material financial analyses performed by Morgan Stanley in connection with its oral opinion and the preparation of its written opinion letter dated October 28, 2018 to the Red Hat Board of Directors. The following summary is not a complete description of Morgan Stanley s opinion or the financial analyses performed and factors considered by Morgan Stanley in connection with its opinion, nor does the order of analyses described represent the relative importance or weight given to those analyses. Except as otherwise noted, the following quantitative information, to the extent that it is based on market data, is based on market data as it existed on or before October 26, 2018, which we refer to as the unaffected date, which was the last trading day prior to the meeting of the Red Hat Board of Directors on October 28, 2018 to approve the merger agreement and the transactions contemplated thereby, including the merger and determine and declare the advisability of the merger agreement and the transactions contemplated thereby, including the merger. The various analyses summarized below were based, as applicable, on the closing price of $116.68 per share of Red Hat common stock as of the unaffected date, the last trading day preceding the October 28, 2018 presentation by Morgan Stanley to the Red Hat Board of Directors, and are not necessarily indicative of current market conditions.

Some of the financial analyses summarized below are included in tabular format. In order to fully understand the financial analyses, the tables must be read together with the text of each summary. The tables alone do not constitute a complete description of the financial analyses. The analyses listed in the tables and described below must be considered as a whole. Considering any portion of such analyses and of the factors considered, without considering all analyses and factors, could create a misleading or incomplete view of the process underlying Morgan Stanley s opinion.

In performing the financial analyses summarized below and arriving at its opinion, Morgan Stanley used and relied upon the base case forecast, risk forecast and outperform forecast provided by Red Hat management. For more information, see the section entitled Proposal 1: Adoption of the Merger Agreement The Merger Financial Forecast beginning on page 69. In accordance with discussions with Red Hat, Morgan Stanley also used and relied upon certain financial projections based on Wall Street research reports, which we refer to as the street case.

Public Trading Comparables Analysis

Morgan Stanley performed a public trading comparables analysis, which attempts to provide an implied value of a company by comparing it to similar companies that are publicly traded.

Morgan Stanley reviewed and compared certain publicly available and internal financial information (including the forecasts and certain financial projections from Wall Street research reports) for Red Hat with comparable publicly available consensus equity analyst research estimates for companies, selected based on Morgan Stanley s professional judgment and experience, that share similar business characteristics and have certain comparable operating characteristics with Red Hat, including similar lines of business, market capitalizations and/or other similar operating characteristics. For purposes of this analysis, with respect to the forecasts, Morgan Stanley used the base case forecast because, in the assessment of Red Hat management, the base case forecast reflected the most likely standalone financial forecast of Red Hat s business and because the differences between the three cases were not material in calendar years 2019 and 2020. For purposes of this analysis, Morgan Stanley used Red Hat s fiscal year ending February 2020 as a proxy for calendar year 2019 and Red Hat s fiscal year ending February 2021 as a proxy for

calendar year 2020. The publicly-traded comparable companies that were reviewed in connection with this analysis were: Adobe Inc., which we refer to as Adobe, salesforce.com, inc., which we refer to as salesforce, Microsoft Corporation, which we refer to as Microsoft,

Table of Contents

Pivotal Software Inc., which we refer to as Pivotal, VMware, Inc., which we refer to as VMware, Citrix Systems, Inc., which we refer to as CTXS, Oracle Corporation, which we refer to as Oracle, SAP SE, which we refer to as SAP, Symantec Corporation, which we refer to as Symantec, and IBM (which collectively we refer to as the comparable companies). Morgan Stanley characterized a subset of these comparable companies, comprised of Adobe, salesforce, Microsoft, Pivotal and VMware, that share similar business, financial and operating characteristics with Red Hat as the business comparable companies.

For purposes of this analysis, Morgan Stanley analyzed the ratio of aggregate value, which we refer to as AV, defined as the fully diluted market capitalization plus total debt and non-controlling interests, less cash and equivalents, to an estimate of revenue and unlevered free cash flow, which we refer to as UFCF, defined as operating cash flow (excluding net interest income and expenses) less capital expenditures, for calendar years 2019 and 2020, in each case, for each of the comparable companies, based on publicly available financial data and Wall Street research reports.

The following table presents the results of this analysis:

Comparable Company	CY2019E AV/Revenue	CY2020E AV/Revenue	CY2019E AV/UFCF	CY2020E AV/UFCF
Adobe	11.1x	9.5x	26.6x	23.0x
Salesforce	6.8x	5.7x	32.2x	25.2x
Microsoft	6.0x	5.4x	20.9x	18.3x
Pivotal	5.8x	4.7x	N.M.(1)	N.M.(1)
VMware	5.3x	4.9x	14.2x	12.8x
CTXS	4.6x	4.3x	13.4x	13.1x
Oracle	4.6x	4.4x	11.7x	10.7x
SAP	4.3x	4.0x	26.5x	22.6x
Symantec	3.1x	3.0x	10.7x	9.7x
IBM	1.9x	1.9x	11.6x	11.2x

(1) N.M. indicates a negative UFCF or a multiple above 60x.

Based on the results of this analysis and its professional judgment and experience, Morgan Stanley applied:

a calendar year 2019 AV/revenue range of 5.0x 6.0x to the base case forecast for calendar year 2019 revenue, which resulted in an implied per share equity value range of $116.25 to $136.69, and to the street case for calendar year 2019 revenue, which resulted in an implied per share equity value range of $114.53 to $134.63;

a calendar year 2019 AV/UFCF range of 16.0x 22.5x to the base case forecast for calendar year 2019 UFCF, which resulted in an implied per share equity value range of $110.74 to $150.01, and to the street case for calendar year 2019 UFCF, which resulted in an implied per share equity value range of $104.11 to $140.70;

a calendar year 2020 AV/revenue range of 4.5x 5.5x to the base case forecast for calendar year 2020 revenue, which resulted in an implied per share equity value range of $122.07 to $146.07, and to the street case for calendar year 2020 revenue, which resulted in an implied per share equity value range of $115.43 to $137.96; and

a calendar year 2020 AV/UFCF range of 14.5x 18.5x to the base case forecast for calendar year 2020 UFCF, which resulted in an implied per share equity value range of $118.48 to $147.28, and to the street case for calendar year 2020 UFCF, which resulted in an implied per share equity value range of $104.07 to $128.90.

No company utilized in the public trading comparables analysis is identical to Red Hat. In evaluating and selecting comparable companies, Morgan Stanley made judgments and assumptions with respect to industry

Table of Contents

performance, general business, regulatory, economic, market and financial conditions and other matters, which are beyond Red Hat s control. These include, among other things, the impact of competition on Red Hat s businesses and the industry generally, industry growth and the absence of any material change in Red Hat s financial condition and prospects and the industry, and in the financial markets in general. Mathematical analysis (such as determining the average or median) is not in itself a meaningful method of using comparable company data.

Discounted Cash Flow Analysis

Morgan Stanley performed a discounted cash flow analysis, which is designed to provide an implied value of a company by calculating the present value of the estimated future cash flows and terminal value of such company. Morgan Stanley calculated a range of equity values per share for Red Hat common stock based on this discounted cash flow analysis to value Red Hat on a standalone basis.

Morgan Stanley performed a discounted cash flow analysis for each of the three scenarios composing the forecasts (including the extrapolated forecast). For each of the base case forecast, the risk forecast and the outperform forecast, Red Hat management s projections were prepared for the fiscal years ending February 28, 2019 through February 28, 2034.

Morgan Stanley first calculated the estimated unlevered free cash flows of Red Hat based on the forecasts for the period from fiscal year 2019 through fiscal year 2034. The estimated unlevered cash flows were calculated as earnings before interest, taxes, depreciation and amortization, less (i) stock based compensation, (ii) less taxes at the effective tax rate, (iii) less capital expenditures, (iv) less capital expenditures for acquisitions, (v) plus or less changes in net working capital. Morgan Stanley also calculated a range of terminal values by applying perpetuity growth rates ranging from 2.0% to 3.0%, selected by Morgan Stanley based upon the application of its professional judgment and experience, to the estimated unlevered free cash flows of Red Hat after February 28, 2034. Relying on the forecasts, Morgan Stanley also calculated the amount of net operating losses and other tax shield benefits that Red Hat management projected would accrue and/or be utilized for the period from fiscal year 2019 through fiscal year 2034 (we refer to such net operating losses and other tax shield benefits as tax attributes).

Morgan Stanley then discounted the unlevered free cash flows, terminal values and tax attributes to their present values as of December 31, 2018, using the mid-year discount convention and discount rates ranging from 9.5% to 10.5%. These discount rates were selected, upon the application of Morgan Stanley s professional judgment and experience, to reflect Red Hat s estimated weighted average cost of capital.

Based on the number of shares of Red Hat common stock outstanding and the dilutive securities schedule provided to Morgan Stanley by Red Hat management as of October 19, 2018, Morgan Stanley calculated the estimated implied value per share of Red Hat common stock as follows:

Projections Scenario	Implied Value Per Share
Base case forecast	$117.62 $140.26
Risk forecast	$90.45 $107.57
Outperform forecast	$147.37 $180.08

Precedent Transactions Analysis

Morgan Stanley performed a precedent transactions analysis, which is designed to imply a value of a company based on publicly available financial terms and premiums of selected transactions. Morgan Stanley compared publicly

available statistics for select software company transactions, selected based upon Morgan Stanley s professional judgment and experience, that were announced since 2013 and where the aggregate transaction value was greater than $2.5 billion.

Table of Contents

The following is a list of the precedent software transactions reviewed:

Announcement Date	Target	Acquiror
June 13, 2016	LinkedIn Corporation	Microsoft
June 2, 2016	Qlik Technologies, Inc.	Thoma Bravo, LLC
September 29, 2014	TIBCO Software Inc.	Vista Equity Partners LLC
September 13, 2015	Solera Holdings Inc.	Vista Equity Partners LLC
April 7, 2015	Informatica Corporation	The Permira Funds Canada Pension Plan Investment Board
February 2, 2015	Advent Software, Inc.	SS&C Technologies Holdings, Inc.
October 21, 2015	SolarWinds Inc.	Silver Lake Partners Thoma Bravo, LLC
December 15, 2014	Riverbed Technology, Inc.	Thoma Bravo, LLC Ontario Teachers Pension Plan International Investments
July 11, 2018	CA, Inc.	Broadcom Inc.
May 6, 2013	BMC Software, Inc.	Private investor group led by Bain Capital Partners, LLC, Golden Gate Private Equity, Inc., Insight Venture Partners and GIC Special Investments Pte. Ltd.
March 20, 2018	MuleSoft, Inc.	salesforce
July 28, 2016	NetSuite Inc.	Oracle Corporation
July 1, 2016	Demandware, Inc.	salesforce
September 18, 2014	Concur Technologies, Inc.	SAP SE
June 4, 2013	ExactTarget, Inc.	salesforce

Morgan Stanley reviewed the transactions above for, among other things, the ratio of the AV of each transaction to each target company s revenue for the 12-month period following the announcement date, which we refer to as NTM revenue, and each target company s UFCF for the 12-month period following the announcement date, which we refer to as NTM UFCF. Morgan Stanley determined that, with respect to all such transactions, the bottom quartile, median, mean and top quartile for each of NTM AV/UFCF and NTM AV/revenue were as set out in the table below:

Quartile (x)	NTM AV / UFCF	NTM AV / Revenue
Bottom Quartile	18.2x	3.9x
Median	22.6x	6.4x
Mean	23.0x	6.5x
Top Quartile	28.2x	8.4x

Based on the results of this analysis and its professional judgment and experience, Morgan Stanley applied a NTM AV/UFCF range of 22.5x 28.5x to the street case projections for Red Hat s NTM UFCF, which resulted in an implied per share equity value reference range for a share of Red Hat common stock of $136.20 to $168.77 (as compared to Red Hat s closing share price of $116.68 as at the unaffected date and the merger consideration under the merger agreement of $190.00 per share). Based on the results of this analysis and its professional judgment and experience, Morgan Stanley applied a NTM AV/revenue range of 6.5x 8.5x to the street case projections for Red Hat s NTM revenue, which resulted in an implied per share equity value reference range for a share of Red Hat common stock of $139.01 to $177.45 (as compared to Red Hat s closing share price of $116.68 as at the unaffected date and the merger consideration under the merger agreement of $190.00 per share).

No company or transaction utilized in the precedent transactions analysis is identical to Red Hat or the merger. In evaluating the precedent transactions, Morgan Stanley made judgments and assumptions with respect

Table of Contents

to industry performance, general business, regulatory, economic, market and financial conditions and other matters, many of which are beyond Red Hat s control. These include, among other things, the impact of competition on Red Hat s business and the industry generally, industry growth, and the absence of any material change in the financial condition and prospects of Red Hat and the industry, and in the financial markets in general, which could affect the public trading value of the companies and the aggregate value and equity value of the transactions to which they are being compared. The fact that points in the range of Red Hat s implied value per share of Red Hat common stock derived from the valuation of precedent transactions were less than or greater than the merger consideration is not necessarily dispositive in connection with Morgan Stanley s analysis of the merger consideration, but is one of many factors Morgan Stanley considered.

Premiums Paid Analysis

For reference only, and not as a component of its fairness analysis, Morgan Stanley considered, based on publicly available transaction information, the premiums paid in the precedent transactions listed in the section above captioned Precedent Transactions Analysis .

Morgan Stanley measured the premiums paid in the transactions described above over: (i) the closing price of the target company s stock on the unaffected date (*i.e.*, the day prior to a public announcement related to the transaction or prior to the share price being affected by acquisition rumors or similar merger-related news), which we refer to as the 1-Day Prior Price Premium; and (ii) the arithmetic average of the closing price of the target company s stock for the 30 trading days preceding the target s unaffected date, which we refer to as the 30-Day Average Price Premium. Morgan Stanley determined that, with respect to all such transactions, the top quartile, the median and the bottom quartile of the 1-Day Prior Price Premiums were 43.5%, 26.1% and 14.5% respectively. Based on the results of this analysis and its professional judgment and experience, Morgan Stanley applied a 1-Day Prior Price Premium range of 25% to 45% to Red Hat s closing share price as at the unaffected date resulting in an implied price per share range of $145.85 to $169.19. Morgan Stanley also noted that the merger consideration under the merger agreement implied a 1-Day Prior Price Premium of 63% for Red Hat, as at the unaffected date.

Morgan Stanley determined that, with respect to all such transactions, the top quartile, the median, and the bottom quartile of the 30 Day Average Price Premiums were 50.2%, 35.6% and 15.1% respectively. Based on the results of this analysis and its professional judgment and experience, Morgan Stanley applied a 30-Day Average Price Premium range of 35% to 50% to Red Hat s 30-day average share price (calculated as the arithmetic average of Red Hat s closing share price for the 30 trading days preceding the unaffected date, resulting in an implied price per share range of $172.90 to $192.12. Morgan Stanley also noted that the merger consideration under the merger agreement implied a 30-Day Average Price Premium of 48% for Red Hat.

No company or transaction utilized in the premiums paid analysis is identical to Red Hat or the merger. In evaluating the precedent transactions used for the premiums paid analysis, Morgan Stanley made assumptions with respect to industry performance, general business, regulatory, economic, market and financial conditions and other matters, many of which are beyond Red Hat s control. These include, among other things, the impact of competition on Red Hat s business and the industry generally, industry growth, and the absence of any material change in the financial condition and prospects of Red Hat and the industry, and in the financial markets in general, which could affect the public trading value of the companies and the aggregate value and equity value of the transactions to which they are being compared. The fact that points in the range of implied value per share of Red Hat common stock derived from the premiums paid analysis were less than or greater than the merger consideration is not necessarily dispositive in connection with Morgan Stanley s analysis of the merger consideration, but is one of many factors Morgan Stanley considered.

Equity Research Analysts Price Target Analysis

For reference only, and not as a component of its fairness analysis, Morgan Stanley reviewed the future public trading price targets for shares of Red Hat common stock prepared and published by selected equity

Table of Contents

research analysts prior to the unaffected date. These future share price targets reflected each analyst s estimate as of the date of publication of the future public market trading price of shares of Red Hat common stock and were not discounted to reflect present values. Morgan Stanley observed that the range between the 25th percentile to the 75th percentile of undiscounted analysts unaffected price targets for shares of Red Hat common stock prior to the unaffected date was $150.00 to $169.75, as compared to the merger consideration under the merger agreement of $190.00 per share of Red Hat common stock. In order to better compare the equity research analysts future share price targets with the merger consideration payable under the merger agreement, Morgan Stanley discounted the range of analysts future share price targets for Red Hat using a 10.1% discount rate (which rate was selected based on Morgan Stanley s professional judgment and experience to reflect Red Hat s cost of equity). This analysis indicated an implied range of equity values per share of Red Hat common stock of $136.21 to $154.15.

The public market trading price targets published by equity research analysts do not necessarily reflect current market trading prices for shares of Red Hat common stock and these estimates are subject to uncertainties, including the future financial performance of Red Hat and future financial market conditions.

Historical Trading Range Analysis

For reference only, and not as a component of its fairness analysis, Morgan Stanley reviewed the historical trading range of shares of Red Hat common stock for the period commencing on Red Hat s initial public offering date of August 11, 1999 and ending on the unaffected date, and observed that the merger consideration under the merger agreement of $190 per share of Red Hat common stock was higher than the all-time daily closing high of $176.27 per share during this period.

For reference only, and not as a component of its fairness analysis, Morgan Stanley also reviewed the historical trading range of shares of Red Hat common stock for: (i) the three month period commencing on July 28, 2018 and ending on the unaffected date, noting the daily closing price per share of Red Hat common stock ranged from $116.68 to $151.90 during this period; (ii) the six month period commencing April 26, 2018 and ending on the unaffected date, noting that the daily closing price per share of Red Hat common stock ranged from $116.68 to $176.27 during this period; and (iii) the 12-month period commencing October 26, 2017 and ending on the unaffected date, noting that the daily closing price per share of Red Hat common stock ranged from $116.68 to $176.27 during this period.

General

Morgan Stanley performed a variety of financial and comparative analyses for purposes of rendering its opinion. The preparation of a financial opinion is a complex process and is not necessarily susceptible to a partial analysis or summary description. In arriving at its opinion, Morgan Stanley considered the results of all of its analyses as a whole and did not attribute any particular weight to any analysis or factor it considered. Morgan Stanley believes that selecting any portion of its analyses, without considering all analyses as a whole, would create an incomplete view of the process underlying its analyses and opinion. In addition, Morgan Stanley may have given various analyses and factors more or less weight than other analyses and factors, and may have deemed various assumptions more or less probable than other assumptions. As a result, the ranges of valuations resulting from any particular analysis described above should not be taken to be Morgan Stanley s view of the actual value of Red Hat.

In performing its analyses, Morgan Stanley made numerous assumptions with regard to industry performance, general business, regulatory, economic, market and financial conditions and other matters, which are beyond the control of Red Hat. These include, among other things, the impact of competition on the business of Red Hat and the industry generally, industry growth, and the absence of any material change in the financial condition and prospects of Red Hat and the industry, and in the financial markets in general. Any estimates contained in Morgan Stanley s analyses are not

necessarily indicative of future results or actual values, which may be significantly more or less favorable than those suggested by such estimates.

Table of Contents

Morgan Stanley conducted the analyses described above solely as part of its analysis of the fairness, from a financial point of view, of the merger consideration pursuant to the merger agreement to Red Hat stockholders, and in connection with the delivery of its opinion to the Red Hat Board of Directors. These analyses do not purport to be appraisals or to reflect the prices at which shares of Red Hat common stock might actually trade.

The merger consideration was determined through arm s-length negotiations between Red Hat and IBM and was approved by the Red Hat Board of Directors. Morgan Stanley acted as financial advisor to Red Hat during these negotiations but did not, however, recommend any specific form or amount of merger consideration to Red Hat or the Red Hat Board of Directors, nor opine that any specific consideration constituted the only appropriate consideration for the merger. In addition, Morgan Stanley s opinion did not address the relative merits of the merger as compared to any other alternative business transactions, and Morgan Stanley s opinion expressed no opinion or recommendation as to how Red Hat stockholders should act or vote at the special meeting to be held in connection with the merger or whether to take any other action with respect to the merger. In addition, Morgan Stanley s opinion did not in any manner address the prices at which shares of Red Hat common stock will trade following consummation of the merger or at any time.

Morgan Stanley s opinion and its presentation to the Red Hat Board of Directors was one of many factors taken into consideration by the Red Hat Board of Directors in deciding to approve the execution, delivery and performance by Red Hat of the merger agreement and the transaction contemplated thereby. Consequently, the analyses as described above should not be viewed as determinative of the opinion of the Red Hat Board of Directors with respect to the merger consideration pursuant to the merger agreement or whether the Red Hat Board of Directors would have been willing to agree to different consideration. Morgan Stanley s opinion was approved by a committee of Morgan Stanley investment banking and other professionals in accordance with its customary practice.

Red Hat retained Morgan Stanley based on Morgan Stanley s qualifications, experience and expertise and its familiarity with Red Hat. Morgan Stanley is a global financial services firm engaged in the securities, investment management and individual wealth management businesses. Its securities business is engaged in securities underwriting, trading and brokerage activities, foreign exchange, commodities and derivatives trading, prime brokerage, as well as providing investment banking, financing and financial advisory services. Morgan Stanley, its affiliates, directors and officers may at any time invest on a principal basis or manage funds that invest, hold long or short positions, finance positions, and may trade or otherwise structure and effect transactions, for their own account or the accounts of its customers, in debt or equity securities or loans of IBM, Red Hat, or any other company, or any currency or commodity, that may be involved in the merger, or any related derivative instrument.

Under the terms of its engagement letter, Morgan Stanley provided Red Hat financial advisory services and a financial opinion, described in this section and attached to this proxy statement as Annex C, in connection with the merger. Red Hat has agreed to pay Morgan Stanley a fee of not less than approximately $43.3 million for its services, approximately $6.5 million of which was paid in connection with the delivery of the fairness opinion and approximately $36.8 million of which is contingent upon consummation of the merger. Red Hat has also agreed to reimburse Morgan Stanley for its reasonable and documented expenses, including fees of outside counsel and other professional advisors, incurred from time to time in connection with this engagement. In addition, Red Hat has agreed to indemnify Morgan Stanley and its affiliates, its and their respective directors, officers, employees and agents and each other person, if any, controlling Morgan Stanley or any of its affiliates, against any losses, claims, damages or liabilities, relating to, arising out of or in connection with Morgan Stanley s engagement.

In the two years prior to the date of its opinion, Morgan Stanley or its affiliates have provided financing services for Red Hat and has received fees in connection with such services of approximately less than $1 million in the aggregate. In addition, Morgan Stanley is a counterparty to Red Hat with respect to certain convertible note hedge and warrants

transactions entered into in connection with Red Hat s issuance of $805 million principal

Table of Contents

amount of convertible notes due in 2019. The consummation of the merger, to the extent it occurs prior to the expiration of the warrants transactions, will result in the unwind of warrants, and an expected payment to be made by Red Hat to Morgan Stanley, in an amount to be calculated at the time of closing of the merger. As of the date hereof, in connection with early conversions by holders of the convertible notes, a substantial portion of the convertible note hedge transaction has been exercised by Red Hat. Based on the current share price of Red Hat and remaining time to maturity of the convertible notes in 2019, all or a substantial portion of the remaining convertible note hedge transaction may be exercised prior to closing of the merger.

In the two years prior to the date of its opinion, Morgan Stanley has not been engaged on any financial advisory or financing assignments for IBM, and has not received any fees for such services from IBM during this time. Morgan Stanley may also seek to provide financial advisory and financing services to IBM and Red Hat and their respective affiliates in the future and would expect to receive fees for the rendering of these services.

Financial Forecast

In connection with Red Hat s evaluation of the merger, Red Hat management prepared non-public financial forecasts as to the potential future performance of Red Hat for the fiscal years 2019-2024, which we refer to as the base case forecast. In addition, Red Hat management prepared two alternative forecasts for the years 2019-2024, which we refer to collectively as the alternative forecasts. The first alternative forecast, which we refer to as the risk forecast, used significantly more negative assumptions about the performance of Red Hat, including lower revenue growth and pricing pressures than the base case forecast. The second alternative forecast, which we refer to as the outperform forecast, used significantly more positive assumptions about the performance of Red Hat than the base case forecast, including pervasive adoption of Red Hat s products and increased investments in both organic and inorganic growth opportunities. Red Hat provided the Red Hat Board of Directors, and its advisors, including Guggenheim Securities and Morgan Stanley, with each of the base case forecast and the alternative forecasts in connection with their financial analyses summarized under Proposal 1: Adoption of the Merger Agreement The Merger Opinions of Red Hat s Financial Advisors beginning on page 47. The base case forecast, the alternative forecasts and the extrapolated forecasts (as defined herein) are collectively referred to herein as the forecasts.

Red Hat does not normally publicly disclose long-term forecasts or projections as to future revenue, earnings or other results due to, among other reasons, the uncertainty, unpredictability and subjectivity of the underlying assumptions and estimates, including the difficulty of predicting general economic and market conditions. The forecasts were not prepared with a view to public disclosure and are included in this proxy statement only because such information was made available as described above. The forecasts were not prepared with a view to compliance with generally accepted accounting principles as applied in the United States, which we refer to as GAAP, the published guidelines of the SEC regarding projections and forward-looking statements or the guidelines established by the American Institute of Certified Public Accountants for preparation and presentation of prospective financial information. The prospective financial information included in this proxy statement has been prepared by, and is the responsibility of, Red Hat s management. PricewaterhouseCoopers LLP has not audited, reviewed, examined, compiled nor applied agreed-upon procedures with respect to the accompanying prospective financial information and, accordingly, PricewaterhouseCoopers LLP does not express an opinion or any other form of assurance with respect thereto. The PricewaterhouseCoopers LLP report included in this proxy statement relates to Red Hat s previously issued financial statements. It does not extend to the prospective financial information and should not be read to do so.

Although a summary of the forecasts is presented with numerical specificity, the forecasts reflect numerous assumptions and estimates as to future events made by our management, including with respect to demand for Red Hat s products and services, capital expenditure levels for the applicable periods, acquisition related expenditure levels for the applicable periods and other matters, many of which are difficult to predict and subject to significant economic

and competitive uncertainties beyond Red Hat s control, that our management believed in good faith were reasonable at the time the forecasts were prepared, taking into account the relevant

Table of Contents

information available to management at the time. However, this information is not fact and should not be relied upon as necessarily indicative of actual future results. Important factors that may affect actual results and cause the forecasts not to be achieved include general economic and financial conditions, industry performance, accuracy of certain accounting assumptions, changes in actual or projected cash flows, competitive pressures and other factors described or referenced under the section entitled Forward-Looking Statements beginning on page 24. In addition, the forecasts do not take into account any circumstances or events occurring after the date that they were prepared and do not give effect to the merger. As a result, there can be no assurance that the forecasts will or would be realized, and actual results may be materially better or worse than those contained in the forecasts.

The forecasts are not a reliable indication of future results, and Red Hat and its management team and advisors do not endorse the forecasts as such, and they do not make any representation to readers of this document concerning the ultimate performance of Red Hat or the combined company compared to the forecasts. Red Hat is including these forecasts in this document solely because they were among the financial information made available to the Red Hat Board of Directors, Guggenheim Securities and Morgan Stanley in connection with their evaluation of the merger, and not to influence your decision on how to vote on any proposal.

The forecasts should be evaluated, if at all, in conjunction with the historical financial statements and other information regarding Red Hat contained in our public filings with the SEC. Our management reviewed the forecasts with the Board of Directors, which considered the forecasts in connection with its evaluation and approval of the merger agreement and the merger.

The forecasts constitute forward-looking statements. For information on factors that may cause Red Hat s future results to materially vary, see the section entitled Forward-Looking Statements beginning on page 24.

Except to the extent required by applicable federal securities laws, we do not intend, and expressly disclaim any responsibility, to update or otherwise revise the forecasts to reflect circumstances existing after the date when Red Hat prepared the forecasts or to reflect the occurrence of future events or changes in general economic or industry conditions, even in the event that any of the assumptions underlying the forecasts are shown to be in error.

Certain of the measures included in the forecasts may be considered non-GAAP financial measures, including EBITDA and unlevered free cash flow. Non-GAAP financial measures should not be considered in isolation from, or as a substitute for, financial information presented in compliance with GAAP, and non-GAAP financial measures as used by Red Hat may not be comparable to similarly titled amounts used by other companies.

Guggenheim Securities and Morgan Stanley derived Unlevered Free Cash Flow for purposes of their respective financial analyses based on the forecasts provided by Red Hat management. Unlevered Free Cash Flow was calculated as EBITDA plus or less changes in net working capital, less stock-based compensation, capital expenditures, acquisition related expenditures and cash taxes.

Table of Contents

Base Case Forecast

The following table reflects selected metrics reflected in, or derived from, the base case forecast:

	Fiscal Year Ending February 28					
	2019E	**2020E**	**2021E**	**2022E**	**2023E**	**2024E**
Red Hat Forecast						
Revenue	$ 3,380	$ 3,949	$ 4,638	$ 5,445	$ 6,345	$ 7,281
EBITDA	$ 875	$ 1,025	$ 1,220	$ 1,429	$ 1,677	$ 1,940
Derived by Guggenheim Securities						
Unlevered Free Cash Flow	$ 740	$ 827	$ 1,012	$ 1,219	$ 1,433	$ 1,618
Derived by Morgan Stanley						
Unlevered Free Cash Flow	$ 791	$ 827	$ 1,013	$ 1,219	$ 1,433	$ 1,619

Note: Dollars in millions.

Risk Forecast

The following table reflects selected metrics reflected in, or derived from, the risk forecast:

	Fiscal Year Ending February 28					
	2019E	**2020E**	**2021E**	**2022E**	**2023E**	**2024E**
Red Hat Forecast						
Revenue	$ 3,380	$ 3,916	$ 4,518	$ 5,156	$ 5,772	$ 6,286
EBITDA	$ 875	$ 1,040	$ 1,199	$ 1,358	$ 1,516	$ 1,654
Derived by Guggenheim Securities						
Unlevered Free Cash Flow	$ 740	$ 819	$ 932	$ 1,038	$ 1,108	$ 1,108
Derived by Morgan Stanley						
Unlevered Free Cash Flow	$ 791	$ 819	$ 933	$ 1,038	$ 1,108	$ 1,109

Note: Dollars in millions.

Outperform Forecast

The following table reflects selected metrics reflected in, or derived from, the outperform forecast:

	Fiscal Year Ending February 28					
	2019E	**2020E**	**2021E**	**2022E**	**2023E**	**2024E**

Red Hat Forecast						
Revenue	$ 3,380	$ 3,946	$ 4,647	$ 5,517	$ 6,584	$ 7,864
EBITDA	$ 875	$ 969	$ 1,147	$ 1,366	$ 1,639	$ 1,995
Derived by Guggenheim Securities						
Unlevered Free Cash Flow	$ 740	$ 672	$ 831	$ 1,056	$ 1,339	$ 1,692
Derived by Morgan Stanley						
Unlevered Free Cash Flow	$ 791	$ 672	$ 831	$ 1,056	$ 1,340	$ 1,693

Note: Dollars in millions.

Table of Contents

Certain Extrapolated Forecasts

Red Hat management also prepared certain extrapolations for the fiscal years 2025 through 2034 for each of the base case forecast and the alternative forecasts, which we refer to as the extrapolated forecasts, and shared such extrapolations with the Red Hat Board of Directors, Guggenheim Securities and Morgan Stanley in connection with their financial analyses summarized under Proposal 1: Adoption of the Merger Agreement The Merger Opinions of Red Hat s Financial Advisors beginning on page 47. Red Hat management prepared the extrapolated forecasts by applying an assumed growth rate to Red Hat s forecasted revenue for 2024E for each of the base case forecast and the alternative forecasts. Red Hat management selected an assumed growth rate on the assumption that growth will slow in future years as Red Hat reaches steady state by 2034E. The extrapolated forecasts do not otherwise reflect Red Hat management s expectations, estimates or assumptions regarding prospective industry conditions or other commercial, operational and financial judgments or assessments regarding the future prospects of Red Hat. The extrapolated forecasts are not fact and should not be relied upon as necessarily indicative of actual future results.

The following table reflects selected metrics reflected in, or derived from, the extrapolated forecasts:

	Fiscal Year Ending February 28									
	2025E	**2026E**	**2027E**	**2028E**	**2029E**	**2030E**	**2031E**	**2032E**	**2033E**	**2034E**
Base Case Forecast										
Red Hat Forecast										
Revenue	$ 8,228	$ 9,206	$ 10,199	$ 11,184	$ 12,141	$ 13,045	$ 13,871	$ 14,596	$ 15,196	$ 15,652
EBITDA	$ 2,240	$ 2,507	$ 2,779	$ 3,046	$ 3,299	$ 3,541	$ 3,766	$ 3,965	$ 4,130	$ 4,248
Derived by Guggenheim Securities										
Unlevered Free Cash Flow	$ 1,808	$ 1,966	$ 2,124	$ 2,263	$ 2,372	$ 2,459	$ 2,519	$ 2,545	$ 2,533	$ 2,472
Derived by Morgan Stanley										
Unlevered Free Cash Flow	$ 1,809	$ 1,968	$ 2,125	$ 2,265	$ 2,374	$ 2,461	$ 2,522	$ 2,548	$ 2,537	$ 2,476
Risk Forecast										
Red Hat Forecast										
Revenue	$ 6,830	$ 7,378	$ 7,926	$ 8,466	$ 8,990	$ 9,489	$ 9,956	$ 10,382	$ 10,760	$ 11,083
EBITDA	$ 1,807	$ 1,973	$ 2,145	$ 2,317	$ 2,485	$ 2,657	$ 2,832	$ 3,004	$ 3,171	$ 3,322
Derived by Guggenheim Securities										
Unlevered Free Cash Flow	$ 1,170	$ 1,257	$ 1,341	$ 1,421	$ 1,490	$ 1,559	$ 1,627	$ 1,689	$ 1,744	$ 1,781

Derived by Morgan Stanley										
Unlevered Free Cash Flow	$ 1,171	$ 1,258	$ 1,342	$ 1,423	$ 1,492	$ 1,561	$ 1,629	$ 1,692	$ 1,747	$ 1,784
Outperform Forecast										
Red Hat Forecast										
Revenue	$ 9,310	$ 10,865	$ 12,495	$ 14,158	$ 15,800	$ 17,361	$ 18,779	$ 19,990	$ 20,934	$ 21,562
EBITDA	$ 2,451	$ 2,902	$ 3,380	$ 3,868	$ 4,348	$ 4,814	$ 5,246	$ 5,621	$ 5,920	$ 6,110
Derived by Guggenheim Securities										
Unlevered Free Cash Flow	$ 2,093	$ 2,431	$ 2,755	$ 3,051	$ 3,301	$ 3,500	$ 3,632	$ 3,680	$ 3,634	$ 3,468
Derived by Morgan Stanley										
Unlevered Free Cash Flow	$ 2,094	$ 2,432	$ 2,756	$ 3,053	$ 3,304	$ 3,503	$ 3,636	$ 3,684	$ 3,638	$ 3,473

Note: Dollars in millions.

Interests of the Non-Employee Directors and Executive Officers of Red Hat in the Merger

When considering the recommendation of the Red Hat Board of Directors that you vote to approve the proposal to adopt the merger agreement, you should be aware that our non-employee directors and executive officers may have interests in the merger that are different from, or in addition to, your interests as a stockholder. The Red Hat Board of Directors was aware of and considered these interests to the extent such interests existed at

Table of Contents

the time, among other matters, in evaluating and overseeing the negotiation of the merger agreement, in approving the merger agreement and the merger and in recommending that the merger agreement be adopted by the stockholders of Red Hat.

Treatment of Equity Compensation

Our executive officers hold various types of compensatory awards with respect to Red Hat common stock. Our non-employee directors hold awards of restricted shares and DSUs. None of our non-employee directors or executive officers holds stock options. The merger agreement provides for the treatment set forth below with respect to the awards held by our non-employee directors and executive officers:

Restricted Shares. Each Cash-Out Restricted Share will be converted at the effective time into the right to receive an amount in cash equal to the merger consideration multiplied by the number of shares of Red Hat common stock subject to the award. Each Rollover Restricted Share will be converted at the effective time into a restricted share award consisting of IBM common stock subject to substantially the same terms and conditions as were applicable to the Rollover Restricted Shares (other than any performance conditions, which will be deemed satisfied upon the effective time under the terms of the award) with respect to a number of shares of IBM common stock determined by multiplying the number of shares of Red Hat common stock subject to such Rollover Restricted Share award immediately prior to the effective time by the Exchange Ratio (rounded down to the nearest whole share).

Restricted Stock Units; Deferred Stock Units. Each Cash-Out RSU will be converted at the effective time into the right to receive an amount in cash equal to the merger consideration multiplied by the number of shares of Red Hat common stock subject to the award. Each Rollover RSU will be converted at the effective time into a restricted stock unit with respect to IBM common stock subject to substantially the same terms and conditions as were applicable to the Rollover RSUs with respect to a number of shares of IBM common stock determined by multiplying the number of shares of Red Hat common stock subject to such Rollover RSU award immediately prior to the effective time by the Exchange Ratio (rounded down to the nearest whole share).

Performance Share Units. At the effective time, each Cash-Out PSU will be canceled and the holder thereof will be entitled to receive in consideration for such cancellation an amount in cash equal to the product of (i) the applicable PSU Share Number and (ii) the merger consideration. Each Rollover PSU will be converted at the effective time into a restricted share award consisting of IBM common stock subject to substantially the same terms and conditions as were applicable under such Rollover PSU (other than the performance-based vesting schedule, which will be converted into a service-based vesting schedule in accordance with the applicable award agreement), with respect to a number of shares of IBM common stock determined by multiplying the applicable PSU Share Number by the Exchange Ratio (rounded down to the nearest whole share).

Accelerated Vesting of Equity Compensation Upon Certain Terminations

Pursuant to the terms of Red Hat s stock plans and award agreements, the vesting of each IBM award attributable to a Rollover Restricted Share, Rollover RSU or Rollover PSU, including such awards held by our executive officers, will accelerate in the event of a termination of employment of the holder other than for cause or good cause (as applicable) or, in some cases, a resignation for good reason (in each case to the extent applicable and as defined in the award agreement) during the one-year period immediately following the effective time. In addition, pursuant to Mr. Whitehurst s employment agreement, all of Mr. Whitehurst s outstanding equity awards will also vest in full upon a termination of employment without cause (as defined in his employment agreement) within either three months prior to, or 24 months after, the effective time, or if Mr. Whitehurst terminates his employment for good reason (as defined in his employment agreement) within 24 months after the effective time. The descriptions in this paragraph are subject

to the discussions below under the section entitled New Retention Arrangements with IBM.

Table of Contents

Summary of Equity and Equity Compensation held by Red Hat Non-Employee Directors and Executive Officers

The table below sets forth the estimated value of shares and equity compensation awards held as of December 7, 2018 by non-employee directors, named executive officers and other executive officers of Red Hat based on the merger consideration of $190.00 per share of Red Hat common stock (without subtraction of applicable withholding taxes). Depending on when the merger is completed, certain outstanding equity awards shown in the table below may become vested in accordance with their terms without regard to the merger.

Equity and Equity Compensation Held by Non-Employee Directors and Executive Officers (as of December 7, 2018)

	Shares (#)	Value of Shares ($)	Performance Share Units[1] (#)	Value of Performance Share Units ($)	Restricted Stock Units/ Restricted Shares[2] (#)	Value of Restricted Stock Units/ Restricted Shares ($)	Total Value ($)
Board of Directors							
Narendra K. Gupta, Board Chair	7,345	1,395,550			46,284[3]	8,793,960	10,189,510
Sohaib Abbasi	8,045	1,528,550			31,671[4]	6,017,490	7,546,040
W. Steve Albrecht	15,644	2,972,360			15,392[5]	2,924,480	5,896,840
Charlene T. Begley	8,144	1,547,360			1,710	324,900	1,872,260
Kimberly L. Hammonds	9,551	1,814,690			1,710	324,900	2,139,590
William S. Kaiser	61,652	11,713,880			8,900[6]	1,691,000	13,404,880
Kevin M. Murai					2,429[7]	461,510	461,510
Alfred W. Zollar					2,337[8]	444,030	444,030
Named Executive Officers							
James M. Whitehurst	287,856	54,692,640	293,646	55,792,740	71,258	13,539,020	124,024,400
Eric R. Shander	5,711	1,085,090	46,773	8,886,870	21,106	4,010,140	13,982,100
Paul J. Cormier	160,955	30,581,450	144,315	27,419,850	34,656	6,584,640	64,585,940
Arun Oberoi	86,274	16,392,060	145,158	27,580,020	30,830	5,857,700	49,829,780
Michael R. Cunningham	33,100	6,289,000	72,861	13,843,590	17,538	3,332,220	23,464,810
Other Executive Officers							
DeLisa K. Alexander	15,000	2,850,000	71,493	13,583,670	17,257	3,278,830	19,712,500
Michael A. Kelly			18,906	3,592,140	14,801	2,812,190	6,404,330

(1) The Performance Share Unit column includes (i) performance share units that were granted with performance goals based on total shareholder return, which are shown at 200% of target, or the maximum level of performance, and (ii) performance share units that were granted with performance goals relating to operating performance, which are shown at 200% of target for those performance share units granted in May 2016, and at

target for those performance share units granted in subsequent years, assuming that the merger had been completed on December 7, 2018.

(2) Amounts in this column reflect: (i) unvested and outstanding restricted share awards granted to our non-employee directors vesting over either one year or three years from the date of grant, (ii) unvested and outstanding restricted share awards granted to our executive officers vesting over four years from the date of grant, (iii) unvested and outstanding restricted stock units granted to Mr. Shander and Mr. Kelly prior to becoming executive officers, vesting over four years from the date of grant, and (iv) outstanding DSUs, which represent the right to receive shares of our common stock, issued to our non-employee directors and paid only at the time a director s board service ends.

(3) Includes 46,284 shares of common stock issuable upon payout of DSUs.

(4) Includes 31,671 shares of common stock issuable upon payout of DSUs.

(5) Includes 15,392 shares of common stock issuable upon payout of DSUs.

(6) Includes 7,190 shares of common stock issuable upon payout of DSUs.

(7) Consists of 2,429 shares of an initial restricted share award vesting ratably over three years from the date of grant.

Table of Contents

(8) Consists of (i) 2,052 shares of an initial restricted share award vesting ratably over three years from the date of grant and (ii) 285 shares of a pro-rated annual restricted share award vesting on the first anniversary of the date of grant.

Potential Payments to Executive Officers upon Termination in Connection with a Change in Control

Our executive officers, including our named executive officers, are covered by arrangements which could provide them with severance payments and benefits in the event of a termination of employment in connection with the merger. Mr. Whitehurst is party to an executive employment agreement with Red Hat, which generally provides (subject to the discussion below under the section entitled New Retention Arrangements with IBM) that if his employment is terminated without cause (as defined in his agreement) within either three months prior to, or 24 months after, a change in control (a change in control will occur upon the merger), or if Mr. Whitehurst terminates his employment for good reason (as defined in his agreement) within 24 months after a change in control, Mr. Whitehurst will be entitled to a payment equal to 200% of his annual base salary and target bonus, a pro-rata bonus (also at target) for the year of termination, a payment in respect of 24 months of premiums for health care and life insurance continuation and, if necessary, a gross-up for any excise taxes imposed pursuant to the golden parachute tax provisions of the Code. Our other executive officers (including our other named executive officers) are participants in our Senior Management Change in Control Severance Policy, which provides (subject to the discussion below under the section entitled New Retention Arrangements with IBM) that if within one year after a change in control, the officer is terminated without good cause or the officer terminates employment with good reason (each as defined in the policy), the officer will be entitled to a severance payment equal to 200% of the officer s base salary and average bonus earned for the preceding two years, a pro-rata bonus based on either actual achievement or target (to the extent such achievement does not lend itself to an interim fiscal year calculation) for the year of termination, a payment in respect of premiums for 24 months of health care continuation and for Ms. Alexander and Messrs. Cormier and Cunningham, a gross-up for any excise taxes imposed pursuant to the golden parachute tax provisions of the Code.

Future Red Hat Equity Grants

Red Hat may grant equity awards in the form of restricted share awards, restricted stock units or DSUs prior to the merger in the ordinary course of business consistent with past practice, up to an aggregate grant date fair value of $350 million per year. Such awards may include awards to non-employee directors and executive officers, although whether such awards will be made and the extent of such awards has not yet been determined. It is anticipated that any such awards will provide for accelerated vesting in the event of qualifying terminations of employment during the one-year period immediately following the merger.

Retention Bonus Pools

In connection with the merger, it is anticipated that each of Red Hat and IBM will establish special bonus programs to assist in retaining key employees in the period through and after the merger. Executive officers may receive retention bonus awards under such programs, although the extent and recipients of such awards have not yet been determined.

Table of Contents

Potential Change-in-Control Payments to Executive Officers Other than Named Executive Officers

The following table shows the estimated amounts that each executive officer other than the named executive officers would receive upon a qualifying termination of employment assuming that such event occurred on December 7, 2018. The table does not include information regarding payments described under the section entitled New Retention Arrangements with IBM, which are described below, any retention awards or new Red Hat equity awards that may be made to the executives between the execution date of the merger agreement and the closing of the merger or amounts that the executives were already entitled to receive that were or would be vested as of December 7, 2018. In addition to these assumptions, these estimated amounts are based on certain other assumptions that are described in the footnotes accompanying the table below. Accordingly, the ultimate values to be received by an executive officer in connection with the merger may differ from the amounts set forth below.

Officer	Cash[(1)] ($)	Equity[(2)] ($)	Perquisites/ Benefits[(3)] ($)	Tax Reimbursement[(4)] ($)	Total ($)
DeLisa K. Alexander	2,162,308	16,862,500	44,163		19,068,971
Michael A. Kelly	1,646,626	6,404,330	44,163	N/A	8,095,119

(1) *Cash*. This column includes the value of the cash severance payments payable to each executive officer, which is equal to 200% of the officer s base salary and average bonus earned for the preceding two years, plus a prorated bonus based on either actual achievement or target (to the extent such achievement does not lend itself to an interim fiscal year calculation) for the year of termination. The amounts in this column are further explained in the chart immediately below.

Name	Severance Payment ($)	Prorated Bonus ($)
DeLisa K. Alexander	1,854,363	307,945
Michael A. Kelly	1,438,763	207,863

The severance and prorated bonuses described above are all double trigger in nature, which means that payment of these amounts is conditioned upon a qualifying termination of employment on or within the 12 months following the completion of the merger.

(2) *Equity*. The amounts in this column represent the aggregate value of the Rollover Restricted Shares, Rollover RSUs and Rollover PSUs, which would vest in the event the executive s employment was terminated in a qualifying termination immediately following the closing of the merger. Performance share units included in this column are composed of (i) performance share units that were granted with performance goals based on total shareholder return, which are shown at 200% of target, or the maximum level of performance, and (ii) performance share units that were granted with performance goals relating to operating performance, which are shown at 200% of target for those performance share units granted in May 2016, and at target for those performance share units granted in subsequent years. The amounts in this column are double trigger in nature, which means that payment of these amounts is conditioned upon a qualifying termination of employment on or within the 12 months following the completion of the merger.

(3) *Perquisites/Benefits*. This column includes payments in respect of welfare benefit premiums for 24 months of post-termination coverage. The amounts in this column are double trigger in nature, which means that payment of these amounts is conditioned upon a qualifying termination of employment on or within the 12 months following the completion of the merger.

(4) *Tax Reimbursements*. The Senior Management Change in Control Severance Policy for Ms. Alexander provides that she is eligible for a gross-up payment relating to any golden parachute excise tax to which she is subject, which would have resulted in a gross-up payment being payable to her if the merger had been completed as of December 7, 2018. However, if the merger is completed as anticipated in the latter half of 2019, no gross-up payment is expected to be payable to Ms. Alexander based on the arrangements described in this proxy statement. Any amounts payable in this column would be single trigger in nature.

Table of Contents

New Retention Arrangements with IBM

In connection with the execution of the merger agreement, certain of our executive officers (Ms. Alexander and Messrs. Cormier, Oberoi and Whitehurst) have entered into new retention arrangements with IBM which are conditional upon the closing of the merger. The retention arrangements generally provide that each executive will participate in a retention program following the closing and further provide that each executive s base salary and target cash incentive bonus will continue in effect following the closing during the period of the retention program. The retention program generally provides each executive with cash retention payments if the executive remains employed for a specified period after the closing (three years for Ms. Alexander and Mr. Whitehurst, two years for Messrs. Cormier and Oberoi), and in the case of Mr. Whitehurst, subject to the achievement of performance milestones to be determined by Mr. Whitehurst and IBM. The retention payments are payable in installments with respect to a series of retention periods within the overall retention period. The aggregate individual retention bonuses are $8,500,000 for Mr. Cormier, $6,000,000 for Messrs. Oberoi and Whitehurst and $3,000,000 for Ms. Alexander. If the executive s employment is terminated without cause or due to death or disability, then, subject to the executive s execution of a release, the executive will be entitled to the portion of the retention bonus due for the then current retention period, payable in a lump sum within a reasonable period after termination. In addition, Mr. Whitehurst s retention arrangement provides that he will receive a new award of IBM restricted stock units with a grant date fair value as of the closing equal to $15,000,000. This restricted stock unit award vests one-third on the third anniversary of the closing and two-thirds on the fourth anniversary of the closing, subject to Mr. Whitehurst s continued employment, and is not subject to accelerated vesting. The new retention arrangements generally preserve each executive s existing change in control severance protections from Red Hat for 12 months following the closing (except that good reason has been modified to reflect certain aspects of the executive s role in the combined business, and the severance benefits are also payable upon a death or disability of the executive) and the retention arrangements with Messrs. Cormier and Oberoi also provide that if the executive resigns after the 12-month period immediately following the closing, the executive will be offered the opportunity to enter into a post-termination consulting arrangement with IBM, during which the executive s legacy Red Hat equity awards will continue to vest in accordance with their terms, consistent with existing Red Hat practices. In connection with entering into the retention arrangements, each of the executives also entered into a new restrictive covenant agreement with IBM, which will also be effective upon the closing, and generally includes non-competition and non-solicitation covenants for the longer of three years post-closing and two years post-termination and perpetual confidentiality covenants. Mr. Cunningham also entered into an extension of his existing non-competition agreement for the same period described in the immediately preceding sentence.

Golden Parachute Compensation

The following table shows the estimated amounts that each named executive officer would receive upon a qualifying termination of employment assuming that such event occurred on December 7, 2018. The table does not include information regarding payments described under the section entitled New Retention Arrangements with IBM, which are described above, any retention awards or new Red Hat equity awards that may be made to the executives between the execution date of the merger agreement and the closing of the merger or amounts that the executives were already entitled to receive that were or would be vested as of December 7, 2018. In addition to these assumptions, these estimated amounts are based on certain other assumptions that are described in the footnotes accompanying the table below. Accordingly, the ultimate values to be received by a named executive officer in connection with the merger may differ from the amounts set forth below.

Table of Contents

The table below, along with its footnotes, sets forth the information required by Item 402(t) of Regulation S-K regarding the compensation payable to Red Hat s named executive officers (as identified by Red Hat in its most recent annual proxy statement). This compensation is subject to a vote of Red Hat s stockholders on an advisory non-binding basis, as described below under the section entitled Proposal 2: Advisory Vote on Merger-Related Executive Compensation Arrangements beginning on page 109.

Officer	Cash[1] ($)	Equity[2] ($)	Perquisites/ Benefits[3] ($)	Tax Reimbursement[4] ($)	Total ($)
James M. Whitehurst	6,770,274	69,331,760	109,763		76,211,797
Eric R. Shander	2,364,370	12,897,010	44,163	N/A	15,305,543
Paul J. Cormier	3,587,451	34,004,490	33,133		37,625,074
Arun Oberoi	2,840,415	33,437,720	44,163	N/A	36,322,298
Michael R. Cunningham	2,219,705	17,175,810	44,163		19,439,678

(1) *Cash*. This column includes the value of the cash severance payments payable to each named executive officer. For Mr. Whitehurst, this is equal to 200% of his annual base salary and target bonus, plus a prorated bonus (also at target) for the year of termination. For the other named executive officers, this is equal to 200% of the officer s base salary and average bonus earned for the preceding two years, plus a prorated bonus based either on actual achievement or target (to the extent such achievement does not lend itself to an interim fiscal year calculation) for the year of termination. The amounts in this column are further explained in the chart immediately below.

Name	Severance Payment ($)	Prorated Bonus ($)
James M. Whitehurst	5,500,000	1,270,274
Eric R. Shander	1,940,945	423,425
Paul J. Cormier	3,048,547	538,904
Arun Oberoi	2,397,744	442,671
Michael R. Cunningham	1,911,760	307,945

The severance and prorated bonus described above are all double trigger in nature, which means that payment of these amounts is conditioned upon a qualifying termination of employment on or within the 12 months following the completion of the merger.

(2) *Equity*. The amounts in this column represent the aggregate value of the Rollover Restricted Shares, Rollover RSUs and Rollover PSUs, which would vest in the event the named executive officer s employment was terminated in a qualifying termination immediately following the closing of the merger. Performance share units included in this column are composed of (i) performance share units that were granted with performance goals based on total shareholder return, which are shown at 200% of target, or the maximum level of performance, and (ii) performance share units that were granted with performance goals relating to operating performance, which are shown at 200% of target for those performance share units granted in May 2016, and at target for those performance share units granted in subsequent years. The amounts in this column are double trigger in nature, which means that payment of these amounts is conditioned upon a qualifying termination of employment on or

within the 12 months following the completion of the merger.

(3) *Perquisites/Benefits*. This column includes payments in respect of welfare benefit premiums for 24 months of post-termination coverage. The amounts in this column are double trigger in nature, which means that payment of these amounts is conditioned upon a qualifying termination of employment on or within the 12 months following the completion of the merger.

(4) *Tax Reimbursements*. The employment agreement for Mr. Whitehurst and the Senior Management Change in Control Severance Policy for Messrs. Cormier and Cunningham provide that they are eligible for a

Table of Contents

gross-up payment relating to any golden parachute excise tax to which they are subject, which would have resulted in a gross-up payment being payable to them if the merger had been completed as of December 7, 2018. However, if the merger is completed as anticipated in the latter half of 2019, no gross-up payment is expected to be payable to Messrs. Whitehurst, Cormier and Cunningham based on the arrangements described in this proxy statement. Any amounts payable in this column would be single trigger in nature.

Financing of the Merger

The merger is not conditioned on the ability of IBM or Sub to obtain financing. IBM and Sub have represented to Red Hat that they will have available to them sufficient funds at the effective time to pay all amounts required to be paid by IBM and Sub pursuant to the terms of the merger agreement, including the amounts payable to the holders of Cash-Out Stock Options, Cash-Out Restricted Shares, Cash-Out RSUs and Cash-Out PSUs and to pay all associated fees, costs and expenses. IBM expects to finance the merger through cash on hand and proceeds from debt financing.

IBM has made available to Red Hat copies of the fully executed commitment letter. Pursuant to the commitment letter, and subject to the terms and conditions set forth therein, the commitment parties have committed to provide IBM with the bridge facility.

The funding of the bridge facility provided for in the commitment letter is contingent on the satisfaction of customary conditions, including (i) the execution and delivery of definitive documentation with respect to the bridge facility in accordance with the terms sets forth in the commitment letter, and (ii) the consummation of the merger in accordance with the merger agreement.

The bridge facility commitments will terminate on the earliest of (i) the execution and delivery of the applicable definitive credit documentation with respect to the bridge facility, (ii) the closing of the merger without borrowing of the bridge facility, (iii) the date on which the merger agreement is terminated in accordance with its terms and such termination has either been publicly announced by a party to the merger agreement or the committed parties have received written notice thereof from IBM, (iv) receipt by the committed parties of written notice from IBM of its election to terminate all commitments under the bridge facility in full and (v) the termination date (as it may be extended in accordance with the terms of the merger agreement as in effect on the signing date).

U.S. Federal Income Tax Consequences of the Merger

The following is a summary of the U.S. federal income tax consequences of the merger to U.S. holders and non-U.S. holders (each as defined below) of Red Hat common stock who hold their stock as a capital asset within the meaning of Section 1221 of the Internal Revenue Code of 1986, which we refer to as the Code. This summary is based on the Code, the U.S. Treasury Department regulations issued under the Code, which we refer to as the Treasury Regulations, and administrative rulings and court decisions in effect as of the date of this proxy statement, all of which are subject to change at any time, possibly with retroactive effect. This summary is not binding on the Internal Revenue Service, which we refer to as the IRS, or a court and there can be no assurance that the tax consequences described in this summary will not be challenged by the IRS or that they would be sustained by a court if so challenged. No ruling has been or will be sought from the IRS, and no opinion of counsel has been or will be rendered, as to the U.S. federal income tax consequences of the merger.

For purposes of this discussion, the term U.S. holder means a beneficial owner of Red Hat common stock that is for U.S. federal income tax purposes (i) an individual who is a citizen or resident of the United States, (ii) a corporation (or other entity treated as a corporation for U.S. federal income tax purposes) created or organized under the laws of the United States, any state thereof, or the District of Columbia, (iii) an estate the income of which is includible in gross income for U.S. federal income tax purposes regardless of its source or (iv) a trust if (A) a court within the

United States is able to exercise primary supervision over the administration

Table of Contents

of the trust and one or more U.S. persons have the authority to control all substantial decisions of the trust, or (B) the trust has a valid election in effect under applicable Treasury Regulations to be treated as a U.S. person for U.S. federal income tax purposes. A non-U.S. holder means a beneficial owner of Red Hat common stock that is neither a U.S. holder nor a partnership for U.S. federal income tax purposes.

This summary is not a complete description of all of the U.S. federal income tax consequences of the merger and, in particular, may not address U.S. federal income tax considerations applicable to holders of Red Hat common stock who are subject to special treatment under U.S. federal income tax law including, for example, partnerships (or an entity or arrangement treated as a partnership for U.S. federal income tax purposes) and partners therein, financial institutions, dealers in securities, insurance companies, tax-exempt entities, mutual funds, real estate investment trusts, personal holding companies, regulated investment companies, securities or currency dealers, traders in securities who elect to use the mark-to-market method of accounting, non-U.S. holders that hold, directly or constructively (or that held, directly or constructively, at any time during the five-year period ending on the date of the merger), 5% or more of the outstanding Red Hat common stock, tax-exempt investors, S corporations, holders whose functional currency is not the U.S. dollar, tax-deferred or other retirement accounts, U.S. expatriates, former long-term residents of the United States, holders who acquired Red Hat common stock pursuant to the exercise of an employee stock option or right or otherwise as compensation, and holders who hold Red Hat common stock as part of a hedge, straddle, constructive sale, conversion transaction, or other integrated investment. Also, this summary does not address U.S. federal income tax considerations applicable to holders of Red Hat common stock who exercise appraisal rights under Delaware law. In addition, no information is provided with respect to the tax consequences of the merger under any U.S. federal law other than income tax laws (including, for example the U.S. federal estate, gift, Medicare, and alternative minimum tax laws), or any applicable state, local, or foreign tax laws. This summary does not address the tax consequences of any transaction other than the merger.

If an entity or arrangement treated as a partnership for U.S. federal income tax purposes holds Red Hat common stock, the tax treatment of a partner in such a partnership generally will depend on the status of the partner and the activities of the partnership. Any entity treated as a partnership for U.S. federal income tax purposes that holds Red Hat common stock, and any partners in such partnership, should consult their own independent tax advisors regarding the tax consequences of the merger to their specific circumstances.

The tax consequences of the merger will depend on a holder s specific situation. Holders should consult their tax advisor as to the tax consequences of the merger relevant to their particular circumstances, including the applicability and effect of the alternative minimum tax and any state, local, non-U.S. or other tax laws and of changes in those laws.

Tax Consequences to U.S. Holders

The receipt of cash by U.S. holders in exchange for shares of Red Hat common stock pursuant to the merger will be a taxable transaction for U.S. federal income tax purposes. In general, for U.S. federal income tax purposes, a U.S. holder who receives cash in exchange for shares of Red Hat common stock pursuant to the merger will recognize capital gain or loss in an amount equal to the difference, if any, between (i) the amount of cash received in the merger and (ii) the U.S. holder s adjusted tax basis in its Red Hat common stock exchanged therefor.

A U.S. holder s adjusted tax basis in its shares of Red Hat common stock will generally equal the price the U.S. holder paid for such shares. If a U.S. holder s holding period in the shares of Red Hat common stock surrendered in the merger is greater than one year as of the date of the merger, the gain or loss will be long-term capital gain or loss. Long-term capital gains of certain non-corporate holders, including individuals, are generally subject to U.S. federal income tax at preferential rates. The deductibility of a capital loss recognized on the exchange is subject to limitations.

If a U.S. holder acquired different blocks of Red Hat common stock at different times or different prices, such U.S. holder must determine its adjusted tax basis and holding period separately with respect to each block of Red Hat common stock.

Table of Contents

Tax Consequences to Non-U.S. Holders

Payments made to a non-U.S. holder in exchange for shares of Red Hat common stock pursuant to the merger generally will not be subject to U.S. federal income tax unless:

- the gain, if any, on such shares of Red Hat common stock is effectively connected with a trade or business of the non-U.S. holder in the United States (and, if required by an applicable income tax treaty, is attributable to the non-U.S. holder s permanent establishment in the United States) in which case such gain will generally be subject to U.S. federal income tax at rates applicable to U.S. holders and, if such non-U.S. holder is a corporation, such gain may also be subject to an additional branch profits tax at a 30% rate (or lower applicable treaty rate); or

- the non-U.S. holder is an individual who is present in the U.S. for 183 days or more in the taxable year of the exchange of shares of Red Hat common stock for the merger consideration pursuant to the merger and certain other conditions are met, in which case the gain, if any, on such shares of Red Hat common stock will be subject to tax at a rate of 30% (or lower applicable treaty rate) and such gain may be offset by U.S. source capital losses recognized in the same taxable year.

Information Reporting and Backup Withholding

Payments of cash to a U.S. holder of Red Hat common stock pursuant to the merger may, under certain circumstances, be subject to information reporting and backup withholding, unless the holder provides proof of an applicable exemption or furnishes its taxpayer identification number, and otherwise complies with all applicable requirements of the backup withholding rules. Certain holders (such as corporations and non-U.S. holders) are exempt from backup withholding.

Backup withholding is not an additional tax. Any amounts withheld under the backup withholding rules may be refunded or credited against a holder s U.S. federal income tax liability, if any, provided that such holder furnishes the required information to the IRS in a timely manner. Non-U.S. holders may be required to comply with certification requirements and identification procedures in order to establish an exemption from information reporting and backup withholding.

Holders of Red Hat common stock are urged to consult their own tax advisors with respect to the tax consequences of the merger in their particular circumstances, including the applicability and effect of the alternative minimum tax and any state, local, non-U.S. or other tax laws and of changes in those laws.

Regulatory Approvals

General

Red Hat and IBM have agreed to use their respective reasonable best efforts to take all actions and to do, or cause to be done, all things reasonably necessary, proper or advisable under applicable laws to consummate the merger and the other transactions contemplated by the merger agreement as soon as practicable and no later than the termination date, including obtaining any requisite approvals, subject to certain specified limitations under the merger agreement. These approvals include approvals under the HSR Act and the Council Regulation. Although we expect that all required regulatory clearances and approvals will be obtained, we cannot assure you that these regulatory clearances and

approvals will be timely obtained or obtained at all, or that the granting of these regulatory clearances and approvals will not involve the imposition of additional conditions on the completion of the merger, including the requirement to divest assets. In furtherance thereof, IBM has agreed to effect certain divestitures and other dispositions and take other actions, including accepting certain restrictions on its operations and assets, if necessary to obtain all approvals and authorizations under antitrust laws. For a more complete description, see the section entitled Terms of the Merger Agreement Additional Agreements Efforts to Complete the Merger beginning on page 97. These conditions or changes could result in the conditions to the closing of the merger not being satisfied.

Table of Contents

Other than these approvals and notifications described below, neither Red Hat nor IBM is aware of any material regulatory approvals required to be obtained, or waiting periods required to expire, to consummate the merger. If the parties discover that other approvals or filings and waiting periods are necessary, they will seek to obtain or comply with them, although, as is the case with the regulatory approvals described above, there can be no assurance that they will be obtained on a timely basis, if at all.

HSR Act and Other Antitrust Matters

Under the HSR Act and the rules promulgated thereunder, the merger cannot be completed until Red Hat and IBM each file a notification and report form with the U.S. Federal Trade Commission, which we refer to as the FTC, and the Antitrust Division of the U.S. Department of Justice, which we refer to as the DOJ, and the applicable waiting period thereunder has expired or been terminated. Red Hat and IBM filed their respective HSR Act notifications on November 21, 2018.

Completion of the merger is further subject to receipt of certain other regulatory approvals, including notification, clearance and/or expiration or termination of any applicable waiting period in the European Union.

At any time before or after consummation of the merger, notwithstanding the expiration or termination of the applicable waiting period under the HSR Act or the equivalent under the Council Regulation, the Antitrust Division of the DOJ, the FTC or the European Union, as applicable, could take such action under the antitrust laws as it deems necessary or desirable in the public interest, including seeking to enjoin the completion of the merger, seeking divestiture of substantial assets of the parties or requiring the parties to license, or hold separate, assets or terminate existing relationships and contractual rights. In addition, at any time before or after the completion of the merger, and notwithstanding the expiration or termination of the applicable waiting period under the HSR Act, or the equivalent under the Council Regulation, non-U.S. regulatory bodies and U.S. state attorneys general could take action under other applicable regulatory laws as they deem necessary or desirable in the public interest. Such action could include seeking to enjoin the completion of the merger or seeking divestiture of substantial assets of the parties. Private parties may also seek to take legal action under the antitrust laws under certain circumstances.

Table of Contents

TERMS OF THE MERGER AGREEMENT

The following summary describes certain material provisions of the merger agreement. This summary is not complete and is qualified in its entirety by reference to the merger agreement, which is attached to this proxy statement as Annex A and incorporated into this proxy statement by reference. We encourage you to read the merger agreement carefully in its entirety because this summary may not contain all the information about the merger agreement that is important to you. The rights and obligations of the parties are governed by the express terms of the merger agreement and not by this summary or any other information contained in this proxy statement.

The representations, warranties, covenants and agreements described below and included in the merger agreement were made for purposes of the merger agreement and as of specific dates, were for the benefit of the parties to the merger agreement except as expressly stated therein and may be subject to important qualifications, limitations and supplemental information agreed to by Red Hat, IBM and Sub in connection with negotiating the terms of the merger agreement, including certain qualifications, limitations and supplemental information disclosed in the confidential disclosure schedules to the merger agreement. In addition, the representations and warranties were included in the merger agreement for the purpose of allocating contractual risk between Red Hat, IBM and Sub, and may be subject to standards of materiality applicable to such parties that differ from those generally applicable to investors. In reviewing the representations, warranties, covenants and agreements contained in the merger agreement or any description thereof in this summary, it is important to bear in mind that such representations, warranties, covenants and agreements or any descriptions were not intended by the parties to the merger agreement to be characterizations of the actual state of facts or condition of Red Hat, IBM and Sub or any of their respective affiliates or businesses except as expressly stated in the merger agreement. Moreover, information concerning the subject matter of the representations and warranties may change after the date of the merger agreement. In addition, you should not rely on the covenants in the merger agreement as actual limitations on the respective businesses of Red Hat, IBM and Sub because the parties to the merger agreement may take certain actions that are either expressly permitted in the confidential disclosure schedules to the merger agreement or as otherwise consented to by the appropriate party, which consent may be given without prior notice to the public. The merger agreement is described below, and attached as Annex A hereto, with the intention of providing you with information regarding the terms of the merger. Accordingly, the representations, warranties, covenants and other agreements in the merger agreement should not be read alone, and you should read the information provided elsewhere in this document and in our filings with the SEC regarding Red Hat and our business. Please see the section entitled Where You Can Find More Information beginning on page 123.

Structure of the Merger

Upon the terms and subject to the conditions of the merger agreement and in accordance with the applicable provisions of the DGCL, on the closing date and at the effective time, Sub will merge with and into Red Hat, with Red Hat continuing as the surviving corporation and as a wholly-owned subsidiary of IBM. The merger will have the effects set forth in the merger agreement and the applicable provisions of the DGCL.

Closing and the Effective Time of the Merger

The closing of the merger will take place at 7:45 a.m., Eastern time, on a date to be specified by the parties, which will not be later than the fourth business day after satisfaction or, to the extent permitted by applicable law, waiver of the conditions set forth in the merger agreement (as described below under the section entitled Terms of the Merger Agreement Conditions to the Closing of the Merger beginning on page 102) (other than those conditions that by their terms are to be satisfied or waived at the closing of the merger, but subject to the satisfaction or, to the extent permitted by applicable law, waiver of such conditions at the closing), or on such other date as IBM and Red Hat may

mutually agree.

Table of Contents

As soon as practicable on the closing date, the parties will file a certificate of merger with the Secretary of State of the State of Delaware in accordance with the relevant provisions of the DGCL. The merger will become effective upon the filing of the certificate of merger, or at such later time as is agreed by Red Hat and IBM and specified in the certificate of merger.

Directors and Officers; Certificate of Incorporation; Bylaws

The directors of Sub immediately prior to the effective time will be the initial directors of the surviving corporation until the earlier of their resignation or removal or until their respective successors are duly elected and qualified. The officers of Red Hat immediately prior to the effective time will be the officers of the surviving corporation until the earlier of their resignation or removal or until their respective successors are duly elected and qualified.

At the effective time, the certificate of incorporation and bylaws of the surviving company will be amended and restated in their entirety to be the certificate of incorporation and bylaws of Sub as in effect immediately prior to the effective time, except that (i) references to Sub s name, date of incorporation, registered office and registered agent will be automatically amended and become references to the surviving corporation s name, date of incorporation, registered office and registered agent as provided in the certificate of incorporation and bylaws of Red Hat immediately prior to the effective time, (ii) provisions of the certificate of incorporation relating to the incorporator of Sub will be omitted and (iii) changes necessary in order to give full effect to the provisions described under the section entitled Terms of the Merger Agreement Additional Agreements Directors and Officers Indemnification and Insurance beginning on page 101 will be made.

Merger Consideration

Common Stock

At the effective time and without any action on the part of the holder, each share of Red Hat common stock issued and outstanding immediately prior to the effective time (other than canceled shares, dissenting shares and subsidiary converted shares), will be converted into the right to receive $190.00 in cash, without interest. All shares, when so converted into the right to receive the merger consideration, will no longer be outstanding, will automatically be canceled and will cease to exist, and each holder of a certificate or evidence of shares in book-entry form that immediately prior to the effective time represented any such shares, which we refer to as a certificate, will cease to have any rights with respect thereto, except the right to receive the merger consideration in accordance with the terms of the merger agreement.

If, during the period between the date of the merger agreement and the effective time, any change in the outstanding shares of Red Hat common stock occurs as a result of any reclassification, recapitalization, stock split (including reverse stock split) or combination, exchange or readjustment of shares, or any stock dividend, or any record date for any such purpose is established, the merger consideration and any other amounts payable pursuant the merger agreement will be appropriately adjusted.

Treatment of Equity Compensation

Our executive officers and employees hold various types of compensatory awards with respect to Red Hat common stock. Our non-employee directors hold awards of restricted shares and DSUs. The merger agreement provides for the treatment set forth below with respect to the awards described below. None of our executive officers or directors hold stock options.

Restricted Shares. Each Cash-Out Restricted Share will be converted at the effective time into the right to receive an amount in cash equal to the merger consideration multiplied by the number of shares of Red Hat common stock subject to the award. Each Rollover Restricted Share will be converted at the effective time into a

Table of Contents

restricted share award consisting of IBM common stock subject to substantially the same terms and conditions as were under such Rollover Restricted Shares (other than any performance conditions, which will be deemed satisfied upon the effective time under the terms of the award) with respect to a number of shares of IBM common stock determined by multiplying the number of shares of Red Hat common stock subject to such Rollover Restricted Share award immediately prior to the effective time by the Exchange Ratio (rounded down to the nearest whole share).

Restricted Stock Units; Deferred Stock Units. Each Cash-Out RSU will be converted at the effective time into the right to receive an amount in cash equal to the merger consideration multiplied by the number of shares of Red Hat common stock subject to the award. Each Rollover RSU will be converted at the effective time into a restricted stock unit with respect to IBM common stock subject to substantially the same terms and conditions as were applicable to the Rollover RSUs with respect to a number of shares of IBM common stock determined by multiplying the number of shares of Red Hat common stock subject to such Rollover RSU award immediately prior to the effective time by the Exchange Ratio (rounded down to the nearest whole share).

Performance Share Units. At the effective time, each Cash-Out PSU will be canceled and the holder thereof will be entitled to receive in consideration for such cancellation an amount in cash equal to the product of (i) the applicable PSU Share Number and (ii) the merger consideration. Each Rollover PSU will be converted at the effective time into a restricted share award consisting of IBM common stock subject to substantially the same terms and conditions as were applicable under such Rollover PSU (other than the performance-based vesting schedule, which will be converted into a service-based vesting schedule in accordance with the applicable award agreement), with respect to a number of shares of IBM common stock determined by multiplying the applicable PSU Share Number by the Exchange Ratio (rounded down to the nearest whole share).

Stock Options. At the effective time, each Cash-Out Stock Option will be canceled and the holder thereof will be entitled to receive in consideration for such cancellation an amount in cash equal to the product of (i) the number of shares of Red Hat common stock that are subject to the Cash-Out Stock Option and (ii) the excess, if any, of the merger consideration over the exercise price per share of Red Hat common stock subject to the Cash-Out Stock Option. All Rollover Stock Options will be converted at the effective time into options to acquire, on substantially the same terms and conditions as were applicable under such Rollover Stock Option, the number of shares of IBM common stock (rounded down to the nearest whole share), determined by multiplying the number of shares of Red Hat common stock subject to such Rollover Stock Option immediately prior to the effective time by the Exchange Ratio, with an exercise price per share of IBM common stock (rounded up to the nearest whole cent) equal to (a) the exercise price per share of Red Hat common stock applicable to such Rollover Stock Option divided by (b) the Exchange Ratio.

All amounts payable to the holders of the various compensatory awards above who are employees will be paid through the payroll system or payroll provider of the surviving corporation or its applicable affiliate.

Exchange Procedures

Prior to the effective time, IBM will designate a bank or trust company reasonably acceptable to Red Hat to act as agent for the payment of the merger consideration to holders of Red Hat common stock upon surrender of the certificates, which we refer to as the paying agent. No later than substantially concurrently with the effective time, IBM will deposit, or cause to be deposited, with the paying agent funds in an amount necessary for the payment of the merger consideration as described above under the section entitled Terms of the Merger Agreement Merger Consideration Common Stock beginning on page 84 upon surrender of the certificates.

As soon as reasonably practicable after the effective time (and in any event within five business days after the closing date of the merger), IBM or the surviving corporation will cause the paying agent to mail to each

Table of Contents

holder of record of a certificate whose shares of Red Hat common stock were converted into the right to receive the merger consideration:

- a form of letter of transmittal (including customary provisions regarding delivery of an agent s message with respect to shares held in book-entry form); and

- instructions for use in effecting the surrender of the certificates in exchange for the merger consideration.

Upon surrender of a certificate for cancellation to the paying agent or to such other agent or agents as may be appointed by IBM, together with such letter of transmittal, duly completed and validly executed, and such other documents as may reasonably be required by the paying agent, the holder of such certificate will be entitled to receive in exchange therefor the amount of cash equal to the merger consideration that such holder has the right to receive, and the certificate so surrendered will be canceled immediately.

In the event of a transfer of ownership of Red Hat common stock that is not registered in the stock transfer books of Red Hat, payment of the merger consideration in exchange therefor may be made to a person other than the person in whose name the certificate so surrendered is registered, if such certificate will be properly endorsed or otherwise be in proper form for transfer, and the person requesting such payment will pay any transfer or other taxes required by reason of the payment to a person other than the registered holder of such certificate or establish to the satisfaction of the surviving corporation that such tax has been paid or is not applicable. No interest will be paid or will accrue on the cash payable upon surrender of any certificate.

No Transfers Following Effective Time

At the close of business on the day on which the effective time occurs, the stock transfer books of Red Hat will be closed, and there will be no further registration of transfers on the stock transfer books of the surviving corporation of the shares that were outstanding immediately prior to the effective time.

Termination of Payment Fund

At any time following the one year anniversary of the closing date, the surviving corporation will be entitled to require the paying agent to deliver to it any funds (including any interest received with respect thereto) that had been made available to the paying agent and that have not been disbursed to holders of certificates, and, thereafter, subject to specified time limitations, such holders will be entitled to look only to IBM and the surviving corporation (subject to abandoned property, escheat or other similar laws) as general creditors thereof with respect to the payment of any merger consideration that may be payable upon surrender of any certificates held by such holders, as determined pursuant to the merger agreement, without any interest thereon.

Lost, Stolen or Destroyed Certificates

If any certificate has been lost, stolen, defaced or destroyed, and the claimant makes of an affidavit of that fact and, if required by the surviving corporation, posts a bond in such amount as the surviving corporation may direct as indemnity against any claim that may be made against it with respect to such certificate, then the paying agent or the surviving corporation will pay the merger consideration in respect of such lost, stolen, defaced or destroyed certificate.

Withholding Rights

Each of Red Hat, IBM, the surviving corporation and the paying agent will be entitled to deduct and withhold from the merger consideration and any other amounts payable pursuant to the merger agreement (including amounts payable to any holder of Red Hat common stock, stock options, restricted shares, RSUs, PSUs or DSUs) such amounts as are required to be deducted and withheld with respect to the making of such payment under the Code or any provision of state, local or foreign tax law.

Table of Contents

Appraisal Rights

Any dissenting shares will not be converted into the right to receive the merger consideration. Instead, the holders of such dissenting shares will be entitled to such rights as are granted by Section 262 of the DGCL, unless and until any such holder fails to perfect, withdraws or otherwise loses such holder s appraisal rights under the DGCL with respect to such shares or if a court of competent jurisdiction determines that such holder is not entitled to the relief provided by Section 262 of the DGCL, in which case, such shares of Red Hat common stock will be treated as if they had been converted as of the effective time into the right to receive the merger consideration upon surrender of such certificates that formerly represented such shares of Red Hat common stock. Red Hat has agreed to provide IBM prompt written notice of any demands received by Red Hat for appraisal of shares of Red Hat common stock (or written threats thereof), any written withdrawal or purported withdrawal of any such demand and any other demand, notice or instrument delivered to Red Hat prior to the effective time pursuant to the laws of the State of Delaware that relates to such demand, and IBM will have the opportunity and right to participate in and direct all negotiations and any litigation, suit, action or other proceeding with respect to such demands. Prior to the effective time, Red Hat has agreed not to make any payment with respect to, or offer to settle or settle, or approve the withdrawal of, any such demands or agree to do any of the foregoing, in each case without the prior written consent of IBM.

Representations and Warranties

The merger agreement contains a number of representations and warranties made by the parties thereto that are subject in some cases to exceptions and qualifications, including material adverse effect qualifications. Please see the definition of material adverse effect in this section beginning on page 88. The representations and warranties of Red Hat in the merger agreement relate to, among other things:

- due organization, valid existence, good standing and qualification to do business;
- subsidiaries;
- capitalization, including the number of shares of Red Hat common stock, options and other stock-based awards outstanding and ownership of subsidiaries;
- the absence of restrictions with respect to the capital stock of Red Hat and its subsidiaries;
- corporate authorization of the merger agreement and the transactions contemplated by the merger agreement and the valid and binding nature of the merger agreement;
- the approval and recommendation by the Board of Directors of the merger agreement and the transactions contemplated by the merger agreement;
- the absence of any conflicts with or violations of organizational documents and other agreements or laws;

required filings with, and consents from, governmental entities in connection with the transactions contemplated by the merger agreement;

compliance with applicable laws, the possession of required permits necessary for the conduct of Red Hat s business and absence of governmental investigations;

compliance with SEC filing requirements, including the accuracy of the information contained in such documents and compliance with GAAP, and the rules and regulations of the SEC with respect to consolidated financial statements contained therein;

absence of undisclosed liabilities;

internal controls and disclosure controls and procedures relating to financial reporting;

the absence of certain material changes or events in the business of Red Hat, including that, from February 28, 2018 to the date of the merger agreement, there has not been a material adverse effect;

Table of Contents

absence of litigation;

material contracts;

environmental matters;

labor relations;

employee benefit matters;

tax matters;

real properties;

intellectual property;

insurance matters;

regulatory matters, including compliance with (i) anti-corruption laws, such as the U.S. Foreign Corrupt Practices Act of 1977 and the U.K. Bribery Act 2010, (ii) money laundering related laws, such as the U.S. Currency and Foreign Transaction Reporting Act of 1970 and the U.S. Money Laundering Control Act of 1986, and (iii) economic sanctions/trade laws;

inapplicability of anti-takeover statutes;

voting requirements;

the absence of any undisclosed brokers fee; and

the receipt by the Red Hat Board of Directors of opinions of Red Hat s financial advisors as to the fairness, from a financial point of view, of the merger consideration to be received by Red Hat stockholders pursuant to the merger agreement.

The representations and warranties of IBM and Sub in the merger agreement relate to, among other things:

due organization, valid existence, good standing and power and authority to do business;

corporate authorization of the merger agreement and the transactions contemplated by the merger agreement and the valid and binding nature of the merger agreement;

the absence of any conflicts with or violations of organizational documents and other agreements or laws;

required filings with, and consents from, governmental entities in connection with the transactions contemplated by the merger agreement;

operations of Sub;

financing; and

inapplicability of anti-takeover statutes.

Certain of the representations and warranties made by the parties are qualified as to knowledge, materiality or a material adverse effect, as applicable. For purposes of the merger agreement, a material adverse effect, means any state of facts, change, development, event, effect, condition, occurrence, action or omission, each an effect, that, individually or in the aggregate, would reasonably be expected to (i) result in a material adverse effect on the business, assets, properties, financial condition or results of operations of Red Hat and its subsidiaries, taken as a whole or (ii) prevent, materially impede or materially delay the consummation by Red Hat of the merger or the other transactions contemplated by the merger agreement. However, in no event will any of the following effects, alone or in combination, be deemed to constitute, or be taken into account, in determining whether there has been, or would be, a material adverse effect:

any change in general economic, market or political conditions affecting the United States economy, or any other national or regional economy or the global economy generally that does

Table of Contents

not disproportionately affect Red Hat and its subsidiaries, taken as a whole, relative to other participants of a similar size in its industry, in which case only the incremental disproportionate effect will be taken into account;

any change in GAAP or applicable law that does not disproportionately affect Red Hat and its subsidiaries, taken as a whole, relative to other participants of a similar size in its industry, in which case only the incremental disproportionate effect will be taken into account;

any act of terrorism, war (whether or not declared), national disaster, cyber-attack or any national or international calamity affecting the United States or any other country or region of the world that does not disproportionately affect Red Hat and its subsidiaries, taken as a whole, relative to other participants of a similar size in its industry, in which case only the incremental disproportionate effect will be taken into account;

changes in the financial, credit, banking or securities markets in the United States or any other country or region in the world (including any disruption thereof and any decline in the price of any security or any market index) and including changes or developments in or relating to currency exchange or interest rates that does not disproportionately affect Red Hat and its subsidiaries, taken as a whole, relative to other participants of a similar size in its industry, in which case only the incremental disproportionate effect will be taken into account;

any failure to meet internal or published projections, forecasts or revenue or earnings predictions for any period (provided that the underlying causes of such failures may constitute or be taken into account in determining whether there has been, or would be, a material adverse effect);

any change in the price or trading volume of Red Hat common stock in and of itself (provided that the underlying causes of such change may constitute or be taken into account in determining whether there has been, or would be, a material adverse effect);

the negotiation, execution or delivery of the merger agreement or the public announcement (including as to the identity of the parties thereto) or pendency of the merger or the other transactions contemplated by the merger agreement, any loss of or adverse change in the relationship of Red Hat and its subsidiaries with their respective employees, customers, distributors, licensors, partners or suppliers attributable to the announcement or pendency of the merger agreement or the transactions contemplated thereby; provided that this clause will not apply to any representation or warranty (or any condition to the consummation of the merger relating to such representation and warranty) to the extent the purpose of such representation and warranty is to address the consequences resulting from the execution and delivery of the merger agreement or the consummation of the merger;

the occurrence of natural disasters, force majeure events or weather conditions adverse to the business being carried on by Red Hat and its subsidiaries;

any action or omission of Red Hat or any of its subsidiaries taken with the prior written consent of IBM (or any action not taken as a result of a failure of IBM to consent to an action otherwise requiring IBM s consent); or

any public statement by IBM regarding the open and neutral platform model or those matters set forth in paragraphs 9-12 included in the press release issued by Red Hat and IBM on October 28, 2018.

None of the representations and warranties contained in the merger agreement survive the consummation of the merger.

Conduct of Business Pending the Merger

From the date of the merger agreement until the effective time, except (i) with the prior written consent of IBM (such consent not to be unreasonably withheld, conditioned or delayed), (ii) as required by applicable law or

Table of Contents

(iii) as specifically contemplated by the merger agreement or set forth in the confidential disclosure schedules, Red Hat will, and will cause each Red Hat subsidiary to, use commercially reasonable efforts to carry on their respective business in all material respects in the ordinary course, and consistent with past practice, use commercially reasonable efforts to keep available the services of their present officers, software developers and other employees and to substantially preserve their relationships with customers, suppliers, licensors, licensees, distributors and others having material business dealings with them.

In addition, except (i) with the prior written consent of IBM (such consent not to be unreasonably withheld, conditioned or delayed), (ii) as required by applicable law or (iii) as specifically contemplated by the merger agreement or set forth in the confidential disclosure schedules, Red Hat will not and will not permit any of its subsidiaries to, subject to certain exceptions:

declare, set aside or pay any dividends on, or make any other distributions (whether in cash, stock or property) in respect of, any of its capital stock or other equity or voting interests, except for dividends or distributions paid by any of Red Hat s wholly-owned subsidiaries to Red Hat or other wholly-owned subsidiaries of Red Hat;

split, combine or reclassify any of Red Hat s capital stock or other equity or voting interests, or issue or authorize the issuance of any other securities in respect of, in lieu of or in substitution for, shares of its capital stock or other equity or voting interests;

other than as expressly contemplated by the convertible notes, call options and warrants provision of the merger agreement, purchase, redeem or otherwise acquire any shares of capital stock, other equity or voting interests or any other securities of Red Hat or any of its subsidiaries or any options, restricted shares, warrants, calls or rights to acquire any such shares or other securities;

take any action that would result in any amendment, modification or change of any term of any indebtedness of Red Hat or any of its subsidiaries;

issue, deliver, sell, pledge or otherwise encumber any shares of Red Hat s capital stock, other equity or voting interests or certain equity equivalents, or securities convertible into, or exchangeable or exercisable for, or any options, warrants, calls or rights to acquire, any such stock, interest or Equity Equivalent other than grants of equity compensation in the ordinary course consistent with past practice having an aggregate grant date fair value not to exceed $350 million per annum;

amend or propose to amend its certificate of incorporation or bylaws (or similar organizational documents);

acquire or agree to acquire (i) by merging or consolidating with, or by purchasing all or a substantial portion of the assets of, or by purchasing all or a substantial equity or voting interest in, or by any other manner, any business or person or division thereof or (ii) any other assets outside the ordinary course of business

consistent with past practice; provided that Red Hat will be permitted to take the actions contemplated by this bullet point, so long as (a) the value of any individual acquisition is not greater than $50,000,000 and (b) the aggregate value of all acquisitions is not greater than $150,000,000; provided further that Red Hat will make no acquisition under this bullet point, if such acquisition could reasonably be expected to increase the risk of not obtaining, or the risk of materially impeding or delaying the obtaining of, any approvals from a governmental entity with respect to the merger;

sell, lease, license, sell and lease back, mortgage or otherwise dispose of any of its material properties or assets, except for (i) grants of FOSS licenses or other non-exclusive licenses in the ordinary course of business consistent with past practice or (ii) sales in the ordinary course of business;

subject any of its assets, properties or rights, or any part thereof, to any material lien or suffer such to exist (other than permitted liens) if the obligations supported by such lien other than in the ordinary course of business;

repurchase, prepay or incur any indebtedness in an amount greater than $15,000,000 or make any loans, advances or capital contributions to, or investments in excess of $5,000,000, individually or in

Table of Contents

the aggregate, in any other person other than (i) Red Hat or any indirect wholly-owned subsidiary of Red Hat, (ii) advances of travel and similar expenses to directors and employees in the ordinary course of business consistent with past practice or (iii) settling notices of conversions with respect to the convertible notes;

incur or commit to incur any capital expenditures, or any obligations or liabilities in connection therewith, in excess of $18,000,000 per fiscal quarter in the aggregate or as may be necessary in connection with any emergency repair, maintenance or replacement;

pay, discharge, settle or satisfy any claims, liabilities or obligations, other than any settlement or satisfaction (i) in the ordinary course of business that results solely in monetary obligations of Red Hat and its subsidiaries and (ii) that does not include any material obligation to be performed by, or material restriction imposed against, Red Hat or its subsidiaries following the closing date; provided that this bullet point will not apply to any claims related to any litigation against Red Hat and/or its directors relating to the merger or the other transactions contemplated by the merger agreement;

waive, relinquish, release, grant, transfer or assign any material right other than in the ordinary course of business;

enter into any lease or sublease of real property other than in the ordinary course of business consistent with past practice, modify or amend in any material respect, or exercise any right to renew, any lease or sublease of real property other than in the ordinary course of business consistent with past practice, or acquire any material interest in real property;

enter into, modify or amend in any material respect, or accelerate, terminate or cancel, any material contract (or any contract that would have been a material contract or that would have been required to be disclosed pursuant to a certain provision of the intellectual property representations in the merger agreement if it were in effect as of the date of the merger agreement) or waive any material right to enforce, relinquish, release, transfer or assign any material rights or claims thereunder, in each case, other than (except with respect to any contract of the type set forth in a certain provision of the contracts representations in the merger agreement) in the ordinary course of business consistent with past practice;

adopt, establish, enter into, terminate, materially amend or modify any material benefit plan or benefit agreement;

pay or provide to any company personnel any material compensation or benefit not provided for under a benefit plan or benefit agreement as in effect on the date of the merger agreement other than the payment of base compensation for company personnel, increases of base compensation for company personnel below the vice president level and payment of bonuses, commissions or other similar cash incentive compensation below the vice president level, in each case, in the ordinary course of business consistent with past practice;

grant or amend any award under any benefit plan or remove or modify existing restrictions in any benefit plan or benefit agreement or awards made thereunder, or any restrictive covenant arrangement with any company personnel;

grant or pay any severance, separation, change in control, termination, retention or similar compensation or benefits to, or increase in any manner such compensation or benefits of, any company personnel (other than as described under the section entitled Proposal 1: Adoption of the Merger Agreement The Merger Interests of the Non-Employee Directors and the Executive Officers of Red Hat in the Merger New Retention Arrangements with IBM beginning on page 77);

take any action to fund or in any other way secure the payment of compensation or benefits under any benefit plan or benefit agreement;

take any action to accelerate the time of payment or vesting of any rights, compensation, benefits or funding obligations under any benefit plan or benefit agreement or otherwise;

Table of Contents

hire any company personnel at the vice president level or above or terminate the employment of any such company personnel, other than due to such employee s death, disability or cause;

make any material determination under any benefit plan or benefit agreement that is inconsistent with the ordinary course of business or past practice; provided that in the case of this bullet point and the seven preceding bullet points above, except as required to ensure that any benefit plan or benefit agreement as in effect on the date of the merger agreement is not then out of compliance with applicable law, as required under any collective bargaining agreement, labor union contract, trade union agreement or other works council agreement, as specifically required pursuant to the merger agreement, or in accordance with certain sections of the confidential disclosure schedules;

enter into any contract that is material to Red Hat and its subsidiaries, taken as a whole, containing any material restriction on the ability of Red Hat or any of its subsidiaries to assign all or any material portion of its material rights, interests or obligations thereunder, unless such restriction expressly excludes any assignment to IBM and any of its subsidiaries following the consummation of the merger and the other transactions contemplated by the merger agreement;

except as required by applicable law, adopt or enter into any collective bargaining agreement, labor union contract, trade union agreement or other works council agreement applicable to the employees of Red Hat or any of its subsidiaries that has a material effect on Red Hat and its subsidiaries, taken as a whole;

write down any of its material assets or make any change in any financial or material tax accounting principle, method or practice, other than as required by GAAP or applicable law;

fail to maintain, allow to lapse or abandon any material registered or applied-for trademarks owned by Red Hat or any of its subsidiaries, except in the ordinary course of business consistent with past practice;

materially amend or modify any of Red Hat s Patent Promise, Open Source Assurance program, or Enterprise Agreements or Product Appendices other than in the ordinary course of business;

settle or compromise any material suit, claim, action, assessment, investigation, proceeding or audit with respect to taxes, make, revoke or change any material tax election (other than an election pursuant to Section 965(h) of the Code), fail to timely make an election pursuant to Section 965(h) of the Code, file any material amended tax return, or enter into any closing agreement within the meaning of Section 7121 of the Code (or any similar provision of state, local or non-U.S. law) with respect to a material amount of taxes; or

authorize any of, or commit, resolve or agree to take any of, the foregoing actions.

Additional Agreements

No Solicitation

As of the date of the merger agreement, Red Hat and its subsidiaries agreed to, and to cause their directors, officers and employees to, and use their reasonable best efforts to cause each investment banker, attorney, accountant or other advisor or representative of Red Hat or any of its subsidiaries, collectively with the directors, officers and employees of Red Hat or any of its subsidiaries, which we refer to as the company representatives, to, immediately cease and cause to be terminated any and all existing activities, discussions or negotiations with any third party conducted with respect to any takeover proposal. Red Hat also agreed to promptly request that each person and its representatives (other than IBM and its representatives) that had executed a confidentiality agreement in connection with its consideration of making a takeover proposal promptly return or destroy all non-public information furnished to such person.

Red Hat will not modify, amend or terminate, or waive, release or assign any provisions of any confidentiality agreement or standstill agreement (or any similar agreement) relating to a takeover proposal and

Table of Contents

will enforce the provisions of any such agreement; provided that Red Hat will be permitted on a confidential basis to release or waive any explicit or implicit standstill obligations solely to the extent necessary to permit the party referred therein to submit a takeover proposal to the Red Hat Board of Directors on a confidential basis.

Except as expressly permitted by the merger agreement, Red Hat will not, and will not authorize or permit any of its subsidiaries to, or any of its subsidiaries directors, officers or employees to, and it will use its reasonable best efforts to cause the company representatives not to, and will not publicly announce any intention to, directly or indirectly:

- solicit, initiate or knowingly encourage, or knowingly take any other action to facilitate, any takeover proposal or any inquiries or the making of any proposal that would reasonably be expected to lead to a takeover proposal, except that ministerial acts that are not otherwise prohibited by the merger agreement (*e.g.*, answering unsolicited phone calls) will not (in and of itself) be deemed to facilitate for purposes of, or otherwise constitute a violation of, the merger agreement;

- enter into, continue or otherwise participate in any discussions or negotiations regarding, or furnish to any person (or any representative thereof) any information with respect to any takeover proposal; or

- execute or enter into any letter of intent, memorandum of understanding, agreement in principle, acquisition agreement, merger agreement, option agreement, joint venture agreement, partnership agreement or other agreement, each of which we refer to as an acquisition agreement, relating to any takeover proposal;

Notwithstanding the foregoing, at any time prior to obtaining the requisite stockholder approval at the special meeting, in response to a *bona fide* written unsolicited takeover proposal received after the date of the merger agreement that the Red Hat Board of Directors determines in good faith constitutes, or could reasonably be expected to lead to, a superior proposal, and which takeover proposal did not result from a breach of the merger agreement, Red Hat may, and may permit and authorize its subsidiaries and the company representatives, in each case subject to certain other requirements in the merger agreement:

- furnish information with respect to Red Hat and its subsidiaries to the person making such takeover proposal (and its representatives) pursuant to a confidentiality agreement which contains terms that are at least as restrictive in all material respects on such person as those contained in the confidentiality agreement between Red Hat and IBM (as it may be amended from time to time), which we refer to as the confidentiality agreement, and which will not contain any exclusivity provision or other term that would restrict, in any manner, Red Hat s ability to consummate the transactions contemplated by the merger agreement or to comply with its disclosure obligations to IBM pursuant to the merger agreement (it being understood that such confidentiality agreement need not contain a standstill (or similar obligation) to the extent that IBM is, concurrently with the entry by Red Hat or its subsidiaries into such confidentiality agreement, released from any standstill (or similar obligation) in the confidentiality agreement); provided that all such information has previously been provided, or is concurrently provided, to IBM; and

- participate in discussions or negotiations with, and only with, the person making such takeover proposal (and its representatives) regarding such takeover proposal.

Notwithstanding anything to the contrary in the non-solicitation provision of the merger agreement, Red Hat and the company representatives may, in response to a *bona fide* written unsolicited takeover proposal, contact the person who made such takeover proposal solely to determine whether such person intends to provide any documents (or additional documents) containing the terms and conditions of such takeover proposal.

Red Hat will, as promptly as practicable and in any event within 24 hours after the receipt thereof, advise IBM orally and in writing of (i) any takeover proposal or any request for information or inquiry that contemplates or that could reasonably be expected to lead to a takeover proposal and (ii) the terms and conditions of such takeover proposal, request or inquiry (including any subsequent amendment or other modification to such terms and conditions) and the identity of the person making any such takeover proposal, request or inquiry.

Table of Contents

Commencing upon the provision of any notice referred to above, Red Hat (or its outside counsel) will (i) keep IBM (or its outside counsel) informed on a reasonably current basis regarding the status and terms of discussions and negotiations relating to any such takeover proposal, request or inquiry and (ii) Red Hat will, as promptly as practicable (and in any event within 24 hours following the receipt or delivery thereof), provide IBM (or its outside legal counsel) with unredacted copies of all writings or media (whether or not electronic) containing any terms or conditions of any proposals or proposed transaction agreements (including all schedules and exhibits thereto) relating to any takeover proposal.

For purposes of the merger agreement and this proxy statement, takeover proposal means any proposal or offer from any person or group (other than IBM or Sub or any of their affiliates) with respect to a transaction or a series of transactions, any merger, consolidation, business combination, recapitalization, liquidation or dissolution involving Red Hat or any direct or indirect acquisition, including by way of any merger, consolidation, tender offer, exchange offer, stock acquisition, asset acquisition, binding share exchange, business combination, recapitalization, liquidation, dissolution, joint venture or transaction with a similar acquisitive intent, of (i) assets or businesses that constitute or represent 20% or more of the total revenue, net income, EBITDA or assets of Red Hat and its subsidiaries, taken as a whole, or (ii) 20% or more of the outstanding shares of Red Hat common stock or of any class of capital stock of, or other equity or voting interests in, one or more of Red Hat s subsidiaries (or in each case, options, rights, or warrants to purchase, or securities convertible into or exchangeable for any such securities) which, in the aggregate, directly or indirectly hold assets or businesses that constitute or represent 20% or more of the total revenue, net income, EBITDA or assets of Red Hat and its subsidiaries, taken as a whole.

For purposes of the merger agreement and this proxy statement, superior proposal means any binding *bona fide* unsolicited written offer which did not result from a breach of the non-solicitation provisions or any other provisions of the merger agreement, made by any person (other than IBM or Sub or any of their affiliates), that, if consummated, would result in such person acquiring, directly or indirectly, more than 50% of the voting power of Red Hat common stock or all or substantially all the assets of Red Hat and its subsidiaries, taken as a whole, and which offer, in the reasonable good faith judgment of the Red Hat Board of Directors (after consultation with a financial advisor of nationally recognized reputation and outside legal counsel), (i) would result in a transaction more favorable to Red Hat stockholders than the transactions contemplated by the merger agreement, taking into account all of the terms and conditions of such proposal and the merger agreement (including any changes to the terms of the merger agreement proposed by IBM in response to such superior proposal or otherwise) and (ii) would reasonably be expected to be consummated in accordance with its terms, taking into account all financial, legal, regulatory, timing and other aspects of such proposal.

Change of Recommendation

As described under the section entitled The Special Meeting Board of Directors Recommendation beginning on page 28, and subject to the provisions described below, the Board of Directors has made the recommendation that the holders of shares of Red Hat common stock vote **FOR** the merger proposal. The merger agreement provides that neither the Red Hat Board of Directors nor any committee thereof will (or will agree or resolve to) (i) effect an adverse recommendation change, (ii) recommend, declare advisable or propose to recommend or declare advisable, the approval or adoption of any takeover proposal or resolve or agree to take any such action, or adopt or approve any takeover proposal, or (iii) cause or permit Red Hat to enter into any acquisition agreement constituting or related to, or which is intended to or would reasonably be expected to lead to, any takeover proposal (other than a confidentiality agreement referred to in, and in accordance with, the non-solicitation provisions of the merger agreement), or resolve or agree to take any such action.

Notwithstanding anything to the contrary in the merger agreement, at any time prior to obtaining the requisite stockholder approval at the special meeting, the Red Hat Board of Directors may, in response to a superior proposal received after the date of the merger agreement and not resulting from a breach of the merger

Table of Contents

agreement, effect an adverse recommendation change or terminate this agreement to enter into an alternative acquisition agreement with respect to such superior proposal in accordance with the termination provisions of the merger agreement, or resolve or agree to take any such action, only if:

- the Red Hat Board of Directors has provided prior written notice to IBM at least four business days in advance (as modified, extended or continued in accordance with the merger agreement), which we refer to as the superior proposal notice period, to the effect that the Red Hat Board of Directors is prepared to effect an adverse recommendation change in response to a superior proposal, or to terminate the merger agreement in accordance with the termination provisions of the merger agreement, as applicable, which notice will attach in full the most current version of any written agreement relating to the transaction that constitutes such superior proposal;

- during the applicable superior proposal notice period (or any extension or continuation thereof), prior to its effecting an adverse recommendation change or terminating the merger agreement in accordance with the termination provisions of the merger agreement, Red Hat and the company representatives negotiate in good faith with IBM and its officers, directors and representatives regarding any revisions to the terms of the merger and the other transactions contemplated by the merger agreement proposed by IBM;

- IBM does not make, within the superior proposal notice period (or any extension or continuation thereof) after the receipt of such notice, a proposal that would, in the reasonable good faith judgment of the Red Hat Board of Directors (after consultation with outside legal counsel and a financial advisor of national reputation), cause the offer previously constituting a superior proposal to no longer constitute a superior proposal (it being understood and agreed that any amendment or modification of such superior proposal will require a new notice of a superior proposal with a new superior proposal notice period of three business days); and

- the Red Hat Board of Directors has determined in good faith, after consultation with its outside legal counsel and a financial advisor of nationally recognized reputation, that, in light of such superior proposal and taking into account any revised terms proposed by IBM, such superior proposal continues to constitute a superior proposal and that the failure to make such adverse recommendation change or to so terminate the merger agreement in accordance with the termination provisions of the merger agreement, as applicable, would be inconsistent with the directors fiduciary duties under applicable law.

In addition to the foregoing, at any time prior to the obtaining the requisite stockholder approval at the special meeting, and other than in connection with a takeover proposal, the Red Hat Board of Directors may, in response to an intervening event (as defined below), effect an adverse recommendation change or resolve or agree to take such action, only if:

- the Red Hat Board of Directors has provided prior written notice to IBM at least four business days in advance (as modified, extended or continued in accordance with the merger agreement), which we refer to as the intervening event notice period, to the effect that the Red Hat Board of Directors is prepared to effect an adverse recommendation change, which notice will describe the intervening event in reasonable detail;

during applicable intervening event notice period (or any extension or continuation thereof), prior to its effecting an adverse recommendation change in response to an intervening event, Red Hat and the company representatives negotiate in good faith with IBM and its officers, directors and representatives regarding any revisions to the terms of the merger and the other transactions contemplated by the merger agreement proposed by IBM;

IBM does not make, within the applicable intervening event notice period (or any extension or continuation thereof) after the receipt of such notice, a proposal that would, in the reasonable good faith judgment of the Red Hat Board of Directors (after consultation with outside legal counsel and a

Table of Contents

financial advisor of national reputation), cause the intervening event to no longer constitute an intervening event (it being understood and agreed that any material change in any event, occurrence or facts relating to such intervening event (other than in respect of any revisions proposed or proposals made by IBM as referred to above) will require a new notice of an intervening event with a new intervening event notice period of three business days); and

the Red Hat Board of Directors has determined in good faith, after consultation with its outside legal counsel and a financial advisor of nationally recognized reputation that, in light of such intervening event and taking into account any revised terms proposed by IBM, such intervening event continues to constitute an intervening event and that the failure to make such adverse recommendation change would be inconsistent with the directors fiduciary duties under applicable law.

For purposes of the merger agreement and this proxy statement, intervening event means any event, development or change in circumstances that was not known to the Red Hat Board of Directors, or the consequences of which were not reasonably foreseeable as of the date of the merger agreement, which event, change or development becomes known to the Red Hat Board of Directors prior to obtaining the requisite stockholder approval at the special meeting and which causes the Red Hat Board of Directors to determine in good faith, after consultation with its outside legal counsel and a financial advisor of national reputation, that failure to make an adverse recommendation change would be reasonably likely to result in a breach of its fiduciary duties under applicable law. However, in no event will the following events, changes or developments constitute an intervening event: (i) the receipt, existence or terms of a takeover proposal or any matter relating thereto or consequence thereof or (ii) any change in the price or trading volume of the Red Hat common stock or any other securities of Red Hat (provided that the underlying causes of such changes may constitute or be taken into account in determining whether there has been an intervening event).

For a description of termination fees, see the section entitled Terms of the Merger Agreement Termination of the Merger Agreement Termination Fees beginning on page 106.

Notwithstanding the foregoing, nothing in the merger agreement will prevent Red Hat from complying with its disclosure obligations under applicable U.S. federal or state law with regard to a takeover proposal; provided that this right will not be deemed to permit Red Hat or the Red Hat Board of Directors to effect an adverse recommendation change except in accordance with the requirements of the merger agreement.

Efforts to Obtain Required Stockholder Approvals

Unless the merger agreement has been earlier terminated, including pursuant to Red Hat s right to terminate the merger agreement to enter into an agreement with respect to a superior proposal (see the section entitled Terms of the Merger Agreement Additional Agreements Change of Recommendation beginning on page 94), Red Hat has agreed to hold a special meeting and to use its reasonable best efforts to solicit votes of the Red Hat stockholders in favor of obtaining the requisite approval of the Red Hat stockholders for the merger proposal, and the Red Hat Board of Directors will include its recommendation in this proxy statement. Red Hat will provide updates to IBM with respect the proxy solicitation for the special meeting (including interim results) as reasonably requested by IBM.

Table of Contents

Red Hat may postpone or adjourn the special meeting if:

- Red Hat is unable to obtain a quorum of its stockholders at such time, to the extent (and only to the extent) necessary in order to obtain a quorum of its stockholders and Red Hat will use its reasonable best efforts to obtain such a quorum as promptly as practicable, provided, that the special meeting will not be postponed or adjourned by more than 30 days after the date on which the special meeting was (or was required to be) originally scheduled, without the prior written consent of IBM;

- there are not sufficient affirmative votes in person or by proxy at such meeting to adopt the merger agreement to allow reasonable time for the solicitation of proxies for purposes of obtaining the requisite stockholder approval at the special meeting; provided, that the special meeting will not be postponed or adjourned by more than 30 days after the date on which the special meeting was (or was required to be) originally scheduled, without the prior written consent of IBM;

- the Red Hat Board of Directors has determined in good faith (after consultation with outside legal counsel) that such delay is required by applicable law (i) to comply with comments made by the SEC with respect to this proxy statement or (ii) to allow reasonable additional time for the filing or mailing of any supplemental or amended disclosure that Red Hat has determined, after consultation with outside legal counsel, is reasonably likely to be required under applicable law and for such supplemental or amended disclosure to be disseminated and reviewed by Red Hat stockholders prior to the special meeting, provided, that the special meeting will not be postponed or adjourned by more than 10 business days, or such other amount of time reasonably agreed by Red Hat and IBM to be necessary to comply with applicable law (it being agreed by the parties that such 10 business day period will recommence if Red Hat (after consultation with outside legal counsel) will determine supplemental or amended disclosure is required to be disseminated and reviewed by Red Hat stockholders during such original 10 business day period); or

- Red Hat is required to do so by a court of competent jurisdiction in connection with any litigation against Red Hat and/or its directors relating to the merger or the other transactions contemplated by the merger agreement; provided, that the special meeting will not be postponed or adjourned by more than 10 days at a time without the prior written consent of IBM.

In addition, Red Hat has agreed to postpone or adjourn the special meeting if instructed to so by IBM if there are not sufficient affirmative votes in person or by proxy to adopt the merger proposal to allow reasonable time for the solicitation of proxies for purposes of obtaining the adoption of the merger proposal.

Generally, the record date of the special meeting may not be changed without the prior written consent of IBM; provided, however, that Red Hat may change the record date of the special meeting without the prior written consent of IBM in the event that (i) supplemental or amended disclosure is required to be disseminated to stockholders or the special meeting is postponed or adjourned in accordance with the stockholder meeting provisions of the merger agreement or (ii) Red Hat postpones the special meeting at the instruction of IBM and, in either case, as a result, the initial record date fixed by the Red Hat Board of Directors is more than 60 days before the date of the subsequent meeting.

Efforts to Complete the Merger

Red Hat and IBM have agreed to, and will cause their respective subsidiaries to, use their respective reasonable best efforts to take all actions and to do, or cause to be done, all things necessary, proper or advisable under applicable laws to consummate the merger and the other transactions contemplated by the merger agreement as soon as practicable and no later than the termination date.

Table of Contents

In furtherance and not in limitation of the undertakings pursuant to the reasonable best efforts provisions of the merger agreement, each of IBM and Red Hat will:

- prepare and file any notification and report forms and related material required under the HSR Act and other applicable antitrust laws with respect to the transactions contemplated by the merger agreement, and any additional filings or notifications and related material that are necessary, proper or advisable to permit consummation of the transactions contemplated by the merger agreement, as promptly as reasonably practicable and advisable;

- provide or cause to be provided as promptly as reasonably practicable and advisable any information and documentary material that may be requested by the DOJ or FTC under the HSR Act or by other governmental entities under applicable antitrust laws (if any); and

- use its reasonable best efforts to obtain prompt expiration or termination of any applicable waiting period or other approval of consummation of the transactions contemplated by the merger agreement by the DOJ or FTC or other applicable governmental entities.

Without limiting the generality of the undertakings of IBM described above in this section of the proxy statement entitled Efforts to Complete the Merger, Red Hat and IBM (if requested by IBM), along with their respective subsidiaries, will use their reasonable best efforts to obtain clearance under any applicable antitrust laws so as to enable the parties to the merger agreement to consummate the merger and the other transactions contemplated by the merger agreement as promptly as practicable, and in any event prior to the termination date, which reasonable best efforts will include:

- proposing, negotiating, committing to and effecting, by consent decree, hold separate order or otherwise, the sale, divestiture, disposition, license or other disposition of any subsidiaries, operations, divisions, businesses, product lines, contracts, customers or assets of IBM or any of its subsidiaries (including Red Hat or any of its subsidiaries);

- taking or committing to take such other actions that may limit or impact IBM s or any of its subsidiaries (including Red Hat s or any of its subsidiaries) freedom of action with respect to, or its ability to retain, any of IBM s or any of its subsidiaries (including Red Hat s or any of its subsidiaries) operations, divisions, businesses, product lines, contracts, customers or assets;

- entering into any orders, settlements, undertakings, contracts, consent decrees, stipulations or other agreements to effectuate any of the foregoing or in order to vacate, lift, reverse, overturn, settle or otherwise resolve any order that prevents, prohibits, restricts or delays the consummation of the merger and the other transactions contemplated by the merger agreement, in any case, that may be issued by any court or other governmental entity; and

creating, terminating or divesting relationships, contractual rights or obligations of Red Hat, IBM or their respective subsidiaries, in each case in connection with obtaining all, or eliminating any requirement to obtain any, waiting period expirations or terminations, consents, clearances, waivers, exemptions, licenses, orders, registrations, approvals, permits and authorizations for the transactions contemplated by the merger agreement under the HSR Act or any other applicable antitrust laws or from any governmental entity so as to enable the closing to occur no later than the termination date.

Red Hat will not, unless requested to do so by IBM, commit to or effect any action contemplated in the four bullet points of the immediately preceding sentence. Notwithstanding anything to the contrary contained in the merger agreement, none of IBM, Red Hat or any of their respective subsidiaries will be required to take any action, or commit to take any action, or agree to any condition or limitation that (i) is not conditioned on the consummation of the merger or (ii) that would result in, or would reasonably be expected to result in, individually or in the aggregate, (A) a material adverse effect on Red Hat and its subsidiaries, taken as a whole, or (B) a material adverse effect on IBM and its subsidiaries, taken as a whole, measured on a scale relative to the size of Red Hat and its subsidiaries, taken as a whole, any of the foregoing which we refer to as a burdensome condition.

Table of Contents

Notwithstanding the foregoing, IBM has committed, if required by a governmental entity in connection with obtaining the required regulatory clearance for the merger and the other transactions contemplated by the merger agreement, to effect such actions solely involving certain assets or businesses of Red Hat.

In furtherance and not in limitation of the covenants of the parties contained in the reasonable best efforts provisions of the merger agreement, if any administrative or judicial action or proceeding by a governmental entity of competent jurisdiction is instituted challenging the merger and the other transactions contemplated by the merger agreement, each of Red Hat and IBM will use its reasonable best efforts to:

- oppose fully and vigorously, including by defending through litigation, any such action or proceeding;
- pursue vigorously all available avenues of administrative and judicial appeal; and
- seek to have vacated, lifted, reversed or overturned any judgment that is in effect that prohibits, prevents or restricts consummation of the transactions contemplated by the merger agreement.

Notwithstanding anything to the contrary contained in the merger agreement, none of Red Hat, IBM or any of their respective subsidiaries will be required to (and Red Hat and its subsidiaries will not, without the prior written consent of IBM) take any action, or commit to take any action, under the immediately preceding paragraph above that (i) is not conditioned on the consummation of the merger or (ii) would result in, or would reasonably be expected to result in, individually or in the aggregate, a burdensome condition. To assist IBM in complying with its obligations set forth in the reasonable best efforts provisions of the merger agreement, Red Hat will, and will cause its subsidiaries to, provide to IBM such cooperation as may be reasonably requested by IBM.

Neither IBM nor Sub will, nor will they permit their respective subsidiaries to, acquire or agree to acquire any rights, assets, business, person or division thereof (through acquisition, license, joint venture, collaboration or otherwise), if such acquisition would reasonably be expected to increase the risk of not obtaining, or the risk of materially delaying the obtaining of, the consent, approval order or authorization of any governmental entity with respect to the merger or the other transactions contemplated by the merger agreement.

Subject to applicable law and the requirements of applicable governmental entities, Red Hat and IBM and their respective counsel will, in connection with the efforts referenced above:

- cooperate in all respects with each other in connection with any filing or submission with a governmental entity in connection with the transactions contemplated by the merger agreement and in connection with any investigation or other inquiry by or before a governmental entity relating to the transactions contemplated by the merger agreement, including any proceeding initiated by a private person;
- where legally permissible, have the right to review in advance, and to the extent practicable each will consult and consider in good faith the views of the other regarding, any material filing made with, or written materials to be submitted to, any governmental entity in connection with the transactions contemplated by the merger agreement and of any material communication received or given in connection with any

proceeding by a private person, in each case regarding any of the transactions contemplated by the merger agreement;

promptly inform each other of any material communication (or any other material correspondence or memoranda) received from, or given to, the Antitrust Division of the DOJ or the FTC or any other applicable governmental entity; and

where legally permissible, promptly furnish each other with copies of all correspondence, filings and written communications between them or their subsidiaries or affiliates, on the one hand, and any governmental entity or its respective staff, on the other hand, with respect to the transactions contemplated by the merger agreement.

Table of Contents

Subject to applicable law and the requirements of applicable governmental entities, Red Hat and IBM will (with respect to any in-person discussion or meeting), and will to the extent practicable (with respect to any telephonic discussion or meeting), provide the other party and its counsel with advance notice of and the opportunity to participate in any material discussion or meeting with any governmental entity in respect of any filing, investigation or other inquiry in connection with the transactions contemplated by the merger agreement. Red Hat and IBM will jointly develop, consult and cooperate with one another with respect to the strategy for obtaining any necessary approvals under the antitrust laws or responding to any request from, inquiry by, or investigation by (including directing the timing, nature and substance of all such responses) any governmental entity in connection with the merger agreement and the transactions contemplated by the merger agreement, including determining the timing and content of any registrations, filings, agreements, forms, notices, petitions, statements, submissions of information, applications and other documents, communications and correspondence contemplated by, made in accordance with, or subject to the reasonable best efforts provisions of the merger agreement.

Notwithstanding the foregoing, in the event of any dispute between the parties relating to the strategy or appropriate course of action or content of any submission made in connection with obtaining any clearances under applicable antitrust laws with respect to the merger, the parties will escalate such dispute to the general counsels of Red Hat and IBM for resolution. If such dispute is not resolved pursuant to the preceding sentence, IBM will have the right to make the final determination with respect to such matter. Notwithstanding anything to the contrary in the merger agreement, IBM will, on behalf of the parties and in reasonable consultation with Red Hat, have the right, in its sole discretion, to determine the nature and timing of any divestitures or other remedial undertakings made for the purpose of securing any required approvals under the antitrust laws to the extent any such divestitures or other remedial undertakings would be conditioned upon and only be effective after the closing.

Employee Matters

Following the closing, IBM will cause Red Hat and its subsidiaries to honor all compensation and benefit plans, programs, policies, practices or agreements maintained or sponsored by Red Hat or any of its subsidiaries, or to which Red Hat or any of its subsidiaries is a party, as in effect on the date of the merger agreement. IBM or its affiliates may amend, modify, replace or terminate such arrangements in accordance with their terms.

During the 12-month period following the closing, IBM will provide, or will cause one of its affiliates to provide, to employees of Red Hat who remain employed after the closing, which we refer to as continuing employees, (i) base salaries or wages which are no less favorable than those provided to continuing employees immediately prior to the closing, (ii) target incentive opportunities (excluding any retention, change in control and equity-based compensation) which are no less favorable, in each case, than those provided to continuing employees immediately prior to the closing; and (iii) retirement and welfare benefits (excluding any severance benefits, post-employment health benefits, post-employment welfare benefits and defined benefit pension and nonqualified deferred compensation plans) which are no less favorable in the aggregate than those provided to continuing employees immediately prior to the closing.

IBM has agreed to give to continuing employees who, after the closing, participate in employee benefit plans maintained by IBM or its affiliates credit for eligibility (other than for any defined benefit pension, post-employment health benefits or post-employment welfare benefits plan), vesting and, for severance and vacation benefits only, determining the level of benefits, but not for benefit accrual, for service prior to the closing with Red Hat or any of its subsidiaries, to the same extent recognized by Red Hat and its subsidiaries prior to the closing.

With respect to any benefit plan or benefit agreement maintained by IBM that provides welfare benefits in which continuing employees are eligible to participate after the closing, IBM has agreed that it will, and will cause the surviving corporation to, (i) waive all limitations as to preexisting conditions and exclusions with

100

Table of Contents

respect to participation and coverage requirements applicable to such employees to the extent such conditions and exclusions were satisfied or did not apply to such employees under the welfare plans of Red Hat and its subsidiaries prior to the closing (other than with respect to pre-existing health conditions pursuant to underwriting requirements under fully insured plans) and (ii) credit continuing employees for any co-payments and deductibles paid prior to the closing in satisfying any analogous deductible or out-of-pocket requirements only to the same extent recognized by Red Hat or its subsidiaries prior to the closing.

The Compensation Committee of the Red Hat Board of Directors may, prior to the closing, reasonably and in good faith determine the level of attainment of the applicable performance goals with respect to performance periods under any annual and quarterly cash bonus plans which are ongoing as of the closing. Payment with respect to such cash bonus plans will occur after the closing date at the earlier of the time IBM normally pays bonuses to similarly situated employees, or the time Red Hat normally pays such bonuses. Payment will be made at the greater of the target or actual level of performance, pro-rated for the portion of the applicable performance period which has elapsed through the closing date.

During the 12-month period following the closing, IBM will, or will cause Red Hat and its subsidiaries to, provide continuing employees whose employment is terminated (in a manner that would trigger severance benefits) with severance benefits in accordance with such employee s individual employment or severance agreement or, if no such agreement exists, in accordance with the applicable severance policy of Red Hat or its subsidiaries in effect immediately prior to the closing.

Following the closing, IBM will cause Red Hat and its subsidiaries to honor the terms of each collective bargaining agreement, labor union contract, trade union agreement or other works council agreement applicable to the continuing employees until such agreement expires pursuant to its terms or is modified by the respective parties.

For the avoidance of doubt, the merger agreement does not confer any rights or remedies of any kind or

description upon any person (including any continuing employees and any of their beneficiaries and dependents) other than IBM, its subsidiaries, Red Hat and their respective successors and assigns.

Directors and Officers Indemnification and Insurance

IBM and Sub have agreed that all rights to indemnification, advancement of expenses and exculpation from liabilities for acts or omissions occurring at or prior to the effective time now existing in favor of the current or former directors or officers of Red Hat and its subsidiaries as provided in their respective certificate of incorporation or bylaws (or comparable organizational documents) and any indemnification or other agreements of Red Hat as in effect on the date of the merger agreement will be assumed by the surviving corporation in the merger, without further action, at the effective time, and will survive the merger and will continue in full force and effect in accordance with their terms, and IBM will cause the surviving corporation to comply with and honor the foregoing obligations.

In the event that the surviving corporation or any of its successors or assigns (i) consolidates with or merges into any other person and is not the continuing or surviving corporation or entity of such consolidation or merger or (ii) transfers or conveys all or substantially all its properties and assets to any person, or if IBM dissolves the surviving corporation, then, and in each such case, IBM will cause proper provision to be made so that the successors and assigns of the surviving corporation assume the obligations set forth in the indemnification, exculpation and insurance provisions of the merger agreement.

IBM will obtain, or cause to be obtained, as of the effective time, a tail insurance policy with a claims period of six years from the effective time with respect to directors and officers liability insurance covering each person currently covered by the Red Hat s directors and officers liability insurance policy for acts or omissions occurring prior to the effective time on terms that are no less favorable than those of such policy of

Table of Contents

Red Hat in effect on the date of the merger agreement, which insurance will, prior to the completion of the merger, be in effect and prepaid for such six-year period. However, in no event will IBM or the surviving corporation be required to pay, with respect to the entire six-year period following the effective time, premiums for insurance under this paragraph which in the aggregate exceed 300% of the aggregate premiums paid by Red Hat for the period in its most recent fiscal year for such purpose; provided that IBM will nevertheless be obligated to provide such coverage, with respect to the entire six-year period following the effective time, as may be obtained for such 300% amount.

Restructuring

Red Hat has agreed, prior to the closing, to undertake certain identified internal transactions as reasonably requested by IBM. IBM will, promptly upon request by Red Hat, reimburse Red Hat for all reasonable and documented out-of-pocket costs and expenses incurred by Red Hat, its subsidiaries and their advisors in connection with the obligations of Red Hat and its subsidiaries pursuant to the restructuring provision of the merger agreement. Additionally, in the event the merger agreement is terminated following any of these transactions being undertaken, IBM will indemnify Red Hat for any expenses and incremental taxes incurred as a result of such transactions.

Other Covenants and Agreements

The merger agreement contains certain other covenants and agreements, including covenants relating to, among other things:

preparation by Red Hat of this proxy statement;

confidentiality of and access by IBM to certain information about Red Hat;

consultation between Red Hat and IBM in connection with public statements with respect to the transactions contemplated by the merger agreement;

IBM causing Sub to comply with all of Sub s obligations under the merger agreement;

the treatment of equity awards of Red Hat, which is described in the section entitled Terms of the Merger Agreement Merger Consideration Treatment of Equity Compensation beginning on page 84;

actions with respect to Red Hat s outstanding convertible notes, the convertible note hedge transactions and the warrant transactions;

Red Hat providing notice to IBM of any stockholder litigation or dispute;

Red Hat taking all reasonable steps to cause the transactions contemplated by the merger agreement to be exempt under Section 16 of the Exchange Act;

Red Hat and IBM providing each other with certain notices;

Red Hat taking all actions necessary to remove or otherwise minimize the effect of any anti-takeover laws on the merger and the other transactions contemplated by the merger agreement;

Red Hat cooperating with IBM and using its reasonable best efforts to cause Red Hat common stock to be delisted from the NYSE as promptly as practicable following the effective time and deregistered pursuant to the Exchange Act as promptly as practicable following such delisting.

Conditions to the Closing of the Merger

The respective obligations of IBM, Sub and Red Hat to effect the merger are subject to the satisfaction or waiver (to the extent permitted by applicable law) on or prior to the closing date of the following conditions:

receipt of Red Hat stockholder approval of the merger proposal;

Table of Contents

(i) any waiting period (and any extension thereof) applicable to the merger under the HSR Act having been terminated or having expired and (ii) any other approval or waiting period under certain other applicable antitrust laws, as set out in the merger agreement, having been obtained or terminated or having expired, in each case without the imposition, individually or in the aggregate, of a burdensome condition;

(i) no temporary restraining order, preliminary or permanent injunction or other judgement or law of, or issued by, certain courts of competent jurisdiction or other governmental entities, as set out in the merger agreement, being in effect, in each case having the effect of making the merger illegal or otherwise prohibiting consummation of the merger or imposition, individually or in the aggregate, a burdensome condition, collectively which we refer to as legal restraints, and (ii) no governmental entity having instituted any action or proceeding (which remains pending at what would otherwise be the closing date) before certain courts or other governmental entities of competent jurisdiction, as set out in the merger agreement, seeking to temporarily or permanently enjoin, restrain or otherwise prohibit consummation of the merger or impose a legal restraint.

The obligations of IBM and Sub to effect the merger are further subject to the satisfaction or waiver (to the extent permitted by applicable law) on or prior to the closing date of the following conditions:

the representations and warranties of Red Hat relating to the absence of a material adverse effect, as specified in the merger agreement, being true and correct in all respects as of the date of the merger agreement and as of the closing date with the same effect as though made as of such date;

the representations and warranties of Red Hat relating to the organization, good standing and corporate power of Red Hat, its subsidiaries, certain capitalization matters, authority to enter into the merger agreement, the approval of the merger agreement by the Red Hat Board of Directors, the stockholder vote required for adoption of the merger agreement, broker s fees and the opinions of Red Hat s financial advisors, each as specified in the merger agreement, being true and correct in all material respects as of the date of the merger agreement and as of the closing date with the same effect as though made as of such date (except to the extent expressly made as of an earlier date, in which case as of such earlier date);

all other representations and warranties of Red Hat set forth in the merger agreement, other than those referenced in the two preceding bullet points above, being true and correct (disregarding all qualifications or limitations as to material, materiality, material adverse effect and words of similar import set forth therein) as of the date of the merger agreement and as of the closing date with the same effect as though made as of the closing date (except to the extent expressly made as of an earlier date, in which case as of such earlier date), except in the case of this bullet point where the failure to be true and correct would not reasonably be expected to have, individually or in the aggregate, a material adverse effect;

Red Hat having performed in all material respects all obligations required to be performed by it under the merger agreement at or prior to the closing date;

since the date of the merger agreement, no effect having occurred that would reasonably be expected to have, individually or in the aggregate, a material adverse effect, of which the existence or consequences are still continuing; and

IBM having received a certificate signed on behalf of Red Hat by the Chief Executive Officer and the Chief Financial Officer of Red Hat, certifying that the conditions set forth in the five preceding bullet points have been satisfied.

The obligation of Red Hat to effect the merger is further subject to the satisfaction or waiver (to the extent permitted by applicable law) on or prior to the closing date of the following conditions:

the representations and warranties of IBM and Sub set forth in the merger agreement being true and correct (disregarding all qualifications or limitations as to material, materiality, material adverse

Table of Contents

effect and words of similar import set forth therein) as of the date of the merger agreement and as of the closing date with the same effect as though made as of the closing date (except to the extent expressly made as of an earlier date, in which case as of such earlier date), except for any such failure to be true and correct that would not, individually or in the aggregate, prevent or materially delay the consummation of the merger;

IBM and Sub having performed in all material respects all obligations required to be performed by them under the merger agreement at or prior to the closing date; and

Red Hat having received a certificate signed on behalf of IBM by the Chief Executive Officer and the Chief Financial Officer of IBM, certifying that conditions set forth in the two preceding bullet points have been satisfied.

Termination of the Merger Agreement

Termination

The merger agreement may be terminated, and the merger may be abandoned, at any time prior to the effective time:

by the mutual written consent of IBM, Sub and Red Hat;

by either IBM or Red Hat, if:

the merger has not been consummated by 11:59 p.m., Eastern time, on October 28, 2019, which we refer to as the initial termination date for any reason; provided that if as of the initial termination date all conditions to the merger agreement are satisfied (other than those conditions that by their terms are to be satisfied at the closing, each of which is capable of being satisfied at the closing) or waived (to the extent permitted by applicable law), other than certain conditions in the merger agreement, either Red Hat or IBM, by written notice to the other, may extend the initial termination date to 11:59 p.m., Eastern time, on the date that is three months after the initial termination date, which we refer to as the first extended termination date; provided, further, that if as of the first extended termination date all conditions to the merger agreement are satisfied (other than those conditions that by their terms are to be satisfied at the closing, each of which is capable of being satisfied at the closing) or waived (to the extent permitted by applicable law), other than certain conditions in the merger agreement, either Red Hat or IBM, by written notice to the other, may extend the first extended termination date to 11:59 p.m., Eastern time, on the date that is six months after the initial termination date, which we refer to as the second extended termination date; provided, however, that the right to terminate the merger agreement under the foregoing will not be available to any party whose action or failure to act has been a principal cause of or directly resulted in the failure of the merger to occur on or before such date and such action or failure to act constitutes a breach of the merger agreement, collectively which we refer to as the end date termination right;

any legal restraint having the effect of making the merger illegal or otherwise prohibiting consummation of the merger or imposing, individually or in the aggregate, a burdensome condition is in effect and will have become final and nonappealable (it being understood and agreed by the parties that only a court of competent jurisdiction or other governmental entity in certain identified jurisdictions will constitute a court of competent jurisdiction or other governmental entity); and provided, that the right to terminate the merger agreement under this clause will not be available to a party if the failure of such party, and in the case of IBM, including the failure of Sub, to perform any of its obligations under the merger agreement has been a principal cause of or directly resulted in the issuance of such final, non-appealable legal restraint, which we refer to as the legal restraint termination right; or

the special meeting of Red Hat stockholders has been held and the stockholder approval of the merger agreement and the transactions contemplated thereby have not been obtained at the

Table of Contents

stockholders meeting or at any adjournment or postponement of the special meeting, which we refer to as the stockholder vote termination right.

by IBM:

prior to the special meeting of Red Hat stockholders if (i) an adverse recommendation change has occurred or (ii) Red Hat has delivered a notice of an intervening event or a notice of a superior proposal and IBM has, in response thereto, delivered a notice of its intent to terminate the merger agreement prior to the expiration of the intervening event notice period or the superior proposal notice period, as applicable, and has publicly and irrevocably waived certain of its rights under the merger agreement, which we collectively refer to as the IBM change of recommendation termination right, provided, in the case of clause (ii), IBM is not entitled to terminate the merger agreement pursuant to this provision unless IBM provides at least one business day advance written notice; or

if Red Hat has breached any of its representations or warranties or failed to perform any of its covenants or other agreements contained in the merger agreement, which breach or failure to perform (i) would give rise to the failure of a condition set forth in the conditions to obligations of IBM and Sub provision in the merger agreement relating to the accuracy of Red Hat s representations and warranties or performance of obligations of Red Hat and (ii) (A) is incapable of being cured prior to the termination date or (B) is not cured by Red Hat on or before the earlier of (1) the termination date and (2) the date that is 30 business days after written notice from IBM of such breach or failure; provided that IBM will not have the right to terminate the merger agreement pursuant to this clause if IBM or Sub is then in material breach of the merger agreement or if any representation or warranty of IBM or Sub will have become untrue, in either case, so as to result in the failure of any of certain conditions in the merger agreement;

by Red Hat:

at any time prior to obtaining the Red Hat stockholder approval of the merger agreement at the special meeting, if (i) Red Hat has received a superior proposal after the date of the merger agreement that did not result from a breach of the merger agreement, (ii) the Red Hat Board of Directors has authorized Red Hat to enter into, and Red Hat concurrently enters into, an acquisition agreement to consummate the alternative transaction contemplated by such superior proposal, (iii) simultaneously with, and as a condition to, any such termination, Red Hat pays or causes to be paid to IBM (or its designee) the termination fee described in the section entitled Terms of the Merger Agreement Termination of the Merger Agreement Termination Fees beginning on page 106 and (iv) Red Hat has complied with the relevant procedures with respect to such superior proposal as described in the section entitled Terms of the Merger Agreement Additional Agreements No Solicitation beginning on page 92, which we refer to as the Red Hat alternative acquisition termination right; or

if IBM has breached any of its representations or warranties or failed to perform any of its covenants or other agreements contained in the merger agreement, which breach or failure to perform (i) would

give rise to the failure of a condition set forth in the conditions to obligations of Red Hat provision in the merger agreement relating to the accuracy of IBM s and Sub s representations and warranties or performance of obligations of IBM and Sub and (ii) (A) is incapable of being cured by the termination date or (B) is not cured by IBM or Sub on or before the earlier of (i) the termination date and (ii) the date that is 30 business days after written notice from Red Hat of such breach or failure; provided that Red Hat will not have the right to terminate the merger agreement pursuant to this provision if Red Hat is then in material breach of the merger agreement or if any representation or warranty of Red Hat will have become untrue, in either case, so as to result in the failure of any of certain conditions in the merger agreement.

Table of Contents

Effect of Termination

In the event of termination of the merger agreement by either Red Hat or IBM as described above under the section entitled Terms of the Merger Agreement Termination of the Merger Agreement Termination beginning on page 104, the merger agreement will become void and have no effect, and there will not be any liability or obligation on the part of any party, except that:

- no termination will affect the obligations of the parties contained in the confidentiality agreement;
- no termination will relieve any party from liability for damages in case of any willful breach (as described below) of any of its representations, warranties, covenants or agreements set forth in the merger agreement, in which case liability for any and all damages, costs, expenses, liabilities or losses of any kind, in each case, incurred or suffered by the other party as a result of such breach will not be affected by termination of the merger agreement or any payment of the termination fee pursuant to the fees and expenses provision of the merger agreement; and
- certain other provisions of the merger agreement, including provisions with respect to the allocation of fees and expenses, including, if applicable, the termination fees described in the section entitled Terms of the Merger Agreement Termination of the Merger Agreement Termination Fees beginning on page 106, will survive such termination.

For the purpose of the merger agreement, willful breach means, with respect to any agreement or covenant in the merger agreement, an act or omission (including a failure to cure circumstances) taken or omitted to be taken that the breaching party intentionally takes (or intentionally fails to take) and knows (or reasonably should have known) would, or would reasonably be expected to, cause a material breach of such representation, warranty, agreement or covenant.

Termination Fees

Under the merger agreement, Red Hat will be required to pay a termination fee equal to $975 million in connection with a termination of the merger agreement under the following circumstances:

- in the event the merger agreement is terminated by Red Hat pursuant to the Red Hat alternative acquisition termination right, then the termination fee will be paid simultaneously with, and as a condition to, such termination;
- in the event the merger agreement is terminated by IBM pursuant to the IBM change of recommendation termination right, then the termination fee will be paid within two business days of such termination; or
- prior to the stockholders meeting, a takeover proposal has been made to Red Hat or Red Hat stockholders and (i) the merger agreement is terminated by (A) either Red Hat or IBM at the termination date, (B) either

Red Hat or IBM if the requisite stockholder approval is not obtained at the stockholders meeting or (C) IBM if Red Hat has breached any representation, warranty or covenant, such that the conditions relating to the accuracy of Red Hat s representations and warranties or performance of covenants would fail to be satisfied and (ii) within 12 months of the termination of the merger agreement, (x) Red Hat enters into an acquisition agreement with respect to a takeover proposal or (y) any takeover proposal is consummated provided that for the purposes of this bullet, references to 20% in the definition of alternative proposal are deemed to be references to 50.1%, then the termination fee will be paid no later than the first to occur of the events referred to in the immediately preceding clauses (x) and (y).

Notwithstanding anything to the contrary in the merger agreement, in the event the merger agreement is terminated by Red Hat for any reason at a time when IBM would have had the right to terminate the merger agreement, IBM will be entitled to receipt of any termination fee that would have been (or would have subsequently become) payable had IBM terminated the merger agreement at such time.

Table of Contents

In no event will Red Hat be required to pay the termination fees described above on more than one occasion.

The termination fee, if paid, will be credited against any damages, to the extent proven, resulting from or arising out of any pre-termination willful breach of the merger agreement by Red Hat (as such damages are determined taking into account any termination fee previously paid by Red Hat).

Expenses

If Red Hat fails promptly to pay the amount due to IBM in connection with a termination fee described above under the section entitled Terms of the Merger Agreement Termination of the Merger Agreement Termination Fees beginning on page 106 and, in order to obtain such payment, IBM commences a legal proceeding that results in a judgment against Red Hat for such amount, Red Hat will pay to IBM its reasonable costs and expenses (including attorneys fees and expenses) in connection with such legal proceeding and any appeal relating thereto, together with interest at the prime rate as published in *The Wall Street Journal* in effect on the date such payment was required to be made.

Except as expressly set forth in the merger agreement, each party bears its own expenses in connection with the merger agreement and the transactions contemplated thereby.

Amendment and Waiver

Amendment

The parties to the merger agreement may at any time, whether before or after the requisite stockholder approval at the special meeting has been obtained, amend the merger agreement; provided, however, that after the requisite stockholder approval at the special meeting has been obtained, no amendment will be made that by law requires further approval by Red Hat stockholders without the further approval of Red Hat stockholders.

Termination of the merger agreement prior to the effective time will not require the approval of the stockholders of IBM, Red Hat or any of their affiliates.

Waiver; Extension

At any time prior to the effective time, the parties to the merger agreement may:

- extend the time for the performance of any of the obligations or other acts of the other parties to the merger agreement;
- waive any inaccuracies in the representations and warranties contained in the merger agreement or in any document delivered pursuant to the merger agreement; and
- waive compliance with any of the agreements or conditions contained in the merger agreement.

In each case, provided, however, that after the requisite stockholder approval at the special meeting has been obtained, no waiver will be made that by law requires further approval by Red Hat stockholders without the further approval of

Red Hat stockholders.

Any such extension or waiver will be valid only if set forth in an instrument in writing signed by the party or parties to be bound thereby. The failure of any party to the merger agreement to assert any of its rights under the merger agreement or otherwise will not constitute a waiver of such rights.

Governing Law

The merger agreement is governed by, and construed in accordance with, the laws of the state of Delaware, regardless of the laws that might otherwise govern under applicable principles of conflicts of laws thereof.

Table of Contents

Specific Performance

The parties will be entitled to an injunction or injunctions to prevent breaches of the merger agreement and to enforce specifically the terms and provisions of the merger agreement in certain chosen courts, in addition to any other remedy to which they are entitled at law or in equity. The parties have further agreed not to assert that a remedy of specific enforcement is unenforceable, invalid, contrary to law or inequitable for any reason, nor to assert that a remedy of monetary damages would provide an adequate remedy for any such breach.

In the event any party to the merger agreement brings any action, claim, complaint, suit, action or other proceeding to enforce specifically the performance of the terms and provisions of the merger agreement prior to the closing, the termination date will automatically be extended by such period during which such action, claim, complaint, suit, action or other proceeding is pending, plus 20 business days, or such other time period established by the court presiding over such action, claim, complaint, suit, action or other proceeding.

Table of Contents

PROPOSAL 2: ADVISORY VOTE ON MERGER-RELATED EXECUTIVE COMPENSATION ARRANGEMENTS

The Merger-Related Compensation Proposal

Section 14A of the Exchange Act, which was enacted as part of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, requires that we provide our stockholders with the opportunity to vote to approve, on a non-binding, advisory basis, the payment of certain compensation that will or may become payable to the named executive officers of Red Hat in connection with the merger, as disclosed in the section of this proxy statement entitled Proposal 1: Adoption of the Merger Agreement The Merger Interests of the Non-Employee Directors and Executive Officers of Red Hat in the Merger Potential Payments to Executives upon Termination Following Change in Control beginning on page 75. We are asking our stockholders to approve, on a non-binding, advisory basis, a resolution relating to the compensation that will or may become payable to the named executive officers of Red Hat in connection with the merger.

The Red Hat Board of Directors encourages you to review carefully the named executive officer merger-related compensation information disclosed in this proxy statement. The Red Hat Board of Directors unanimously recommends that you vote **FOR** the following resolution:

RESOLVED, that the stockholders of Red Hat, Inc. approve, on a non-binding, advisory basis, the compensation that will or may become payable to Red Hat s named executive officers that is based on or otherwise relates to the merger as disclosed pursuant to Item 402(t) of Regulation S-K in the section entitled Proposal 1: Adoption of the Merger Agreement The Merger Interests of the Non-Employee Directors and Executive Officers of Red Hat in the Merger Golden Parachutes Compensation in Red Hat s proxy statement for the special meeting.

Stockholders should note that this proposal is not a condition to completion of the merger, and as an advisory vote, the result will not be binding on Red Hat, the Red Hat Board of Directors or IBM. Further, the underlying plans and arrangements are contractual in nature and not, by their terms, subject to stockholder approval. Accordingly, regardless of the outcome of the advisory vote, if the merger is consummated our named executive officers will be entitled to receive the compensation that is based on or otherwise relates to the merger in accordance with the terms and conditions applicable to that compensation.

Vote Required and Board of Directors Recommendation

Approval of the merger-related compensation proposal requires the affirmative vote of a majority of the voting power of the shares of Red Hat common stock entitled to vote which are present, in person or by proxy, and voting at the special meeting, provided a quorum is present.

The Red Hat Board of Directors unanimously recommends that you vote **FOR** the merger-related compensation proposal.

Table of Contents

PROPOSAL 3: ADJOURNMENT OF THE SPECIAL MEETING

The Adjournment Proposal

We are asking you to approve a proposal to approve one or more adjournments of the special meeting to a later date or dates, if necessary or appropriate, to solicit additional proxies if there are insufficient votes to adopt the merger agreement at the then-scheduled date and time of the special meeting. If our stockholders approve the adjournment proposal, we could adjourn the special meeting and any adjourned session of the special meeting and use the additional time to solicit additional proxies, including the solicitation of proxies from stockholders that have previously returned properly executed proxies voting against adoption of the merger agreement. Among other things, approval of the adjournment proposal could mean that, even if we had received proxies representing a sufficient number of votes against adoption of the merger agreement such that the proposal to adopt the merger agreement would be defeated, we could adjourn the special meeting without a vote on the adoption of the merger agreement and seek to convince the holders of those shares to change their votes to votes in favor of adoption of the merger agreement. Additionally, we may seek to adjourn the special meeting if a quorum is not present at the special meeting, subject to the terms of the merger agreement.

Red Hat does not intend to call a vote on this proposal if the merger proposal is approved by the requisite number of shares of Red Hat common stock at the special meeting.

Vote Required and Board of Directors Recommendation

Approval of the proposal to approve one or more adjournments of the special meeting requires the affirmative vote of a majority of the voting power of the shares of Red Hat common stock entitled to vote which are present, in person or by proxy, at the special meeting, whether or not a quorum is present.

The Red Hat Board of Directors believes that it is in the best interests of Red Hat and its stockholders to be able to adjourn the special meeting, if necessary or appropriate, for the purpose of soliciting additional proxies in respect of the merger agreement proposal if there are insufficient votes to adopt the merger agreement at the then-scheduled date and time of the special meeting.

The Red Hat Board of Directors unanimously recommends that you vote **FOR** the adjournment proposal.

Table of Contents

MARKET PRICES AND DIVIDEND DATA

Red Hat common stock is listed on the NYSE under the symbol RHT. As of the close of business on the record date, there were 176,759,752 shares of our common stock outstanding, held by approximately 1,083 stockholders of record.

The following table sets forth, for the indicated periods, quarterly high and low intraday prices of Red Hat common stock for the periods shown as reported by the NYSE:

	High	Low
FY 2019 Quarter Ended		
February 28, 2019 (through December 11, 2018)	$ 179.04	$ 176.00
November 30, 2018	$ 179.49	$ 115.31
August 31, 2018	$ 177.70	$ 130.71
May 31, 2018	$ 173.58	$ 143.31
FY 2018 Quarter Ended		
February 28, 2018	$ 150.30	$ 117.76
November 30, 2017	$ 129.61	$ 104.51
August 31, 2017	$ 107.77	$ 86.26
May 31, 2017	$ 90.01	$ 80.93
FY 2017 Quarter Ended		
February 28, 2017	$ 85.01	$ 68.54
November 30, 2016	$ 82.73	$ 71.52
August 31, 2016	$ 81.81	$ 70.09
May 31, 2016	$ 77.56	$ 65.43

The closing price of Red Hat s common stock on the NYSE on October 26, 2018, the last trading day prior to announcement of the merger, was $116.68 per share. On December 11, 2018, the latest practicable trading day before the date of this proxy statement, the closing price of our common stock on the NYSE was $176.53 per share. You are encouraged to obtain current market quotations for our common stock. No assurance can be given concerning the market price for Red Hat common stock before the date on which the merger will be completed. The market price for Red Hat common stock will fluctuate between the date of this proxy statement and the date on which the merger is completed.

We have never declared or paid any cash dividends on our common stock. Furthermore, under the terms of the merger agreement, from the date of the merger agreement until the earlier of the effective time or the termination of the merger, Red Hat may not declare, set aside or pay any dividends without the prior written consent of IBM.

Following the merger, there will be no further market for shares of Red Hat common stock and we anticipate that our stock will be delisted from the NYSE and deregistered under the Exchange Act. As a result, following the merger and such deregistration, we would no longer file periodic reports with the SEC.

Table of Contents

SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The tables below set forth, as of December 7, 2018 (unless otherwise indicated), certain information regarding beneficial ownership of our common stock. We determine beneficial ownership of our common stock in accordance with the rules of the SEC. Under these rules, beneficial ownership includes any shares as to which the individual or entity has sole or shared voting power or investment power and includes any shares of our common stock which the individual has the right to acquire on or before February 5, 2019 through payout of DSUs or RSUs. As of December 7, 2018, we had 176,782,990 shares of common stock outstanding. For purposes of computing the percentage and amount of outstanding shares of common stock held by each individual or entity, any shares which that individual or entity has the right to acquire on or before February 5, 2019 are deemed to be outstanding for the individual or entity but such shares are not deemed to be outstanding for the purpose of computing the percentage ownership of any other individual or entity.

Ownership by Our Directors and Executive Officers

The following table includes information regarding the number of shares of our common stock beneficially owned by each of our directors and Named Executive Officers (as such term is defined in Item 402(a)(3) of Regulation S-K under the Exchange Act), as well as all of our current directors and executive officers as a group, as of December 7, 2018.

NAME AND ADDRESS OF BENEFICIAL OWNER[1]	TITLE(S)	AMOUNT AND NATURE OF BENEFICIAL OWNERSHIP[2]	PERCENT OF COMMON STOCK OUTSTANDING
James M. Whitehurst[3]	Director, President and Chief Executive Officer	359,114	*
Paul J. Cormier[4]	Executive Vice President and President, Products and Technologies	195,611	*
Arun Oberoi[5]	Executive Vice President, Global Sales and Services	117,104	*
William S. Kaiser[6]	Director	70,552	*
Narendra K. Gupta[7]	Board Chair	51,919	*
Michael R. Cunningham[8]	Executive Vice President and General Counsel	50,638	*
Sohaib Abbasi[9]	Director	38,006	*
W. Steve Albrecht[10]	Director	29,326	*
Eric R. Shander[11]	Executive Vice President and Chief Financial Officer	21,005	*

Kimberly L. Hammonds[12]	Director	11,261	*
Charlene T. Begley[13]	Director	9,854	*
Kevin Murai[14]	Director	2,429	*
Alfred W. Zollar[15]	Director	2,337	*
All current executive officers and directors as a group (15 persons)		996,499	*

* Less than one percent of the outstanding common stock.

(1) The address for each beneficial owner is c/o Red Hat, Inc., 100 East Davie Street, Raleigh, North Carolina 27601.

(2) Each person named in the table reported that he or she has sole voting and investment power (or shares such power with his or her spouse) with respect to all shares shown as beneficially owned by him or her, except as noted in the footnotes below and subject to community property laws, if applicable. The inclusion herein of any shares of common stock does not constitute an admission of direct or indirect beneficial ownership of those shares.

Table of Contents

(3) Consists of (i) 287,856 shares of common stock and (ii) 71,258 shares of restricted stock vesting over four years from the date of grant.
(4) Consists of (i) 1,984 shares of common stock and (ii) 34,656 shares of restricted stock vesting over four years from the date of grant and (iii) 158,971 shares of common stock held of record by the Paul J. Cormier Grantor Retained Annuity Trust of 2018.
(5) Consists of (i) 86,274 shares of common stock and (ii) 30,830 shares of restricted stock vesting over four years from the date of grant.
(6) Consists of (i) 61,652 shares of common stock, (ii) 1,710 shares of restricted stock vesting one year from the date of grant and (iii) 7,190 shares of common stock issuable upon payout of DSUs.
(7) Consists of (i) 7,345 shares of common stock and (ii) 44,574 shares of common stock issuable upon payout of DSUs.
(8) Consists of (i) 33,100 shares of common stock and (ii) 17,538 shares of restricted stock vesting over four years from the date of grant.
(9) Consists of (i) 7,985 shares of common stock, (ii) 29,961 shares of common stock issuable upon payout of DSUs and (iii) 60 shares of common stock held of record by the Abbasi Family 2003 Charitable Remainder Unitrust for which Mr. Abbasi is the trustee.
(10) Consists of (i) 15,644 shares of common stock, (ii) 13,682 shares of common stock issuable upon payout of DSUs.
(11) Consists of (i) 5,711 shares of common stock and (ii) 12,915 shares of restricted stock vesting over four years from the date of grant and (iii) 2,379 shares of common stock issuable upon vesting of RSUs.
(12) Consists of (i) 9,551 shares of common stock and (ii) 1,710 shares of restricted stock vesting one year from the date of grant.
(13) Consists of (i) 8,144 shares of common stock and (ii) 1,710 shares of restricted stock vesting one year from the date of grant.
(14) Consists of 2,429 shares of restricted stock vesting over three years from the date of grant.
(15) Consists of 2,337 shares of restricted stock vesting over either one year or three years from the date of grant.

Ownership of More than 5% of Our Common Stock

The following table sets forth information on each person or entity who we believe, based on our review of public filings, or information provided, by such persons or entities, beneficially owns more than 5% of our common stock as of December 7, 2018.

NAME AND ADDRESS OF BENEFICIAL OWNER	AMOUNT AND NATURE OF BENEFICIAL OWNERSHIP	PERCENT OF COMMON STOCK OUTSTANDING[1]
T. Rowe Price Associates, Inc.[2]	21,489,796	12.16%
100 East Pratt Street		
Baltimore, MD 21202		

The Vanguard Group, Inc.[3] 100 Vanguard Boulevard Malvern, PA 19355	18,508,464	10.47%
FMR LLC[4] 245 Summer Street Boston, MA 02210	13,500,181	7.64%
BlackRock, Inc.[5] 55 East 52nd Street New York, NY 10055	11,481,615	6.50%
Prudential Financial, Inc.[6] 751 Broad Street Newark, NJ 07102	9,863,126	5.58%

Table of Contents

(1) Percentages are calculated based on our common stock outstanding as of December 7, 2018.

(2) Based solely on information provided by T. Rowe Price Associates, Inc., which we refer to as Price Associates, in a letter dated March 9, 2018 regarding its beneficial ownership of our common stock as of December 31, 2017. As of December 31, 2017, Price Associates had sole power to vote or direct the vote over 7,663,763 shares and sole power to dispose or direct the disposition of 21,489,796 shares. These securities are owned by various individual and institutional investors which Price Associates serves as an investment adviser with power to direct investments and/or sole power to vote the securities. For the purposes of the reporting requirements of the Securities Exchange Act of 1934, Price Associates is deemed to be a beneficial owner of such securities; however, Price Associates expressly disclaims that it is, in fact, the beneficial owner of such securities.

(3) Based solely on a Schedule 13G/A filed with the SEC on February 12, 2018 by The Vanguard Group, Inc., which we refer to as Vanguard. As of December 31, 2017, Vanguard reported sole power to vote or direct the vote over 251,996 shares, shared power to vote or direct the vote over 40,989 shares, sole power to dispose or direct the disposition of 18,218,719 shares and shared power to dispose or direct the disposition of 289,745 shares. Includes 197,750 shares beneficially owned by Vanguard Fiduciary Trust Company, which we refer to as VFTC, as a result of its serving as investment manager of collective trust accounts. Also includes 144,935 shares beneficially owned by Vanguard Investments Australia, Ltd., which we refer to as VIA, as a result of its serving as investment manager of Australian investment offerings. VFTC and VIA are wholly-owned subsidiaries of Vanguard.

(4) Based solely on a Schedule 13G/A filed with the SEC on February 13, 2018 by FMR LLC. As of December 31, 2017, FMR LLC reported sole power to vote or direct the vote over 3,242,102 shares and sole power to dispose or direct the disposition of 13,500,181 shares. Includes shares beneficially owned by FIAM LLC, Fidelity Institutional Asset Management Trust Company, Fidelity Management & Research (Hong Kong) Limited, Fidelity Management & Research Company, FMR Co., Inc. and Strategic Advisors, Inc. FMR Co., Inc. beneficially owns 5% or greater of the outstanding shares reported on the Schedule 13G/A. Abigail P. Johnson is a Director, the Chairman and the Chief Executive Officer of FMR LLC. Members of the Johnson family, including Abigail P. Johnson, are the predominant owners, directly or through trusts, of Series B voting common shares of FMR LLC, representing 49% of the voting power of FMR LLC. The Johnson family group and all other Series B shareholders have entered into a shareholders voting agreement under which all Series B voting common shares will be voted in accordance with the majority vote of Series B voting common shares. Accordingly, through their ownership of voting common shares and the execution of the shareholders voting agreement, members of the Johnson family may be deemed, under the Investment Company Act of 1940, to form a controlling group with respect to FMR LLC. Neither FMR LLC nor Abigail P. Johnson has the sole power to vote or direct the voting of the shares owned directly by the various investment companies registered under the Investment Company Act, which we refer to as Fidelity Funds, advised by Fidelity Management & Research Company, a wholly-owned subsidiary of FMR LLC, which power resides with the Fidelity Funds Boards of Trustees. Fidelity Management & Research Company carries out the voting of the shares under written guidelines established by the Fidelity Funds Boards of Trustees.

(5) Based solely on a Schedule 13G/A filed with the SEC on January 29, 2018 by BlackRock, Inc. and includes shares held by certain of its subsidiaries. As of December 31, 2017, BlackRock, Inc. reported sole power to vote or direct the vote over 9,990,897 shares and sole power to dispose or direct the disposition of 11,481,615 shares.

(6) Based solely on a Schedule 13G/A filed with the SEC on January 26, 2018 by Prudential Financial, Inc., Prudential, and includes shares held by certain of its subsidiaries. As of December 31, 2017, Prudential reported sole power to vote or direct the vote over 444,123 shares, shared power to vote or direct the vote over 5,166,492 shares, sole power to dispose or direct the disposition of 444,123 shares and shared power to dispose or direct the disposition of 9,419,003 shares. Jennison Associates LLC, which we refer to as Jennison, filed a separate Schedule 13G/A with the SEC on February 5, 2018, reporting beneficial ownership of 9,552,072 shares. However, these shares have not been listed separately because the shares reported by Prudential, which indirectly

owns 100% of the equity interests of Jennison, includes 9,552,072

Table of Contents

shares beneficially owned by Jennison. Jennison furnishes investment advice to several investment companies, insurance separate accounts and institutional clients, which we refer to as Managed Portfolios. As a result of its role as investment adviser of the Managed Portfolios, Jennison may be deemed to be the beneficial owner of the shares held by such Managed Portfolios.

Table of Contents

APPRAISAL RIGHTS

If the merger is completed, stockholders who do not vote (whether in person or by proxy) in favor of the adoption of the merger proposal and who properly exercise and perfect their demand for appraisal of their shares and who do not withdraw such demand or lose their right to appraisal will be entitled to appraisal rights in connection with the merger under Section 262 of the DGCL, which we refer to as Section 262.

The following discussion is not a complete statement of the law pertaining to appraisal rights under the DGCL and is qualified in its entirety by the full text of Section 262, which is attached to this proxy statement as Annex D and incorporated herein by reference. The following summary does not constitute any legal or other advice and does not constitute a recommendation that stockholders exercise their appraisal rights under Section 262. Only a holder of record of shares of Red Hat common stock is entitled to demand appraisal rights for the shares registered in that holder s name. A person having a beneficial interest in shares of Red Hat common stock held of record in the name of another person, such as a bank, broker or other nominee, must act promptly to cause the record holder to follow the steps summarized below properly and in a timely manner to perfect appraisal rights. If you hold your shares of Red Hat common stock through a bank, broker or other nominee and you wish to exercise appraisal rights, you should consult with your bank, broker or the other nominee.

Under Section 262, holders of shares of Red Hat common stock who (i) do not vote in favor of the merger proposal; (ii) continuously are the record holders of such shares through the effective time; and (iii) otherwise follow the procedures set forth in Section 262 will be entitled to have their shares appraised by the Court of Chancery of the State of Delaware and to receive in lieu of the merger consideration payment in cash of the amount determined by the Court of Chancery to be the fair value of the shares of Red Hat common stock, exclusive of any element of value arising from the accomplishment or expectation of the merger, together with interest to be paid on the amount determined to be fair value as determined by the court (subject, in the case of interest payments, to any voluntary cash payments made by the surviving corporation pursuant to subsection (h) of Section 262 of the DGCL). Unless the Court of Chancery, in its discretion, determines otherwise for good cause shown, interest on an appraisal award will accrue and compound quarterly from the effective time through the date the judgment is paid at 5% over the Federal Reserve discount rate (including any surcharge) as established from time to time during such period; provided that if at any time before the Court of Chancery of the State of Delaware enters judgment in the appraisal proceeding, the surviving corporation pays to each stockholder entitled to appraisal an amount in cash, interest will accrue after the time of such payment only on the amount that equals the sum of (i) the difference, if any, between the amount so paid and the fair value of the shares as determined by the Court of Chancery of the State of Delaware and (ii) any interest accrued prior to the time of such voluntary payment, unless paid at such time. The surviving corporation is under no obligation to make such voluntary cash payment prior to such entry of judgment. Stockholders considering seeking appraisal should be aware that the fair value of their shares as determined pursuant to Section 262 of the DGCL could be more than, the same as or less than the $190.00 per share consideration payable pursuant to the merger agreement if they did not seek appraisal of their shares.

Under Section 262, where a merger agreement is to be submitted for adoption at a meeting of stockholders, the corporation, not less than 20 days prior to the meeting, must notify each of its stockholders entitled to appraisal rights that appraisal rights are available and include in the notice a copy of Section 262. This proxy statement constitutes Red Hat s notice to stockholders that appraisal rights are available in connection with the merger, and the full text of Section 262 is attached to this proxy statement as Annex D. In connection with the merger, any holder of shares of Red Hat s common stock who wishes to exercise appraisal rights or who wishes to preserve such holder s right to do so should review Annex D carefully. Failure to strictly comply with the requirements of Section 262 in a timely and proper manner will result in the loss of appraisal rights under the DGCL. In addition, the Delaware Court of Chancery will dismiss appraisal proceedings as to all Red Hat stockholders who assert appraisal rights unless (i) the total

number of shares of Red Hat common stock for which appraisal rights have been pursued and perfected exceeds 1% of the outstanding shares of Red Hat common stock

Table of Contents

measured in accordance with subsection (g) of Section 262 of the DGCL or (ii) the value of the aggregate merger consideration in respect of the shares of Red Hat common stock for which appraisal rights have been pursued and perfected exceeds $1 million. Because of the complexity of the procedures for exercising the right to seek appraisal of shares of Red Hat common stock, Red Hat believes that if a stockholder is considering exercising appraisal rights, that stockholder should seek the advice of legal counsel. A stockholder who loses his, her, or its appraisal rights will be entitled to receive the merger consideration as described in the merger agreement upon surrender of the certificates that formerly represented such shares of Red Hat common stock.

Stockholders wishing to exercise the right to seek an appraisal of their shares of Red Hat common stock must fully comply with Section 262, which means doing, among other things, ALL of the following:

- the stockholder must not vote in favor of the merger proposal;
- the stockholder must deliver to Red Hat a written demand for appraisal before the vote on the merger proposal at the special meeting;
- the stockholder must continuously hold the shares from the date of making the demand through the effective time (a stockholder will lose appraisal rights if the stockholder transfers the shares before the effective time); and
- the stockholder or the surviving corporation must file a petition in the Court of Chancery of the State of Delaware requesting a determination of the fair value of the shares within 120 days after the effective time. The surviving corporation is under no obligation to file any petition and has no intention of doing so.

Filing Written Demand

Any holder of shares of Red Hat common stock wishing to exercise appraisal rights must deliver to Red Hat, before the vote on the merger proposal at the special meeting, a written demand for the appraisal of the stockholder s shares, and that stockholder must not vote in favor of the merger proposal either in person or by proxy. A holder of shares of Red Hat common stock exercising appraisal rights must hold of record the shares on the date the written demand for appraisal is made and must continue to hold the shares of record through the effective time. A proxy that is submitted and does not contain voting instructions will, unless revoked, be voted in favor of the merger proposal, and it will cause a stockholder to lose the stockholder s right to appraisal and will nullify any previously delivered written demand for appraisal. Therefore, a stockholder who submits a proxy and who wishes to exercise appraisal rights must submit a proxy containing instructions to vote against the merger proposal or abstain from voting on the merger proposal. However, neither voting against the merger proposal nor abstaining from voting or failing to vote on the merger proposal will, in and of itself, constitute a written demand for appraisal satisfying the requirements of Section 262. The written demand for appraisal must be in addition to and separate from any proxy or vote on the merger proposal. A proxy or vote against the merger proposal will not constitute a demand. A stockholder s failure to make the written demand prior to the taking of the vote on the merger proposal at the special meeting will cause the stockholder to lose its appraisal rights in connection with the merger.

Only a holder of record of shares of Red Hat common stock is entitled to demand appraisal rights for the shares registered in that holder s name. A demand for appraisal in respect of shares of Red Hat common stock should be

executed by or on behalf of the holder of record and must reasonably inform Red Hat of the identity of the holder and state that the person intends thereby to demand appraisal of the holder s shares in connection with the merger. If the shares are owned of record in a fiduciary capacity, such as by a trustee, guardian or custodian, such demand must be executed by or on behalf of the record owner, and if the shares are owned of record by more than one person, such as in a joint tenancy or a tenancy in common, the demand should be executed by or on behalf of all joint owners. An authorized agent, including an authorized agent for two or more joint owners, may execute a demand for appraisal on behalf of a holder of record; however, the agent must identify the record owner or owners and expressly disclose that, in executing the demand, the agent is acting as agent for the record owner or owners.

Table of Contents

STOCKHOLDERS WHO HOLD THEIR SHARES IN BROKERAGE OR BANK ACCOUNTS OR OTHER NOMINEE FORMS, AND WHO WISH TO EXERCISE APPRAISAL RIGHTS, SHOULD CONSULT WITH THEIR BROKERS, BANKS AND OTHER NOMINEES, AS APPLICABLE, TO DETERMINE THE APPROPRIATE PROCEDURES FOR THE BROKER, BANK OR OTHER NOMINEE HOLDER TO MAKE A DEMAND FOR APPRAISAL OF THOSE SHARES. A PERSON HAVING A BENEFICIAL INTEREST IN SHARES HELD OF RECORD IN THE NAME OF ANOTHER PERSON, SUCH AS A BROKER, BANK OR OTHER NOMINEE, MUST ACT PROMPTLY TO CAUSE THE RECORD HOLDER TO FOLLOW PROPERLY AND IN A TIMELY MANNER THE STEPS NECESSARY TO PERFECT APPRAISAL RIGHTS.

All written demands for appraisal pursuant to Section 262 should be mailed or delivered to:

Red Hat, Inc.

Attn: Corporate Secretary

100 East Davie Street

Raleigh, North Carolina 27601

Any holder of shares of Red Hat common stock may withdraw his, her or its demand for appraisal and accept the merger consideration by delivering to Red Hat a written withdrawal of the demand for appraisal within 60 days after the effective date of the merger. However, any such attempt to withdraw the demand made more than 60 days after the effective time will require written approval of the surviving corporation. No appraisal proceeding in the Court of Chancery of the State of Delaware will be dismissed without the approval of such court and such approval may be conditioned upon such terms as the court deems just.

Notice by the Surviving Corporation

If the merger is completed, within 10 days after the effective time, the surviving corporation will notify each holder of shares of Red Hat common stock who has made a written demand for appraisal pursuant to Section 262 and who has not voted in favor of the merger proposal of the date that the merger has become effective.

Filing a Petition for Appraisal

Within 120 days after the effective time, but not thereafter, the surviving corporation or any holder of shares of Red Hat common stock who has complied with Section 262 and is entitled to appraisal rights under Section 262 may commence an appraisal proceeding by filing a petition in the Court of Chancery of the State of Delaware, with a copy served on the surviving corporation in the case of a petition filed by a stockholder, demanding a determination of the fair value of the shares held by all stockholders entitled to appraisal. A beneficial owner of shares held either in a voting trust or by a nominee on behalf of such person may, in such person s own name, file a petition for appraisal. If a petition for appraisal is not timely filed, then the right to an appraisal will cease. The surviving corporation is under no obligation, and has no present intention, to file such a petition, and holders should not assume that the surviving corporation will file a petition or initiate any negotiations with respect to the fair values of shares of Red Hat common stock. Accordingly, any holders of shares of Red Hat common stock who desire to have their shares appraised by the Court of Chancery of the State of Delaware should assume that they will be responsible for filing a petition for appraisal with the Court of Chancery of the State of Delaware in the manner prescribed in Section 262. The failure of a holder of Red Hat common stock to file such a petition for appraisal within the period specified in Section 262 will nullify the stockholder s previous written demand for appraisal.

Within 120 days after the effective time, any holder of shares of Red Hat common stock who has complied with the requirements for the exercise of appraisal rights, or a beneficial owner of shares held either in a voting trust or by a nominee on behalf of such person, will be entitled, upon written request, to receive from the surviving corporation a statement setting forth the aggregate number of shares not voted in favor of the merger

Table of Contents

proposal and with respect to which Red Hat received demands for appraisal, and the aggregate number of holders of such shares. The surviving corporation must mail this statement to the requesting stockholder within 10 days after receipt of the written request for such a statement or within 10 days after the expiration of the period for delivery of demands for appraisal, whichever is later.

If a petition for an appraisal is duly filed by a holder of shares of Red Hat common stock and a copy thereof is served upon the surviving corporation, the surviving corporation will then be obligated within 20 days after such service to file with the Delaware Register in Chancery a duly verified list containing the names and addresses of all stockholders who have demanded payment for their shares and with whom agreements as to the value of their shares have not been reached. After notice to the stockholders as required by the court, the Court of Chancery of the State of Delaware is empowered to conduct a hearing on the petition to determine those stockholders who have complied with Section 262 and who have become entitled to appraisal rights thereunder. The Court of Chancery may require the stockholders who demanded appraisal of their shares to submit their stock certificates to the Register in Chancery for notation thereon of the pendency of the appraisal proceedings, and if any stockholder fails to comply with the direction, the Court of Chancery may dismiss that stockholder from the proceedings.

Determination of Fair Value

After determining the holders of Red Hat common stock entitled to appraisal, the Court of Chancery of the State of Delaware will appraise the fair value of the shares of Red Hat common stock, exclusive of any element of value arising from the accomplishment or expectation of the merger, together with interest, if any, to be paid upon the amount determined to be the fair value. In determining fair value, the Court of Chancery of the State of Delaware will take into account all relevant factors. In *Weinberger v. UOP, Inc.*, the Supreme Court of Delaware discussed the factors that could be considered in determining fair value in an appraisal proceeding, stating that proof of value by any techniques or methods which are generally considered acceptable in the financial community and otherwise admissible in court should be considered, and that [f]air price obviously requires consideration of all relevant factors involving the value of a company. Section 262 provides that fair value is to be exclusive of any element of value arising from the accomplishment or expectation of the merger. In *Cede & Co. v. Technicolor, Inc.*, the Supreme Court of Delaware stated that such exclusion is a narrow exclusion [that] does not encompass known elements of value, but which rather applies only to the speculative elements of value arising from such accomplishment or expectation. In *Weinberger*, the Supreme Court of Delaware also stated that elements of future value, including the nature of the enterprise, which are known or susceptible of proof as of the date of the merger and not the product of speculation, may be considered.

Stockholders considering seeking appraisal should be aware that the fair value of their shares as so determined by the Court of Chancery of the State of Delaware could be more than, the same as or less than the consideration they would receive pursuant to the merger if they did not seek appraisal of their shares and that an opinion of an investment banking firm as to the fairness from a financial point of view of the consideration payable in a merger is not an opinion as to, and does not in any manner address, fair value under Section 262 of the DGCL. Although Red Hat believes that the merger consideration is fair, no representation is made as to the outcome of the appraisal of fair value as determined by the Court of Chancery of the State of Delaware, and stockholders should recognize that such an appraisal could result in a determination of a value higher or lower than, or the same as, the merger consideration. Neither Red Hat nor IBM anticipates offering more than the $190.00 per share consideration to any stockholder of Red Hat exercising appraisal rights. Each of Red Hat and IBM reserves the right to assert, in any appraisal proceeding, that for purposes of Section 262, the fair value of a share of Red Hat common stock is less than the $190.00 per share consideration.

Unless the Court of Chancery of the State of Delaware in its discretion determines otherwise for good cause shown, interest from the effective time through the date of payment of the judgment will be compounded quarterly and will accrue at 5% over the Federal Reserve discount rate (including any surcharge) as established from time to time during the period between the effective time and the date of payment of the judgment;

Table of Contents

provided that if at any time before the Court of Chancery of the State of Delaware enters judgment in the appraisal proceeding, the surviving corporation pays to each stockholder entitled to appraisal an amount in cash, interest will accrue after the time of such payment only on the amount that equals the sum of (i) the difference, if any, between the amount so paid and the fair value of the shares as determined by the Court of Chancery of the State of Delaware and (ii) any interest accrued prior to the time of such voluntary payment, unless paid at such time. The surviving corporation is under no obligation to make such voluntary cash payment prior to such entry of judgment. The costs of the appraisal proceedings (which do not include attorneys fees or the fees and expenses of experts) may be determined by the Court of Chancery of the State of Delaware and taxed upon the parties as the Court of Chancery of the State of Delaware deems equitable under the circumstances. Upon application of a stockholder, the Court of Chancery of the State of Delaware may also order that all or a portion of the expenses incurred by a stockholder in connection with an appraisal, including, without limitation, reasonable attorneys fees and the fees and expenses of experts, be charged pro rata against the value of all the shares entitled to be appraised.

If any stockholder who demands appraisal of his, her or its shares of Red Hat common stock under Section 262 fails to perfect, or loses or successfully withdraws, such holder s right to appraisal, the stockholder s shares of Red Hat common stock will be deemed to have been converted at the effective time into the right to receive the merger consideration less applicable withholding taxes. A stockholder will fail to perfect, or effectively lose or withdraw, the holder s right to appraisal if no petition for appraisal is filed within 120 days after the effective time or if the stockholder delivers to the surviving corporation a written withdrawal of the holder s demand for appraisal and an acceptance of the merger consideration in accordance with Section 262.

From and after the effective time, no stockholder who has demanded appraisal rights will be entitled to vote Red Hat common stock for any purpose, or to receive payment of dividends or other distributions on the stock, except dividends or other distributions on the holder s shares of Red Hat common stock, if any, payable to stockholders of Red Hat of record as of a time prior to the effective time; provided, however, that if no petition for an appraisal is filed, or if the stockholder delivers to the surviving corporation a written withdrawal of the demand for an appraisal and an acceptance of the merger, either within 60 days after the effective time or thereafter with the written approval of the corporation, then the right of such stockholder to an appraisal will cease. Once a petition for appraisal is filed with the Court of Chancery of the State of Delaware, however, the appraisal proceeding may not be dismissed as to any stockholder of Red Hat without the approval of the court.

Failure to comply strictly with all of the procedures set forth in Section 262 may result in the loss of a stockholder s statutory appraisal rights. Consequently, any stockholder of Red Hat wishing to exercise appraisal rights is encouraged to consult legal counsel before attempting to exercise those rights.

Table of Contents

FUTURE STOCKHOLDER PROPOSALS

If the merger is completed, we will have no public stockholders and there will be no public participation in any of our future stockholder meetings. However, if the merger is not completed, Red Hat s stockholders will continue to be entitled to attend and participate in future Annual Meetings of Stockholders when held. Red Hat will hold an Annual Meeting of Stockholders in 2019 only if the merger has not already been completed, which we refer to as the 2019 annual meeting.

If the 2019 annual meeting is held, stockholders may submit proposals for consideration at our 2019 annual meeting of stockholders. To be considered for inclusion in next year s proxy statement, your proposal must be submitted in accordance with the SEC s Rule 14a-8 and must be received by our Corporate Secretary at our principal executive offices no later than February 28, 2019.

Our By-Laws require that we be given advance written notice for nominations for directors and proposals of business that you wish to submit for consideration at our 2019 annual meeting other than those intended to be included in next year s proxy statement under SEC Rule 14a-8. Written notice consistent with our By-Laws must be delivered to our Corporate Secretary no later than the close of business on April 11, 2019, nor earlier than March 12, 2019. However, if the date of our 2019 annual meeting is more than 30 days before or more than 60 days after the anniversary of the date of the 2018 Annual Meeting of Stockholders, your notice will be timely if it is received not earlier than the 90th day prior to the date of our 2019 annual meeting and not later than the close of business on the later of (i) the 60th day prior to the date of our 2019 annual meeting or (ii) the 10th day following the day on which public announcement of the date of our 2019 annual meeting is first made.

All matters submitted must comply with the applicable requirements or conditions established by the SEC and our By-Laws. Any proposals of business or nominations should be addressed to: Red Hat, Inc., 100 East Davie Street, Raleigh, North Carolina, 27601, Attn: Corporate Secretary.

Table of Contents

HOUSEHOLDING INFORMATION

The SEC has adopted rules that permit companies and intermediaries such as brokers to satisfy delivery requirements for proxy statements and annual reports with respect to two or more stockholder sharing the same address by delivering a single proxy statement or annual report, as applicable, addressed to those stockholders. As permitted by the Exchange Act, only one copy of this proxy statement is being delivered to stockholders residing at the same address, unless stockholders have notified the company whose shares they hold of their desire to receive multiple copies of this proxy statement. This process, which is commonly referred to as householding potentially provides extra convenience for stockholders and cost savings for companies. If, at any time, you no longer wish to participate in householding and would prefer to receive a separate proxy statement, or if you are receiving multiple copies of this proxy statement and wish to receive only one, please contact Red Hat at the address identified below. Red Hat will promptly deliver, upon oral or written request, a separate copy of this proxy statement to any stockholder residing at an address to which only one copy was mailed. Requests for additional copies should be directed to Red Hat at its address below.

Red Hat, Inc.

Attn: Investor Relations

100 East Davie Street

Raleigh, North Carolina 27601

(919) 754-3700

Table of Contents

WHERE YOU CAN FIND MORE INFORMATION

We file annual, quarterly and current reports, proxy statements and other documents with the SEC under the Exchange Act. Our SEC filings are available to the public over the Internet at the SEC s website at www.sec.gov. In addition, stockholders may obtain free copies of the documents filed with the SEC by Red Hat through the Investor Relations section of our website at https://investors.redhat.com. The information on our website is not, and will not be deemed to be, a part hereof or incorporated into this or any other filings with the SEC.

The SEC allows us to incorporate by reference information into this proxy statement, which means that we can disclose important information to you by referring you to other documents filed separately with the SEC. The information incorporated by reference is deemed to be part of this proxy statement, except for any information superseded by information in this proxy statement or incorporated by reference subsequent to the date of this proxy statement. This proxy statement incorporates by reference the documents set forth below that we have previously filed with the SEC. These documents contain important information about us and our financial condition and are incorporated by reference into this proxy statement.

The following Red Hat filings with the SEC are incorporated by reference:

- Red Hat s Annual Report on Form 10-K for the fiscal year ended February 28, 2018, filed with the SEC on April, 26, 2018;
- Red Hat s Quarterly Reports on Form 10-Q for the fiscal quarter ended August 31, 2018, filed with the SEC on October 9, 2018 and for the fiscal quarter ended May 31, 2018, filed with the SEC on July 9, 2018;
- Red Hat s Definitive Proxy Statement on Schedule 14A, as supplemented, filed with the SEC on June 25, 2018; and
- Red Hat s Current Reports on Form 8-K filed with the SEC on December 10, 2018; October 29, 2018; September 20, 2018; August 10, 2018; June 21, 2018 (Film No. 18912054); May 10, 2018; and May 7, 2018 (other than the portions of such documents not deemed to be filed).

We also incorporate by reference into this proxy statement each additional document we may file under Sections 13(a), 13(c), 14 or 15(d) of the Exchange Act between the date of this proxy statement and the earlier of the date of the special meeting or the termination of the merger agreement. These documents include periodic reports, such as Annual Reports on Form 10-K and Quarterly Reports on Form 10-Q, as well as Current Reports on Form 8-K (other than current reports on Form 8-K furnished pursuant to Item 2.02 or Item 7.01 of Form 8-K, including any exhibits included with such information, unless otherwise indicated therein) and proxy solicitation materials. The information provided on our website is not part of this proxy statement, and therefore is not incorporated by reference herein.

You may obtain any of the documents we file with the SEC, by requesting them in writing or by telephone from us at the following address:

Red Hat, Inc.

Attn: Corporate Secretary

100 East Davie Street

Raleigh, North Carolina 27601

(919) 754-3700

If you would like to request documents from us, please do so by January 4, 2019, to receive them before the special meeting. If you request any documents from us, we will mail them to you by first class mail, or another equally prompt method, within one business day after we receive your request.

Table of Contents

If you have any questions about this proxy statement, the special meeting or the merger or need assistance with voting procedures, you should contact:

Innisfree M&A Incorporated

501 Madison Avenue, 20th Floor

New York, New York 10022

Toll-free: (888) 750-5835

Banks & Brokers may call collect: (212) 750-5833

Table of Contents

MISCELLANEOUS

IBM has supplied, and Red Hat has not independently verified, all of the information relating to IBM and Sub in this proxy statement exclusively concerning IBM and Sub.

You should rely only on the information contained in this proxy statement, the annexes to this proxy statement and the documents we refer to in this proxy statement to vote on the merger. We have not authorized anyone to provide you with information that is different from what is contained in this proxy statement. This proxy statement is dated December 12, 2018. You should not assume that the information contained in this proxy statement is accurate as of any date other than that date (or as of an earlier date if so indicated in this proxy statement) and the mailing of this proxy statement to stockholders does not create any implication to the contrary. This proxy statement does not constitute a solicitation of a proxy in any jurisdiction where, or to or from any person to whom, it is unlawful to make a proxy solicitation.

Table of Contents

ANNEX A

AGREEMENT AND PLAN OF MERGER

by and among

INTERNATIONAL BUSINESS MACHINES CORPORATION

SOCRATES ACQUISITION CORP.

and

RED HAT, INC.

Dated as of October 28, 2018

Table of Contents

TABLE OF CONTENTS

		Page
	ARTICLE I	
	THE MERGER	
Section 1.01	The Merger	A-1
Section 1.02	Closing	A-1
Section 1.03	Effective Time of the Merger	A-2
Section 1.04	Effects of the Merger	A-2
Section 1.05	Certificate of Incorporation and Bylaws	A-2
Section 1.06	Directors	A-2
Section 1.07	Officers	A-2
	ARTICLE II	
	CONVERSION OF SECURITIES	
Section 2.01	Conversion of Capital Stock	A-3
Section 2.02	Exchange of Certificates	A-4
	ARTICLE III	
	REPRESENTATIONS AND WARRANTIES	
Section 3.01	Representations and Warranties of the Company	A-6
Section 3.02	Representations and Warranties of Parent and Sub	A-22
	ARTICLE IV	
	COVENANTS RELATING TO CONDUCT OF BUSINESS	
Section 4.01	Conduct of Business	A-25
Section 4.02	No Solicitation	A-28
	ARTICLE V	
	ADDITIONAL AGREEMENTS	
Section 5.01	Preparation of the Proxy Statement; Shareholders Meeting	A-32
Section 5.02	Access to Information; Confidentiality	A-33
Section 5.03	Reasonable Best Efforts; Consultation and Notice	A-34
Section 5.04	Equity Awards	A-37
Section 5.05	Indemnification, Exculpation and Insurance	A-40
Section 5.06	Fees and Expenses	A-41
Section 5.07	Public Announcements	A-42
Section 5.08	Sub Compliance	A-42
Section 5.09	Stock Exchange Delisting; Deregistration	A-42
Section 5.10	Convertible Notes; Call Options and Warrants	A-42
Section 5.11	Employee Matters	A-44
Section 5.12	Restructuring	A-46
	ARTICLE VI	

CONDITIONS PRECEDENT

Section 6.01 Conditions to Each Party s Obligation to Effect the Merger A-46
Section 6.02 Conditions to Obligations of Parent and Sub A-47
Section 6.03 Conditions to Obligation of the Company A-47
Section 6.04 Frustration of Closing Conditions A-48

Table of Contents

		Page
	ARTICLE VII	
	TERMINATION, AMENDMENT AND WAIVER	
Section 7.01	Termination	A-48
Section 7.02	Effect of Termination	A-49
Section 7.03	Amendment	A-50
Section 7.04	Extension; Waiver	A-50
	ARTICLE VIII	
	GENERAL PROVISIONS	
Section 8.01	Nonsurvival of Representations and Warranties	A-50
Section 8.02	Notices	A-51
Section 8.03	Definitions	A-52
Section 8.04	Exhibits; Interpretation	A-55
Section 8.05	Counterparts	A-55
Section 8.06	Entire Agreement; No Third-Party Beneficiaries	A-55
Section 8.07	Governing Law	A-56
Section 8.08	Assignment	A-56
Section 8.09	Consent to Jurisdiction; Service of Process; Venue	A-56
Section 8.10	Waiver of Jury Trial	A-56
Section 8.11	Enforcement	A-57
Section 8.12	Severability	A-57

Table of Contents

GLOSSARY

Term	Section
Acquisition Agreement	4.02(b)
Adverse Recommendation Change	4.02(c)
affiliate	8.03(a)
Agreement	Preamble
Alternative Arrangements	5.10(d)
Anti-Corruption Laws	3.01(q)(iv)(A)
Antitrust Counsel Only Material	5.03(a)(v)
Antitrust Laws	5.03(a)(v)
Assumed Shares	5.04(a)(x)
Bankruptcy Exceptions	3.01(d)(i)
Baseline Financials	3.01(e)(iii)
Benefit Agreement	8.03(b)
Benefit Plan	8.03(c)
Burdensome Condition	5.03(a)(iii)
Business Day	8.03(d)
Call Options	8.03(e)
Canceled Shares	2.01(b)(i)
Capitalization Date	3.01(c)(i)
Cash Bonus Plans	5.11(d)
Cash-Out PSU	5.04(a)(xi)
Cash-Out Restricted Share	5.04(a)(xi)
Cash-Out RSU	5.04(a)(xi)
Cash-Out Stock Option	5.04(a)(xi)
Certificate	2.01(c)
Certificate of Merger	1.03
Chosen Courts	8.09
Closing	1.02
Closing Date	1.02
Code	2.02(f)
Commitment Letter	3.02(d)
Commonly Controlled Entity	8.03(f)
Company	Preamble
Company Board	Recitals
Company Board Recommendation	3.01(d)(ii)
Company Bylaws	3.01(a)
Company Charter	3.01(a)
Company Common Stock	Recitals
Company Letter	3.01
Company Personnel	8.03(g)
Company Preferred Stock	3.01(c)(i)
Company Representatives	4.02(b)
Company SEC Documents	3.01(e)(i)
Company Shareholder	2.01(d)(i)

Company Stock Plans	3.01(c)(i)
Confidentiality Agreement	4.02(b)
Continuation Period	5.11(a)
Continuing Employees	5.11(a)
Contract	8.03(h)
Convertible Notes	8.03(i)

Table of Contents

Term	Section
Damages	7.02
Delaware Secretary of State	1.03
DGCL	Recitals
Dissenting Shares	2.01(d)(i)
DOJ	5.03(a)(v)
DSUs	3.01(c)(i)
Economic Sanctions/Trade Laws	3.01(q)(iv)(B)
Effect	8.03(l)
Effective Time	1.03
Electronic Delivery	8.05
Environmental Law	3.01(j)
Equity Equivalents	3.01(c)(ii)
ERISA	3.01(l)(i)
ESPP	3.01(c)(i)
Exchange Act	3.01(d)(iv)
Exchange Ratio	5.04(a)(xi)
Fee Letter	3.02(d)
Filed SEC Document	3.01
Financing Sources	8.11
Firmware	3.01(o)(ii)
First Extended Termination Date	7.01(b)(i)
FOSS	3.01(o)(ii)
FTC	5.03(a)(v)
GAAP	3.01(e)(ii)
Government Official	3.01(q)(i)
Governmental Entity	3.01(d)(iv)
Hedge Counterparty	5.10(d)
HSR Act	3.01(d)(iv)
Indebtedness	8.03(j)
Initial Termination Date	7.01(b)(i)
Intellectual Property	3.01(o)(ii)
Intervening Event	4.02(d)
Intervening Event Notice	4.02(d)(i)
Intervening Event Notice Period	4.02(d)(i)
IRS	3.01(l)(ii)
Judgment	3.01(d)(iii)
knowledge	8.03(k)
Law	3.01(d)(iii)
Lease	3.01(n)(ii)
Leased Real Property	3.01(n)(ii)
Legal Proceedings	3.01(g)
Legal Restraints	6.01(c)
Lenders	3.02(d)
Liens	3.01(b)
Material Adverse Effect	8.03(l)
Material Contracts	3.01(h)(i)(M)
Merger	Preamble

Merger Consideration	2.01(c)
Money Laundering Laws	3.01(q)(iv)(C)
Multiemployer Plan	3.01(l)(iii)
Neutral Platform Model	Recitals

Table of Contents

Term	Section
Notes Indenture	5.10(a)
OFAC	3.01(q)(iv)(B)
Parent	Preamble
Parent Common Stock	5.04(a)(ii)
Parent Letter	3.02
Paying Agent	2.02(a)
Pension Plan	3.01(l)(i)
Permits	3.01(i)
Permitted Liens	3.01(n)(i)
person	8.03(m)
Personal Data	3.01(o)(ii)
Proxy Statement	3.01(d)(iv)
PSU Share Number	5.04(a)(xi)
PSUs	3.01(c)(i)
Repurchase Transaction	5.10(c)
Residual Shares	5.04(a)(x)
Restricted Shares	3.01(c)(i)
Rollover PSU	5.04(a)(xi)
Rollover Restricted Share	5.04(a)(xi)
Rollover RSU	5.04(a)(xi)
Rollover Stock Option	5.04(a)(xi)
RSUs	3.01(c)(i)
Sanctions Target	3.01(q)(iv)(D)
SEC	3.01
Second Extended Termination Date	7.01(b)(i)
Securities Act	3.01(e)(i)
Shareholder Approval	3.01(s)
Shareholders Meeting	5.01(c)
Software	3.01(o)(ii)
Stock Options	3.01(c)(i)
Sub	Preamble
Subsidiary	8.03(n)
Subsidiary Converted Shares	2.01(b)(ii)
Superior Proposal	4.02(b)
Superior Proposal Notice	4.02(c)(i)
Superior Proposal Notice Period	4.02(c)(i)
Surviving Corporation	1.01
Takeover Proposal	4.02(b)
tax return	3.01(m)(i)
taxes	3.01(m)(i)
taxing authority	3.01(m)(i)
Termination Date	7.01(b)(i)
Termination Fee	5.06(b)
Third Party Software	3.01(o)(ii)
Trademarks	3.01(o)(ii)
Transaction Litigation	5.03(c)
Trustee	5.10(a)

Warrants	8.03(o)
Welfare Plan	3.01(l)(iv)
Willful Breach	8.03(p)

Table of Contents

AGREEMENT AND PLAN OF MERGER dated as of October 28, 2018 (this "Agreement"), by and among INTERNATIONAL BUSINESS MACHINES CORPORATION, a New York corporation ("Parent"), SOCRATES ACQUISITION CORP., a Delaware corporation and a wholly owned subsidiary of Parent ("Sub"), and RED HAT, INC., a Delaware corporation (the "Company").

WHEREAS, the parties intend that, on the terms and subject to the conditions set forth in this Agreement, Sub shall merge with and into the Company (the "Merger"), with the Company surviving the Merger, pursuant to and in accordance with the provisions of the Delaware General Corporation Law (the "DGCL");

WHEREAS, the board of directors of Parent has unanimously approved and declared advisable this Agreement, the Merger and the other transactions contemplated by this Agreement;

WHEREAS, the board of directors of Sub has unanimously approved and declared advisable this Agreement, the Merger and the other transactions contemplated by this Agreement and recommended that this Agreement be adopted by Parent, as the sole shareholder of Sub;

WHEREAS, the board of directors of the Company (the "Company Board") has unanimously (a) approved and declared advisable this Agreement, the Merger and the other transactions contemplated by this Agreement, (b) declared that it is in the best interests of the Company that the Company enter into this Agreement and consummate the Merger and the other transactions contemplated by this Agreement on the terms and subject to the conditions set forth in this Agreement, (c) directed that the adoption of this Agreement be submitted to a vote at a meeting of the Company Shareholders and (d) recommended that this Agreement be adopted by the holders of shares of common stock, par value $0.0001 per share, of the Company (the "Company Common Stock");

WHEREAS, it is the intention of the parties that, following the Effective Time, the Company shall remain an open and neutral platform, partnering broadly with information technology participants (the "Neutral Platform Model") and continuing to support the open source community; and

WHEREAS Parent, Sub and the Company desire to make certain representations, warranties, covenants and agreements in connection with the Merger and also to prescribe various conditions to the Merger.

NOW, THEREFORE, in consideration of the foregoing and the respective representations, warranties, covenants and agreements set forth herein, the parties hereto agree as follows:

ARTICLE I

THE MERGER

Section 1.01 The Merger. Upon the terms and subject to the conditions set forth in this Agreement, and in accordance with the applicable provisions of the DGCL, Sub shall be merged with and into the Company at the Effective Time. At the Effective Time, the separate corporate existence of Sub shall cease and the Company shall continue as the surviving corporation (the "Surviving Corporation") and a wholly owned subsidiary of Parent.

Section 1.02 Closing. The closing of the Merger (the "Closing") will take place at 7:45 a.m., New York time, on a date to be specified by the parties, which shall be not later than the fourth Business Day after satisfaction or (to the extent permitted by applicable Law) waiver of the conditions set forth in Article VI (other than those that by their terms are to be satisfied or waived at the Closing; it being understood that the occurrence of the Closing shall remain subject to the satisfaction or (to the extent permitted by applicable Law) waiver of such conditions at the Closing), at the offices

of Paul, Weiss, Rifkind, Wharton & Garrison LLP, 1285 Avenue of the Americas, New York, New York 10019, or remotely by exchange of documents and signatures (or their electronic counterparts), unless another time, date or place is agreed to in writing by Parent and the Company. The date on which the Closing occurs is referred to in this Agreement as the Closing Date.

Table of Contents

Section 1.03 Effective Time of the Merger. Upon the terms and subject to the conditions set forth in this Agreement, as soon as practicable on the Closing Date, the parties shall properly file with the Secretary of State of the State of Delaware (the Delaware Secretary of State) a certificate of merger in customary form and substance (the Certificate of Merger) in accordance with the relevant provisions of the DGCL. The Merger shall become effective at such date and time as the Certificate of Merger is duly filed with the Delaware Secretary of State or, to the extent permitted by applicable Law, at such subsequent date and time as Parent and the Company shall agree and specify in the Certificate of Merger. The date and time at which the Merger becomes effective is referred to in this Agreement as the Effective Time.

Section 1.04 Effects of the Merger. The effects of the Merger shall be as provided in this Agreement and the applicable provisions of the DGCL. Without limiting the generality of the foregoing, and subject thereto, at the Effective Time all of the property, rights, privileges, powers and franchises of the Company and Sub shall vest in the Surviving Corporation, and all debts, liabilities and duties of the Company and Sub shall become the debts, liabilities and duties of the Surviving Corporation.

Section 1.05 Certificate of Incorporation and Bylaws.

(a) At the Effective Time, the Company Charter shall be amended and restated in its entirety to be the certificate of incorporation of Sub as in effect immediately prior to the Effective Time, except that (i) all references therein to Sub s name, date of incorporation, registered office and registered agent shall be automatically amended and shall become references to the name, date of incorporation, registered office and registered agent of the Company as provided in the Company Charter immediately prior to the Effective Time, (ii) the provisions of the certificate of incorporation relating to the incorporator of Sub shall be omitted, and (iii) changes necessary so that the certificate of incorporation shall be in compliance with Section 5.05 shall have been made, and such amended and restated certificate of incorporation shall become the certificate of incorporation of the Surviving Corporation until thereafter amended in accordance with the applicable provisions of the DGCL and such certificate of incorporation.

(b) At the Effective Time, the Company Bylaws shall be amended and restated in its entirety to be the bylaws of Sub as in effect immediately prior to the Effective Time, except that (i) all references therein to Sub shall be automatically amended and shall become references to the Surviving Corporation and (ii) changes necessary so that the bylaws shall be in compliance with Section 5.05 shall have been made, and such amended and restated bylaws shall become the bylaws of the Surviving Corporation until thereafter amended in accordance with the applicable provisions of the DGCL, the certificate of incorporation of the Surviving Corporation and such bylaws.

Section 1.06 Directors. The directors of Sub immediately prior to the Effective Time shall be the initial directors of the Surviving Corporation until the earlier of their resignation or removal or until their respective successors are duly elected and qualified, as the case may be.

Section 1.07 Officers. The officers of the Company immediately prior to the Effective Time shall be the officers of the Surviving Corporation until the earlier of their resignation or removal or until their respective successors are duly elected and qualified, as the case may be.

Table of Contents

ARTICLE II

CONVERSION OF SECURITIES

Section 2.01 Conversion of Capital Stock. At the Effective Time, by virtue of the Merger and without any action on the part of the holder of any shares of the Company Common Stock or the holder of any shares of capital stock of Sub:

(a) Capital Stock of Sub. Each issued and outstanding share of common stock, par value $0.0001 per share, of Sub shall be converted into and become one fully paid and nonassessable share of common stock, par value $0.0001 per share, of the Surviving Corporation.

(b) Cancelation of Treasury Stock and Parent-Owned Stock; Conversion of Company Common Stock Owned by any Subsidiary of the Company.

(i) All shares of Company Common Stock that are owned directly by the Company, including any shares of Company Common Stock held as treasury stock, or owned by Parent or Sub immediately prior to the Effective Time (collectively, Canceled Shares) shall automatically be canceled and shall cease to exist, and no consideration shall be delivered or deliverable in exchange therefor.

(ii) All shares of Company Common Stock that are owned by any direct or indirect wholly owned Subsidiary of the Company or Parent (other than Sub) immediately prior to the Effective Time (collectively, Subsidiary Converted Shares) shall be converted into such number of fully paid and nonassessable shares of common stock, par value $0.0001 per share, of the Surviving Corporation, such that each such direct or indirect wholly owned Subsidiary that owned capital stock in the Company immediately prior to the Effective Time shall own the same percentage of the outstanding capital stock of the Surviving Corporation immediately following the Effective Time, and any such shares of Company Common Stock shall automatically be canceled and shall cease to exist, and no other consideration shall be delivered or deliverable in exchange therefor.

(c) Conversion of Company Common Stock. Each share of Company Common Stock issued and outstanding immediately prior to the Effective Time (other than (i) Canceled Shares, (ii) Dissenting Shares, and (iii) Subsidiary Converted Shares) shall be converted into the right to receive $190.00 in cash, without interest (the Merger Consideration). At the Effective Time, such shares shall no longer be outstanding and shall automatically be canceled and shall cease to exist, and each holder of a certificate or evidence of shares in book-entry form that immediately prior to the Effective Time represented any such shares (a Certificate) shall cease to have any rights with respect thereto, except the right to receive the Merger Consideration in accordance with the terms of this Agreement.

(d) Statutory Right of Appraisal.

(i) Notwithstanding anything to the contrary set forth in this Agreement, all shares of Company Common Stock that are issued and outstanding immediately prior to the Effective Time (other than Canceled Shares and Subsidiary Converted Shares), and which are held by a holder of shares of Company Common Stock (a Company Shareholder) who has neither voted in favor of adoption of this Agreement nor consented thereto in writing and who has properly and validly exercised its statutory rights of appraisal in respect of such shares of Company Common Stock in accordance with Section 262 of the DGCL (such shares being referred to collectively as the Dissenting Shares until such time as such holder fails to perfect, withdraws or otherwise loses such holder s appraisal rights under the Laws of the State of Delaware with respect to such shares) shall not be converted into, or represent a right to receive, the Merger Consideration pursuant to this Section 2.01. Such Company Shareholders shall be entitled to receive payment of the appraised value of such Dissenting Shares to the extent afforded by Section 262 of the DGCL (in such case, the

Dissenting Shares shall no longer be outstanding and shall automatically be canceled and cease to exist, and each holder of Dissenting

Shares shall cease to have any rights with regard thereto except with regard to such holders right to receive the fair value of such Dissenting Shares to the extent afforded by Section 262 of the DGCL); provided, however, that if, after the Effective Time, such holder fails to perfect, withdraws or otherwise loses such holder s right to appraisal pursuant to Section 262 of the DGCL, or if a court of competent jurisdiction shall determine that such holder is not entitled to the relief provided by Section 262 of the DGCL, such shares of Company Common Stock shall be treated as if they had been converted as of the Effective Time into the right to receive the Merger Consideration in accordance with this Section 2.01, without interest thereon, upon surrender of such Certificate that formerly represented such shares of Company Common Stock in accordance with the terms of Section 2.02.

(ii) The Company shall provide Parent prompt written notice of any demands received by the Company for appraisal of shares of Company Common Stock (or written threats thereof), any written withdrawal or purported withdrawal of any such demand and any other demand, notice or instrument delivered to the Company prior to the Effective Time pursuant to the Laws of the State of Delaware that relates to such demand, and Parent shall have the opportunity and right to participate in and direct all negotiations and any litigation, suit, action or other proceeding with respect to such demands. Except with the prior written consent of Parent, the Company shall not make any payment with respect to, or offer to settle or settle, or approve the withdrawal of, any such demands or agree to do any of the foregoing.

Section 2.02 Exchange of Certificates.

(a) Paying Agent. Prior to the Effective Time, Parent shall designate a bank or trust company reasonably acceptable to the Company to act as agent for the payment of the Merger Consideration upon surrender of Certificates (the Paying Agent). No later than substantially concurrently with the Effective Time, Parent shall deposit, or shall cause to be deposited, with the Paying Agent funds in an amount necessary for the payment of the Merger Consideration pursuant to Section 2.01(c) upon surrender of Certificates; it being understood that all such funds shall be invested as directed by Parent and that any and all interest or other amounts earned with respect to funds made available to the Paying Agent pursuant to this Agreement shall be turned over to Parent.

(b) Exchange Procedures. As soon as reasonably practicable after the Effective Time and in any event within five Business Days following the Closing Date, the Surviving Corporation or Parent shall cause the Paying Agent to mail to each holder of record of a Certificate whose shares of Company Common Stock were converted into the right to receive the Merger Consideration pursuant to Section 2.01(c), (i) a form of letter of transmittal (which shall include an accompanying IRS Form W-9 or the applicable IRS Form W-8, shall specify that delivery shall be effected and risk of loss and title to the Certificates held by such person shall pass only upon proper delivery of the Certificates to the Paying Agent, and shall be in a form and have such other provisions (including customary provisions regarding delivery of an agent s message with respect to shares held in book-entry form) as Parent may reasonably specify) and (ii) instructions for use in effecting the surrender of the Certificates in exchange for the Merger Consideration. Upon surrender of a Certificate for cancelation to the Paying Agent or to such other agent or agents as may be appointed by Parent, together with such letter of transmittal, duly completed and validly executed, and such other documents as may reasonably be required by the Paying Agent, the holder of such Certificate shall be entitled to receive in exchange therefor the amount of cash equal to the Merger Consideration that such holder has the right to receive pursuant to Section 2.01(c), and the Certificate so surrendered shall forthwith be canceled. In the event of a transfer of ownership of Company Common Stock that is not registered in the stock transfer books of the Company, payment of the Merger Consideration in exchange therefor may be made to a person other than the person in whose name the Certificate so surrendered is registered, if such Certificate shall be properly endorsed or otherwise be in proper form for transfer, and the person requesting such payment shall pay any transfer or other taxes required by reason of the payment to a person other than the registered holder of such Certificate or establish to the satisfaction of the Surviving Corporation that such tax has been paid or is not applicable. No interest shall be paid or shall accrue on the cash payable upon surrender of any Certificate.

(c) No Further Ownership Rights in Company Common Stock. All Merger Consideration paid upon the surrender of a Certificate in accordance with the terms of this Article II shall be deemed to have been paid in full satisfaction of all rights pertaining to the shares of Company Common Stock formerly represented by such Certificate. At the close of business on the day on which the Effective Time occurs, the stock transfer books of the Company shall be closed, and there shall be no further registration of transfers on the stock transfer books of the Surviving Corporation of the shares that were outstanding immediately prior to the Effective Time. If, after the close of business on the day on which the Effective Time occurs, Certificates are presented to the Surviving Corporation or the Paying Agent for transfer or any other reason, they shall be canceled and exchanged as provided in this Article II.

(d) No Liability. None of Parent, Sub, the Company, the Surviving Corporation or the Paying Agent shall be liable to any person in respect of any Merger Consideration that would otherwise have been payable in respect of any Certificate which is delivered to a public official in accordance with any applicable abandoned property, escheat or similar Law. If any Certificates shall not have been surrendered prior to two years after the Effective Time (or immediately prior to such earlier date on which any Merger Consideration would otherwise escheat to or become the property of any Governmental Entity), any Merger Consideration payable in accordance with this Article II in respect thereof shall, to the extent permitted by applicable Law, become the property of the Surviving Corporation, free and clear of all claims or interest of any person previously entitled thereto.

(e) Lost Certificates. If any Certificate shall have been lost, stolen, defaced or destroyed, upon the making of an affidavit of that fact by the person claiming such Certificate to be lost, stolen, defaced or destroyed and, if required by the Surviving Corporation, the posting by such person of a bond in such amount as the Surviving Corporation may direct as indemnity against any claim that may be made against it with respect to such Certificate, the Paying Agent or the Surviving Corporation, as the case may be, shall pay the Merger Consideration in respect of such lost, stolen, defaced or destroyed Certificate.

(f) Withholding Rights. Parent, the Company, the Surviving Corporation and the Paying Agent shall be entitled to deduct and withhold from the Merger Consideration and any other amounts payable pursuant to this Agreement (including amounts payable to any holder of shares of Company Common Stock, Stock Options, Restricted Shares, RSUs, PSUs or DSUs) such amounts as are required to be deducted and withheld with respect to the making of such payment under the Internal Revenue Code of 1986, as amended (the Code), or any provision of state, local or foreign tax Law. To the extent that amounts are so deducted and withheld and paid over to the appropriate taxing authority, such amounts shall be treated for all purposes of this Agreement as having been paid to the person in respect of which such deduction and withholding was made.

(g) Termination of Fund. At any time following the one year anniversary of the Closing Date, the Surviving Corporation shall be entitled to require the Paying Agent to deliver to it any funds (including any interest received with respect thereto) that had been made available to the Paying Agent pursuant to Section 2.02(a) and that have not been disbursed to holders of Certificates, and, thereafter, subject to time limitations in Section 2.02(d), such holders shall be entitled to look only to Parent and the Surviving Corporation (subject to abandoned property, escheat or other similar Laws) as general creditors thereof with respect to the payment of any Merger Consideration that may be payable upon surrender of any Certificates held by such holders, as determined pursuant to this Agreement, without any interest thereon.

(h) Necessary Further Actions. If, at any time after the Effective Time, any further action is necessary or desirable to carry out the purposes of this Agreement and to vest the Surviving Corporation with full right, title and possession to all assets, property, rights, privileges, powers and franchises of the Company and Sub, then the directors and officers of the Company and Sub as of immediately prior to the Effective Time will take all such lawful and necessary action.

(i) Adjustment to Merger Consideration. If, during the period between the date of this Agreement and the Effective Time, any change in the outstanding shares of Company Common Stock occurs as a result of any

Table of Contents

reclassification, recapitalization, stock split (including reverse stock split) or combination, exchange or readjustment of shares, or any stock dividend, or any record date for any such purpose is established, the Merger Consideration and any other amounts payable pursuant to this Agreement will be appropriately adjusted; provided, however, that nothing in this Section 2.02(i) shall be construed to permit the Company to take any action that is otherwise prohibited by the terms of this Agreement.

ARTICLE III

REPRESENTATIONS AND WARRANTIES

Section 3.01 Representations and Warranties of the Company. Except (i) to the extent disclosed in publicly available Company SEC Documents filed by the Company with the United States Securities and Exchange Commission (the SEC) or furnished by the Company to the SEC, in each case, on or after March 1, 2016, and prior to the date of this Agreement (a Filed SEC Document) (other than any disclosures contained or referenced therein under the captions Risk Factors, Forward-Looking Statements, Quantitative and Qualitative Disclosures About Market Risk and any other disclosures contained or referenced therein of information, factors or risks, in each case, that are predictive, cautionary or forward-looking in nature) (it being understood that this clause (i) will not apply to any of Section 3.01(a), Section 3.01(c), Section 3.01(d) or Section 3.01(s)) or (ii) as set forth in the letter delivered by the Company to Parent prior to the execution of this Agreement (the Company Letter), the Company represents and warrants to Parent and Sub as follows:

(a) Organization, Standing and Corporate Power. Each of the Company and its Subsidiaries (i) is a corporation or other legal entity duly organized, validly existing and in good standing under the Laws of the jurisdiction of its organization (except, in the case of good standing, for entities organized under the Laws of any jurisdiction that does not recognize such concept), (ii) has all requisite corporate, company, partnership or other organizational power and authority to carry on its business as currently conducted and (iii) is duly qualified or licensed to do business and is in good standing in each jurisdiction (except, in the case of good standing, any jurisdiction that does not recognize such concept) in which the nature of its business or the ownership, leasing or operation of its properties makes such qualification or licensing necessary, other than where the failure to be so organized, existing, qualified or licensed or in good standing (except, in the case of clause (i) above, with respect to the Company) would not reasonably be expected to have, individually or in the aggregate, a Material Adverse Effect. The copies of the certificate of incorporation of the Company, as amended to the date of this Agreement (the Company Charter), and the bylaws of the Company, as amended to the date of this Agreement (the Company Bylaws), in each case as most recently filed with a Filed SEC Document are, in each case, complete and correct copies of such documents. The Company Charter and the Company Bylaws are in full force and effect as of the date of the Agreement.

(b) Subsidiaries. Section 3.01(b) of the Company Letter sets forth a complete and correct list of the name and jurisdiction of organization of each significant subsidiary (as defined by Rule 1-02(w) of Regulation S-X promulgated by the SEC). All the outstanding shares of capital stock of, or other equity or voting interests in, each material Subsidiary of the Company are owned by the Company, by one or more wholly owned Subsidiaries of the Company or by the Company and one or more wholly owned Subsidiaries of the Company, free and clear of all pledges, claims, liens, charges, options, security interests, licenses or other encumbrances of any kind or nature whatsoever (collectively, Liens), except for transfer restrictions imposed by applicable securities Laws, and except as would not be material to the Company and its Subsidiaries, taken as a whole, are duly authorized, validly issued, fully paid and nonassessable. Except for the capital stock of, or other equity or voting interests in, its Subsidiaries, the Company does not own, directly or indirectly, any capital stock of, or other equity or voting interests in, any person. Neither the Company nor any of its Subsidiaries is a party to any partnership, joint venture or limited liability company agreement (other than any such agreement solely between or among the Company and its wholly owned Subsidiaries) that is

material to the Company and its Subsidiaries, taken as a whole.

Table of Contents

(c) Capital Structure.

(i) The authorized capital stock of the Company consists of 300,000,000 shares of Company Common Stock and 5,000,000 shares of preferred stock, par value $0.0001 per share, of the Company (the Company Preferred Stock). At the close of business on October 18, 2018 (the Capitalization Date), (A) (1) 176,542,812 shares of Company Common Stock (excluding treasury shares and Restricted Shares) were issued and outstanding and (2) no shares of Company Preferred Stock were issued and outstanding, (B) 65,848,434 shares of Company Common Stock were held by the Company as treasury shares, (C) 23,155,610 shares of Company Common Stock were reserved and available for issuance in the aggregate pursuant to (x) the Company s 2004 Long-Term Incentive Plan, as amended and restated August 9, 2012, (y) the Ansible, Inc. 2013 Stock Incentive Plan, as amended, (z) Inktank Storage, Inc. 2011 Equity Incentive Plan, and (aa) the Gluster, Inc. 2005 Stock Plan (amended and restated) and (D) 3,851,678 shares of Company Common Stock were reserved and available for issuance pursuant to the Company s 2016 Employee Stock Purchase Plan (the ESPP, and collectively with the plans identified in clause (C), the Company Stock Plans), of which (1) 36,628 shares of Company Common Stock were subject to outstanding options (other than rights under the ESPP) to acquire shares of Company Common Stock from the Company (such options, together with any other stock options granted after the Capitalization Date, in each case whether granted pursuant to the Company Stock Plans or otherwise, the Stock Options), (2) 210,545 shares of Company Common Stock were subject to vesting or transfer restrictions and/or subject to forfeiture back to the Company or repurchase by the Company (such shares, together with any shares granted after the Capitalization Date that are so subject, the Restricted Shares), (3) 4,073,098 shares of Company Common Stock were subject to restricted stock units with service-based, but not performance-based, vesting or delivery requirements (such restricted stock units, together with any other restricted stock units granted after the Capitalization Date, in each case whether granted pursuant to the Company Stock Plans or otherw>

for the year						
(98)	(129)	(81)				
adjustments for prior years						
(1)	4	(3)		(99)	(125)	(84)
Deferred tax:						
origination and reversal of temporary differences						
(57)	(5)	(73)				
tax losses not recognized						
(1)	(1)	(1)		(58)	(6)	(74)
		(157)	(131)	(158)		

The reconciliation of the statutory tax rate in The Netherlands to the effective combined tax rate is as follows:

	2006	2005	2004
Statutory tax rate in The Netherlands	30%	32%	35%
Effect of different tax rates in foreign countries	(1)%	(15)%	(8)%
Tax-exempt income/non-deductible expenses		2%	1%
Adjustments for prior years			1%
Other			2%
	29%	19%	31%

Note 9 Salaries, Wages, and Social Charges

	2006	2005	2004
Salaries and wages	926	839	818
Pension and other postretirement costs	144	106	118
Other social charges	166	196	172
	1,236	1,141	1,108

Pension and other postretirement costs for the years ended December 31, 2006 and 2005 excludes the effect of EUR 29 million and EUR 92 million, respectively, relating to changes in the pension and postretirement plans in the US and Canada in 2006, and The Netherlands in 2005. Charges of EUR 5 million, EUR 3 million and EUR 4 million for share-based compensation are included in salaries and wages for the years ended December 31, 2006, 2005 and 2004 respectively.

Average number of employees	2006	2005	2004
Organon	14,000	14,200	14,700
Intervet	5,400	5,300	5,300
	19,400	19,500	20,000
Number of employees at December 31	19,200	19,400	19,390

The average number of employees working outside The Netherlands during the years ended December 31, 2006, 2005 and 2004 was 13,700, 14,000 and 14,500 respectively.

Table of Contents

OBS GROUP

NOTES TO THE COMBINED FINANCIAL STATEMENTS (Continued)
(All amounts in millions of euros unless otherwise stated)

Note 10 Property, Plant and Equipment, net

	Total	Building and Land	Plant Equipment and Machinery	Other Equipment	Construction in Progress and Prepayments on Projects	Assets Not Used in the Production Process
Balance at January 1, 2005						
Cost of acquisition	2,371	936	919	201	179	136
Depreciation/impairment	(1,224)	(354)	(635)	(131)		(104)
Book value	1,147	582	284	70	179	32
Changes in book value						
Capital expenditures	236	59	132	44		1
Transfer between categories	(73)	7	(3)	4	(82)	1
Disposals	(14)	(3)	(3)	(2)		(6)
Depreciation	(166)	(56)	(81)	(28)		(1)
Impairment	(53)	(19)	(33)	(1)		
Changes in exchange rates	44	25	12	3	2	2
Total changes	(26)	13	24	20	(80)	(3)
Balance at December 31, 2005						
Cost of acquisition	2,484	1,028	1,019	243	99	95
Depreciation/impairment	(1,363)	(433)	(711)	(153)		(66)
Book value	1,121	595	308	90	99	29
Changes in book value						
Acquisitions through business combinations	5	2	3			
Divestures	(2)	(1)	(1)			
Capital expenditures	162	49	64	38	1	10
Transfer between categories		18	(15)	2	(5)	
Disposals	(11)	(2)	(1)	(5)		(3)
Depreciation	(152)	(49)	(69)	(34)		
Impairment						
Changes in exchange rates	(26)	(15)	(4)	(3)	(1)	(3)
Total changes	(24)	2	(23)	(2)	(5)	4
Balance at December 31, 2006						

Cost of acquisition	2,502	1,094	974	264	94	76
Depreciation/impairment	(1,405)	(497)	(689)	(176)		(43)
Book value	1,097	597	285	88	94	33

In cases where the book value of an asset exceeds the recoverable amount, an impairment charge is recognized. In 2005, such a charge was recognized in other operating income/(expense) in the combined statements of income.

In 2005, an impairment charge totaling EUR 53 million was recognized. The impairments mainly relate to Organon s active pharmaceutical ingredients activities, which was the result of difficult market circumstances. The recoverable amount of the business was calculated by determining the value in use, using discount rates in the range of 8% to 16% reflecting the risk specific to the assets.

The book value of property, plant and equipment financed by installment buying and leasing, and not legally owned by the OBS Group was EUR 40 million and EUR 48 million at December 31, 2006 and 2005, respectively.

Purchase commitments for property, plant and equipment totaled EUR 69 million at December 31, 2006. At December 31, 2005, these commitments totaled EUR 35 million.

Both at December 31, 2006 and 2005, no item of property, plant and equipment was registered as security for bank loans.

Table of Contents

OBS GROUP

NOTES TO THE COMBINED FINANCIAL STATEMENTS (Continued)
(All amounts in millions of euros unless otherwise stated)

Note 11 Intangible Assets, net

	Total	Goodwill	Licenses, Software, Know-how, and Intellectual Property Rights
Balance at January 1, 2005			
Cost	251	46	205
Amortization/impairment	(106)	(14)	(92)
Book value	145	32	113
Changes in book value			
Acquisitions	8		8
Investments	51		51
Amortization	(22)		(22)
Impairments	(20)	(15)	(5)
Changes in exchange rates	2	2	
Total changes	19	(13)	32
Balance at December 31, 2005			
Cost	290	30	260
Amortization/impairment	(126)	(11)	(115)
Book value	164	19	145
Changes in book value			
Acquisitions	2		2
Investments	8		8
Amortization	(29)		(29)
Impairment			
Changes in exchange rates			
Total changes	(19)		(19)
Balance at December 31, 2006			
Cost	299	30	269
Amortization/impairment	(154)	(11)	(143)
Book value	145	19	126

The amortization and impairment charges on intangible assets have been recognized on the following line items in the combined statements of income for the years ended December 31:

	2006	2005	2004
Cost of sales	(13)	(9)	(4)
Selling and distribution expenses	(4)	(7)	(4)
Research and development costs	(11)	(6)	(4)
General and administrative expenses	(1)		
Other operating income/(expense)		(20)	
	(29)	(42)	(12)

Impairment tests are performed for all cash generating units containing goodwill at each balance sheet date or whenever there is an indication of impairment. Intangibles with an indefinite useful life are tested annually for impairment. For all other intangible assets, an impairment test is performed whenever an indicator of impairment exists. Impairments of intangible assets of EUR 20 million in

Table of Contents

OBS GROUP

NOTES TO THE COMBINED FINANCIAL STATEMENTS (Continued)
(All amounts in millions of euros unless otherwise stated)

2005 mainly relate to Organon s active pharmaceutical ingredients activities. The estimates of the recoverable amounts were calculated by determining the value in use, using discount rates in the range of 8% to 16% reflecting the risk specific to the assets.

Note 12 Financial non-current assets

	Total	Deferred Tax Assets	Investments in Associates	Other Investments
Balance at January 1, 2005	492	366	3	123
Acquisitions/loans granted/investments	35		3	32
Divestures/repayments	(25)			(25)
Amounts recognized as income/(expense)	(11)	(13)	2	
Fair value adjustments	1			1
Transfers from Akzo Nobel	8	8		
Changes in exchange rates	12	6		6
Balance at December 31, 2005	512	367	8	137
Acquisitions/loans granted/investments	6		3	3
Divestures/repayments	(15)			(15)
Amounts recognized as income/(expense)	(57)	(55)	2	(4)
Fair value adjustments	(1)			(1)
Transfers from Akzo Nobel	(10)	(13)		3
Changes in exchange rates	(23)	(18)		(5)
Balance at December 31, 2006	412	281	13	118

Deferred tax assets

Further details on deferred tax assets are provided in Note 13.

Investments in associates

The investments in associates at December 31, 2006 include a loan to an associate of EUR 3 million. Further details on investments in associates are provided in Note 14.

Other investments

Other investments at December 31, 2006 and 2005 include long-term receivables totaling EUR 61 million and EUR 69 million, respectively, and other financial fixed assets totaling EUR 35 million and EUR 42 million, respectively.

The long-term receivables at December 31, 2006 and 2005 include a subordinated loan of EUR 33 million granted by Akzo Nobel to the Akzo Nobel Pension Fund in The Netherlands. This amount represents a reasonable allocation to the OBS Group of the fair value of the loan. Also included is an allocated balance of EUR 8 million and EUR 15 million as of December 31, 2006 and 2005, respectively, for the loan which will be redeemed by retaining future employee pension premiums. These allocations have been made based upon the ratio of the OBS Group s defined benefit obligations to the total Akzo Nobel Pension Fund defined benefit obligation.

Note 13 Deferred Tax Assets and Liabilities

In assessing the realizability of the deferred tax assets, management considers whether it is probable that some or all of the deferred tax assets will not be realized. The ultimate realization of the deferred tax assets is dependent upon the generation of future taxable income during the periods in

Table of Contents

OBS GROUP

NOTES TO THE COMBINED FINANCIAL STATEMENTS (Continued)
(All amounts in millions of euros unless otherwise stated)

which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income, and tax planning strategies in making this assessment. The amount of the deferred tax assets considered realizable, however, could change in the near term if future estimates of projected taxable income during the carry-forward period are revised.

The tax effects of temporary differences that give rise to a significant portion of the deferred tax assets and liabilities at December 31, 2006 and 2005 are presented below.

	2006 Assets	2005 Assets	2006 Liabilities	2005 Liabilities	2006 Net	2005 Net
Intangible assets	26	61			26	61
Property, plant and equipment	40	47	(32)	(35)	8	12
Inventories	120	114	(22)	(28)	98	86
Trade and other receivables	6	10	(2)	(2)	4	8
Provisions:						
restructuring	1				1	
other provisions	86	133	(1)	(5)	85	128
Other items	21	23		(9)	21	14
Net operating loss carry-forwards	13	22			13	22
Deferred tax assets/liabilities	313	410	(57)	(79)	256	331
Offsetting of tax	(32)	(43)	32	43		
Net deferred tax assets/(liabilities)	281	367	(25)	(36)	256	331

Deferred tax assets and liabilities are offset only when there is a legally enforceable right to set off tax assets against tax liabilities and when the deferred tax assets and liabilities relate to the same tax authority.

The movement in deferred tax assets and liabilities during the year is as follows:

	Balance January 1, 2005	Changes in Exchange Rates	Recognized in Income	Other	Balance December 31, 2005
Intangible assets	34		27		61
Property, plant and equipment	(7)	1	18		12
Inventories	105		(19)		86
Trade and other receivables	4		4		8
Provisions:					
restructuring	4		(4)		

other provisions	133	1	(5)	(1)	128
Other items	26	3	(15)		14
Net operating loss carry-forwards	33	1	(12)		22
Net deferred tax assets/(liabilities)	332	6	(6)	(1)	331

Table of Contents

OBS GROUP

NOTES TO THE COMBINED FINANCIAL STATEMENTS (Continued)
(All amounts in millions of euros unless otherwise stated)

	Balance January 1, 2006	Changes in Exchange Rates	Recognized in Income	Other	Balance December 31, 2006
Intangible assets	61	(4)	(31)		26
Property, plant and equipment	12	(5)	1		8
Inventories	86		12		98
Trade and other receivables	8		(4)		4
Provisions:					
restructuring			1		1
other provisions	128	(5)	(37)	(1)	85
Other items	14	(1)	8		21
Net operating loss carry-forwards	22	(1)	(8)		13
Net deferred tax assets/(liabilities)	331	(16)	(58)	(1)	256

Classification of the deferred tax assets and liabilities in the combined balance sheets, which is determined at fiscal entity level, is as follows:

	2006	2005
Deferred tax assets	281	367
Deferred tax liabilities	(25)	(36)
	256	331

At December 31, 2006, tax losses carried forward amounted to EUR 60 million, of which EUR 14 million (EUR 5 million of deferred tax assets) is not recognized in the combined balance sheets. Of the total tax losses carried forward, no tax losses carried forward will expire within one year and EUR 46 million can be carried forward indefinitely.

At December 31, 2005, tax losses carried forward amounted to EUR 180 million, of which EUR 20 million (EUR 6 million of deferred tax assets) is not recognized in the combined balance sheets. Of the total tax losses carried forward, EUR 1 million will expire within one year and EUR 83 million can be carried forward indefinitely.

Note 14 Investments in Associates

These combined financial statements include the OBS Group s ownership in the following investments in associates as of December 31, 2006 and 2005:

	Country of

Legal Entity	Incorporation	Ownership
South Egypt Drug Industries Co. (Sedico)	Egypt	22%
BioConnection B.V.	The Netherlands	41%

Table of Contents

OBS GROUP

NOTES TO THE COMBINED FINANCIAL STATEMENTS (Continued)
(All amounts in millions of euros unless otherwise stated)

A summary of financial information for the investments in associates on a 100% basis is provided below:

	2006	2005	2004
Net revenues	51	43	30
Income before taxes	11	9	3
Net income	8	7	3
Share of net income recognized in the combined statements of income	2	2	1
Current assets	47	47	
Non-current assets	15		
Total assets	62	47	
Current liabilities	18	6	
Non-current liabilities	8	13	
Shareholders equity	36	28	
Total liabilities and equity	62	47	
Investments in associates included in the combined balance sheets	13	8	

Note 15 Inventories, net

	2006	2005
Raw materials and supplies	191	291
Semi-finished goods	425	329
Finished products and goods for resale	235	241
	851	861

Of the total carrying amount of inventories at December 31, 2006 and 2005, EUR 1 million and EUR 1 million, respectively, were stated at net realizable value (fair value less cost to sell). In 2006, 2005 and 2004, EUR 22 million, EUR 24 million and EUR 25 million, respectively, were recognized in the combined statements of income for the write-down of inventories to their net realizable values, while EUR 3 million, EUR 6 million and EUR 1 million, respectively, of write-downs were reversed in the period of sale.

Additionally, for the years ended December 31, 2006, 2005 and 2004, the OBS Group recorded an expense in the combined statements of income of EUR 46 million, EUR 46 million and EUR 53 million, respectively, in regard of impairments in relation to obsolete inventories. There are no inventories subject to retention of title clauses.

Note 16 Income Tax Receivable and Payable

Income tax receivable of EUR 74 million and EUR 62 million at December 31, 2006 and 2005, respectively, represents the amount of income taxes recoverable in respect of current and prior periods. Income tax payable of EUR 133 million and EUR 194 million at December 31, 2006 and 2005, respectively, relates to the amount of taxes payable for current and prior periods to both the tax authorities and Akzo Nobel.

For those OBS Group entities located in countries where they were included in the tax grouping of other Akzo Nobel entities within the respective entity s tax jurisdiction, the current tax payable or receivable of these OBS Group entities represents the income tax amount to be paid to or to be

Table of Contents

OBS GROUP

NOTES TO THE COMBINED FINANCIAL STATEMENTS (Continued)
(All amounts in millions of euros unless otherwise stated)

received from the country tax leading holding of Akzo Nobel. For the purpose of these combined financial statements, it is assumed that only the current year is outstanding. As of December 31, 2006 and 2005, income tax receivable from Akzo Nobel entities of EUR 15 million and income tax payable to Akzo Nobel entities of EUR 15 million, respectively, are included in the income tax receivable and income tax payable in the combined balance sheets.

Income tax receivable and payable have been offset in cases where there is a legally enforceable right to set off current tax asset against current tax liability and when the intention exists to settle on a net basis or to realize the receivable and payable simultaneously.

Note 17 Trade and Other Receivables, net

	2006	2005
Trade receivables	589	611
Prepaid expenses	33	29
Other receivables	113	126
	735	766

Trade receivables are shown net of impairment losses of EUR 15 million and EUR 15 million at December 31, 2006 and 2005, respectively. In the year ended December 31, 2006, 2005 and 2004, the OBS Group recorded net additions and reversals of impairment losses of EUR 2 million, EUR 2 million and EUR 3 million in the combined statements of income, respectively.

Note 18 Cash and Cash Equivalents

	2006	2005
Short-term investments	164	12
Cash on hand and in banks	75	47
	239	59

Short-term investments almost entirely consist of cash loans, time deposits, marketable private borrowings, and marketable securities immediately convertible into cash.

At December 31, 2006 and 2005, the entire amount of cash and cash equivalents was freely available.

Note 19 Invested Equity

The invested equity balance in the combined financial statements of the OBS Group constitutes Akzo Nobel s investment in the OBS Group and represents the excess of total assets over total liabilities. Invested equity includes

the effects of carve-out allocations from Akzo Nobel and the funding of the OBS Group activities through the in-house banking, cash pooling loans from and to related parties with Akzo Nobel, and the OBS Group s cumulative net income, including income directly recognized in equity. As a consequence, invested equity does not constitute any contract that evidences a residual interest in the assets after deducting liabilities.

Cumulative translation reserves

The cumulative translation reserves comprise all foreign currency differences arising from the translation of the OBS Group s financial statements of net investments in foreign subsidiaries.

Assets and liabilities of foreign subsidiaries are translated into euros at exchange rates on the balance sheet date. Revenues and expenses are translated into euros at rates approximating the

Table of Contents

OBS GROUP

NOTES TO THE COMBINED FINANCIAL STATEMENTS (Continued)
(All amounts in millions of euros unless otherwise stated)

foreign exchange rates ruling at the dates of the transactions. Exchange differences resulting from translation into euros of shareholders equities and of intercompany loans of a permanent nature with respect to subsidiaries outside the euro region are recorded within invested equity. Upon disposal or liquidation of a foreign entity, these cumulative translation adjustments are recognized as income or expense.

A description of the amounts recorded in invested equity is as follows:

Share-based payment costs funded by Akzo Nobel

The share-based payment costs funded by Akzo Nobel represents share-based payment expenses, allocated to the OBS Group, based on the actual OBS employees participating in the Akzo Nobel share plans. See Note 20.

Interest expense funded by Akzo Nobel

The interest expense funded by Akzo Nobel represents interest charges allocated to the OBS Group based on average levels of funding provided to the OBS Group by Akzo Nobel. See Note 3 and 7.

Corporate overhead costs funded by Akzo Nobel

The corporate overhead costs funded by Akzo Nobel represent an allocation of charges to the OBS Group incurred by Akzo Nobel for various corporate administrative costs, on behalf of the business units of the OBS Group. See Note 3.

Insurance expense funded by Akzo Nobel

The insurance expense funded by Akzo Nobel represents insurance expenses incurred by Akzo Nobel on behalf of the OBS Group that have been allocated to the OBS Group. See Note 3.

Tax transfers from/(to) Akzo Nobel

The tax transfers from/(to) Akzo Nobel represent intercompany tax payments, receipts and settlements, from and to the OBS Group and the Akzo Nobel tax leading holding companies.

Employee benefits and other non-cash transfers

These amounts primarily represent allocations of employee benefit related assets and liabilities in regard to pension plans accounted for by Akzo Nobel on behalf of the OBS Group.

Cash transfers from/(to) Akzo Nobel

The cash transfers from/(to) Akzo Nobel consist of group contributions from or to Akzo Nobel, capital contributions funded by Akzo Nobel, the net movement of funding by Akzo Nobel and intra group movements. As of December 31, 2006 and 2005, invested equity includes EUR 1,049 million and EUR 899 million, respectively, of funding by Akzo Nobel, which does not have the characteristics of debt. Also, as of December 31, 2006 and 2005, invested equity includes EUR 289 million and EUR 28 million, respectively, of net loans due from and due to related parties,

respectively.

Note 20 Share-Based Payments

Akzo Nobel sponsors the following stock options plans and share plans in which certain employees of the OBS Group participate. As the share-based payment plans are Akzo Nobel plans, amounts have been recognized through invested equity.

Table of Contents

OBS GROUP

NOTES TO THE COMBINED FINANCIAL STATEMENTS (Continued)
(All amounts in millions of euros unless otherwise stated)

Stock Option Plans

Akzo Nobel grants options to all members of the Board of Management, Senior Vice Presidents and Executives. Stock options granted cliff-vest and are exercisable after three years. The options granted to Senior Vice Presidents and Executives expire after five years and options granted from 2002 onwards expire after seven years. Options granted to members of the Board of Management from 2000 expire after ten years and options granted from 2003 onwards expire after seven years. All outstanding options issued from 1999 cannot be exercised during the first three years. One option entitles the holder thereof to buy one Akzo Nobel N.V. common share or one American Depository Share (ADS). The exercise price is the Euronext Amsterdam opening price on the first day that the Akzo Nobel share is quoted ex dividend or the opening price for an ADS on NASDAQ/NMS on the first day that the Akzo Nobel ADS is quoted ex dividend. Also, for the options granted since 2005, certain economic value added performance criteria are included in the vesting conditions. Through June 30, 2005, the option holder could also request that the option be cash settled.

Since 2005, Akzo Nobel grants performance related stock options to Executives. Under this plan, Executives are granted a conditional number of options, under shareholder approval, whose vesting is conditional on the achievement of financial performance targets, expressed as Economic Value Added on Invested Capital (EOI). The percentage of granted, contingent options that vest depends on Akzo Nobel s average EOI over a three-year period. One option entitles the holder thereof to buy one Akzo Nobel N.V. common share or one ADS. The option holder can also request that the option be cash settled.

These option plans could be cash settled through July 1, 2005, and were modified as of this date to be share settled. The fair value of employee service received in return for share options granted are measured by reference to the fair value of share options granted. Until July 1, 2005, the OBS Group recognized at each balance sheet the fair value of the options outstanding per that date, taking into account the passage of time of the three-year vesting period. The change in this fair value was recognized in income. Compensation expense of EUR 2 million has been recognized under these plans for each of the years ended December 31, 2006, 2005 and 2004.

Employee Share Plan

In 2001, Akzo Nobel introduced the Akzo Nobel Employee Share Plan, whereby Akzo Nobel N.V. common shares are granted to the employees each year. Generally, these shares vest if the employee has remained in Akzo Nobel s service for a period of three years. In November 2003, the Board of Management of Akzo Nobel decided to accelerate the settlement of this plan whereby the granted shares vested at May 1, 2004. Instead of issuing shares to employees, Akzo Nobel settled its liability with the OBS Group employees by making an approximate EUR 4 million cash payment during the year ended December 31, 2004. Additionally, the Board of Management of Akzo Nobel concurrently terminated this plan during May 2004.

The OBS Group has recognized compensation expense of EUR 2 million under this plan for the year ended December 31, 2004.

Performance Share Plan (Executives and Board of Management)

In 2004, Akzo Nobel introduced a conditional performance stock option plan for the Board of Management and on January 1, 2005 for Executives. Under this plan, members of the Board of Management and Executives were granted a conditional number of shares. The vesting of the shares is conditional on the achievement of performance targets, expressed as Total Shareholder Return

Table of Contents

OBS GROUP

NOTES TO THE COMBINED FINANCIAL STATEMENTS (Continued)
(All amounts in millions of euros unless otherwise stated)

(TSR) of Akzo Nobel, relative to the TSR of a group of competitors during the relative performance period. The percentage of granted, contingent shares that vest depends on Akzo Nobel s TSR, relative to those of competitors, achieved during the three-year vesting period. The awards will be satisfied by the delivery of Akzo Nobel N.V. shares, or in exceptional cases, by means of a cash payment.

Due to the performance criteria of the share plan, the OBS Group bases compensation expense on the best available estimate of the number of shares that are expected to vest and revises that estimate, if necessary, if subsequent information indicates that actual forfeitures are likely to differ from initial estimates. Management expects the conditional shares granted to vest based on available information. Expense of EUR 3 million, EUR 1 million and EUR 0.1 million has been recognized during the years ended December 31, 2006, 2005 and 2004, respectively.

The following is a summary of activity pertaining to the OBS Group employees that participated in the various Akzo Nobel stock option and share plans:

Outstanding	Common Shares	Weighted Average Exercise Price in EUR	American Depositary Shares	Weighted Average Exercise Price in USD
Balance at January 1, 2004	1,207,600	39.80	112,090	31.27
Options granted	220,080	31.45	66,400	37.28
Options forfeited	(225,339)	40.15	(12,870)	26.89
Balance at December 31, 2004	1,202,341	38.21	165,620	34.02
Options granted	257,523	31.98		
Options forfeited	(242,785)	43.27	(7,600)	31.60
Balance at December 31, 2005	1,217,079	35.88	158,020	34.14
Options granted	231,270	46.46		
Options exercised	(236,640)	35.31	(59,880)	33.17
Options forfeited	(112,050)	44.91	(9,060)	37.14
Balance at December 31, 2006	1,099,659	37.31	89,080	34.49

The following is a summary of activity pertaining to the OBS Group Executives and Board of Management that participated in the Akzo Nobel performance share plan:

Outstanding	Performance Share Plan (Executives and Board of Management)

Balance at January 1, 2004	
Granted	22,000
Balance at December 31, 2004	22,000
Granted	382,202
Forfeited	(5,963)
Accreted dividend	15,402
Balance at December 31, 2005	413,641
Granted	266,635
Forfeited	(14,363)
Accreted dividend	30,989
Balance at December 31, 2006	696,902

Table of Contents

OBS GROUP

NOTES TO THE COMBINED FINANCIAL STATEMENTS (Continued)
(All amounts in millions of euros unless otherwise stated)

Fair value and assumptions used

The expected value of performance stock options for the Board of Management and Executives is based on a binomial lattice option pricing model, using certain assumptions. These assumptions were used for these calculations only, and do not necessarily represent an indication of management s expectations of future developments. In addition, option valuation models require the input of highly subjective assumptions, including expected share price volatility. The OBS Group s employee stock options have characteristics significantly different from those of traded options and changes in the subjective assumptions used for the calculation can materially affect the fair value estimate.

The fair value and the assumptions used for the options granted were as follows:

	Common Shares, in EUR			American Depository Shares, in USD
	2006	2005	2004	2004
Fair value at measurement date	9.97	7.45	7.94	8.48
Share price at measurement date	46.46	31.98	31.45	37.25
Exercise price	46.46	31.98	31.45	37.25
Expected share price volatility (%)	24.8	33.4	35.2	32.7
Expected option life (years)	5	5	5	5
Expected dividend yield (%)	2.74	4.4	4.1	4.1
Risk free interest rate (%)	3.92	3.25	3.2	2.8

The expected volatility is based on the historic volatility (calculated based on the weighted average remaining life of the share options), adjusted for any expected changes to future volatility due to publicly available information. Share options are granted under a service condition and a non-market performance condition. Such conditions are not taken into account in the grant date fair value measurement. There are no market conditions associated with the share option grants.

The grant date fair value of the performance shares is amortized as an expense over the three-year vesting period. The fair value at grant date is based on the Monte Carlo simulation model taking market conditions into account. The value was calculated by external actuaries and amounted to EUR 16.80 for the performance shares conditionally granted in 2006, EUR 12.67 for the 2005 performance shares, and EUR 10.84 for the 2004 performance shares.

Table of Contents

OBS GROUP

NOTES TO THE COMBINED FINANCIAL STATEMENTS (Continued)
(All amounts in millions of euros unless otherwise stated)

Note 21 Provisions

	Total	Pensions and Other Postretirement Benefits	Restructuring of Activities	Other
Balance at January 1, 2005	536	417	8	111
Additions made during the year	49	11	7	31
Utilization	(261)	(152)	(10)	(99)
Amounts reversed during the year	(5)		(1)	(4)
Transfers from Akzo Nobel	12	12		
Unwind of discount	1			1
Changes in exchange rates	22	16	1	5
Balance at December 31, 2005	354	304	5	45
Additions made during the year	48	13	11	24
Utilization	(91)	(63)	(9)	(19)
Amounts reversed during the year	(6)		(1)	(5)
Transfers from Akzo Nobel	18	18		
Changes in exchange rates	(11)	(9)		(2)
Balance at December 31, 2006	312	263	6	43

The above movement schedule includes the current portion of the provisions, which at December 31, 2006 and 2005 amounted to EUR 45 million and EUR 29 million, respectively.

Provisions for pensions and other postretirement benefits

The majority of the OBS Group s employees participate in Akzo Nobel defined benefit pension plans, defined contribution pension plans and other postretirement benefit plans, which provide benefits to employees and former employees of both the OBS Group and other Akzo Nobel businesses. In these plans, the assets and liabilities that relate to employees (and former employees) of the OBS Group are combined with those related to employees (and former employees) of other Akzo Nobel businesses.

The OBS Group has obtained information about each of these Akzo Nobel plans measured in accordance with IAS 19 on the basis of assumptions that apply to each of the plans as a whole, and used a reasonable allocation method to determine the OBS Group s portion of each plan s assets, liabilities and benefit costs under IAS 19. For each of these plans, the defined benefit obligation (at each balance sheet date), and the service cost, contributions, benefit payments, and impact of special events (in each accounting period), relating to the OBS Group, have been determined using approximate actuarial techniques which take into account the membership profile of OBS Group participants

compared to the membership profile for participants in the plan as a whole. Plan assets at each balance sheet date have generally been split in the same proportion as the defined benefit obligation.

Management believes that such allocations have been made on a reasonable basis, but may not necessarily be indicative of the actual separation of these pension plans in the future.

Furthermore, some OBS Group employees participate in stand-alone OBS Group pension and other postretirement benefit plans. The related expenses, assets and liabilities for these plans are accounted for in the OBS Group businesses in accordance with IAS 19.

Table of Contents

OBS GROUP

NOTES TO THE COMBINED FINANCIAL STATEMENTS (Continued)
(All amounts in millions of euros unless otherwise stated)

The defined benefit pension plans in which the OBS Group s employees participate generally provide benefits based on years of service and employees compensation. The funding policies for the plans are consistent with local requirements in the countries of establishment. Obligations under the plans are systematically provided for by depositing funds with trustees or separate foundations, under insurance policies, or by balance sheet provisions. Plan assets principally consist of long-term interest-earning investments, quoted equity securities, and real estate.

A number of OBS Group s current and former employees participate in Akzo Nobel postretirement healthcare and life assurance plans. The OBS Group has accrued for the expected costs of providing such postretirement benefits during the years that the employee rendered the necessary services.

Valuations of the obligations under the pension and other postretirement benefit plans are carried out by independent actuaries. The discount rates applied are based on yields available on high quality corporate bonds that have currencies and terms consistent with the currencies and estimated terms of the OBS Group s obligations.

During 2006, Akzo Nobel closed their US and Canadian defined benefit pension plans in which OBS Group employees and former employees participate to further accrual and implemented defined contribution plans for future benefit provision. During 2006, Akzo Nobel also altered the qualification requirements and changed the existing level of benefits in its US postretirement welfare plan in which OBS Group employees and former employees participate. Due to these changes, the OBS Group s provision for pensions and other postretirement benefits decreased by EUR 29 million, which was recorded in the combined statements of income during the year ended December 31, 2006.

During 2005, Akzo Nobel reached agreement with the unions to a change to its pension arrangements in The Netherlands in which OBS Group employees and former employees participate. With effect from December 31, 2005, the pension plan changed from a defined benefit plan to a defined contribution plan and certain changes were made to the pre-retirement plan. In connection with these changes during 2005 Akzo Nobel paid a one-time nonrefundable contribution of EUR 151 million, prepaid EUR 50 million in July 2005 of loans which are to be repaid by retaining employee pension premiums, and granted a EUR 100 million subordinated loan in September 2005 that had a fair value of EUR 87 million. A proportion of these amounts has been allocated to the OBS Group using the same method used to allocate the rest of the plan s assets. Management believes that this allocation method is reasonable. These changes resulted in a combined curtailment and settlement of defined benefit obligations for the OBS Group of EUR 1,086 million and a settlement of plan assets of EUR 1,059 million, and of the recognition of previously unrecognized gains and prior service costs totalling EUR 32 million. In total, the net effect of the change to The Netherlands pension arrangements was a pre-tax gain of EUR 59 million, which has been recorded in the combined statements of income in 2005.

Effective December 31, 2005, due to changes in the national healthcare system in The Netherlands, the OBS Group also terminated its postretirement healthcare plan in that country, except for a gradually declining transition arrangement until June 30, 2009. This change resulted in a curtailment of defined benefit obligations of the OBS Group of EUR 29 million, and the recognition of previously unrecognized gains and prior service costs totalling EUR 4 million. In total, the net effect of the termination was a pre-tax gain on the termination of EUR 33 million, which has been recorded in the combined statements of income.

At December 31, 2006 and 2005, the principal defined benefit pension plans covered approximately 24% and 51% of the OBS Group s employees, respectively.

Table of Contents

OBS GROUP

NOTES TO THE COMBINED FINANCIAL STATEMENTS (Continued)
(All amounts in millions of euros unless otherwise stated)

Below, a table is provided with a summary of the changes in the pension and the other postretirement benefit obligations and plan assets for 2006 and 2005.

	Pensions		Other Postretirement Benefits	
Asset/(liability)	**2006**	**2005**	**2006**	**2005**
Defined benefit obligation (DBO)				
Balance at beginning of year	(644)	(1,513)	(87)	(89)
Acquisitions/divestments				
Settlements/curtailments	13	1,086	16	29
Service costs	(31)	(99)	(5)	(7)
Contribution by employees	(2)	(10)		
Interest costs	(26)	(61)	(4)	(5)
Other		2		
Plan amendments			9	
Benefits paid	33	46	6	2
Actuarial gains and losses	14	(74)	10	(7)
Changes in exchange rates	13	(21)	7	(10)
Balance at end of year	(630)	(644)	(48)	(87)
Plan assets				
Balance at beginning of year	362	1,162		
Acquisitions/divestments				
Settlements	(1)	(1,059)		
Contribution by employer	46	123	4	1
Contribution by employees	2	10		
Benefits paid	(33)	(46)	(6)	
Actual return on plan assets	34	152	2	(1)
Other		5		
Changes in exchange rates	(12)	15		
Balance at end of year	398	362		
Funded status	(232)	(282)	(48)	(87)
Unrecognized net loss/(gain)	32	60		16
Unrecognized prior service costs			(6)	
Medicare receivable			(9)	(11)
Net balance provisions	(200)	(222)	(63)	(82)

The pension defined benefit obligation breaks down as follows:

	2006	2005
Wholly or partly funded plans	553	564
Unfunded plans	77	80
	630	644

The difference between the actual and the expected return on plan assets was a gain of EUR 11 million in 2006 and EUR 80 million in 2005.

Table of Contents

OBS GROUP

NOTES TO THE COMBINED FINANCIAL STATEMENTS (Continued)
(All amounts in millions of euros unless otherwise stated)

In the United States, the Medicare Prescription Drug Improvement and Modernization Act of 2003 introduced prescription drug benefits for retirees as well as a federal subsidy to sponsors of postretirement healthcare plans, which both began at January 1, 2006. This reimbursement right has been recognized as an asset under other financial non-current assets, in the combined balance sheets measured at fair value. At December 31, 2006 and 2005, this value was EUR 9 million and EUR 12 million, respectively.

The net periodic pension costs for the defined benefit pension plans were as follows:

	Pensions			Other Postretirement Benefits		
Charge/(income)	**2006**	**2005**	**2004**	**2006**	**2005**	**2004**
Service costs for benefits earned	31	99	101	5	7	7
Interest costs on DBO	26	61	66	4	5	5
Expected return on plan assets	(23)	(72)	(67)			
Amortization of unrecognized losses	1	3	3	(2)		
Settlements/curtailments	(12)	(59)		(17)	(33)	
	23	32	103	(10)	(21)	12

The weighted average assumptions underlying the computations were:

	Pensions			Other Postretirement Benefits		
Percentage	**2006**	**2005**	**2004**	**2006**	**2005**	**2004**
Pension benefit obligation December 31						
discount rate	4.8	4.5	4.7	5.7	5.4	5.4
rate of compensation increase	4.3	4.0	3.1	5.0	4.9	4.2
Net periodic pension costs						
discount rate	4.5	4.7	5.3	5.4	5.4	5.9
rate on compensation increase	4.0	3.0	3.1	4.9	4.2	4.1
expected return on plan assets	6.5	6.7	6.7			

The calculation of the weighted average discount rate as of December 31, 2006 and 2005 excludes the pension plan of the Netherlands. The assumptions for the expected return on plan assets were based on a review of the historical returns of the asset classes in which the assets of the pension plans are invested. The historical returns on these asset classes were weighted based on the expected long-term allocation of the assets of the pension plans.

Akzo Nobel s primary objective with regard to the investment of pension plan assets is to ensure that in each individual scheme sufficient funds are available to satisfy future benefit obligations. For this purpose, asset and liability management (ALM) studies are made periodically for each pension fund. An appropriate asset mix is determined on

the basis of the outcome of these ALM studies, taking into account the local rules and regulations.

Pension plan assets principally consist of long-term interest-earning investments, quoted equity securities, and real estate. At December 31, 2006 and 2005, plan assets did not include financial instruments issued by the OBS Group, nor any property occupied or other assets used by it. The

Table of Contents

OBS GROUP

NOTES TO THE COMBINED FINANCIAL STATEMENTS (Continued)
(All amounts in millions of euros unless otherwise stated)

weighted average pension plan asset allocation at December 31, 2006 and 2005, and the target allocation for 2007 for the pension plans by asset category are as follows:

Percentage	Target Allocation 2007	Actual Allocation at December 31, 2006	2005
Equity securities	55-61	57	61
Long-term interest earning investments	32-38	32	31
Real estate	1-4	1	2
Other	0-6	10	6
Total		100	100

Weighted average assumptions for other postretirement benefits were as follows:

Percentage	2006	2005	2004
Assumed healthcare cost trend rates at December 31:			
healthcare cost trend assumed for next year	11	9	6
rate to which the cost trend rate is assumed to decline (the ultimate trend rate)	5	5	4
year that the rate reached the ultimate trend rate	2013	2009	2009

In line with agreements in place until December 31, 2005, allowances under the healthcare plan in the Netherlands are assumed not to increase in the future.

Assumed healthcare cost trend rates have a significant effect on the amounts reported for the healthcare plans. A one percentage point change in assumed healthcare cost trend rates would have the following effects:

	1 Percentage Point Increase	1 Percentage Point Decrease
Effect on total of service and interest cost		
Effect on postretirement benefit obligation	1	(2)

Cash flows

The OBS Group expects to contribute EUR 29 million to its defined benefit pension plans in 2007.

The following benefit payments, which take into account the effect of future service, are expected to be paid:

	Pensions	Other Postretirement Benefits
2007	29	3
2008	36	3
2009	32	3
2010	34	3
2011	37	3
2012-2016	174	20

Table of Contents

OBS GROUP

NOTES TO THE COMBINED FINANCIAL STATEMENTS (Continued)
(All amounts in millions of euros unless otherwise stated)

The remaining plans primarily represent defined contribution pension plans. Expenses for these plans totaled EUR 102 million in 2006 and EUR 3 million in 2005.

Provisions for restructuring of activities

Provisions for restructuring of activities comprise accruals for certain employee benefits and for costs that are directly associated with plans to exit specific activities and closing down of facilities. For all restructurings a detailed formal plan exists, and the implementation of the plan has started or the plan has been announced. Most restructuring activities relate to relatively smaller restructurings, and are expected to be completed within two years from the balance sheet date. However, for certain plans payments of termination benefits to former employees may take several years longer.

Other provisions

Other provisions relate to a great variety of risks and commitments, including provisions for other long-term employee benefits like long-service leave and jubilee payments, provisions for environmental costs, provision for returns, allowances and legal claims. At December 31, 2006 and 2005, the OBS Group has recorded a provision of EUR 11 million, for returns and allowances. For details on environmental exposures, see Note 27.

The majority of the cash outflows related to other provisions are expected to be within 1 to 5 years. In calculating the other provisions a discount rate of 5%, on average, has been used.

Note 22 Deferred Income

In December 2003, the OBS Group received an initial payment of EUR 88 million from Pfizer for the co-development and co-marketing agreement for asenapine. Such payments are to be reported as deferred income and to be recognized as revenue in subsequent years. For this payment, recognition is based on the estimated co-development costs expected to be incurred over the estimated co-development period, which will be from 2004 to May 2007.

	2006	2005
Non-current deferred income		7
Current deferred income	10	31
	10	38

Note 23 Borrowings (Non-current)

	2006	2005
Debt to credit institutions	6	13
Other borrowings	39	46

	45	59

During 2006 and 2005, the weighted average effective interest rate was 5.9% and 4.4%, respectively.

Aggregate maturities of non-current borrowings at December 31, 2006 are as follows:

	2007-2011	**After 2011**
Debt to credit institutions	1	5
Other borrowings	36	3
	37	8

Table of Contents

OBS GROUP

NOTES TO THE COMBINED FINANCIAL STATEMENTS (Continued)
(All amounts in millions of euros unless otherwise stated)

At December 31, 2006 and 2005, none of the borrowings were secured by means of mortgages, etc.

Finance lease liabilities are included under other borrowings. The amounts payable in respect of these finance lease liabilities at December 31, 2006 are due as follows:

	Minimum Lease Payments	Interest	Principal
Next year	6	1	5
Between 1 and 5 years	10		10
More than 5 years			
	16	1	15

Note 24 Borrowings (Current)

	2006	2005
Debt to credit institutions	75	90
Current portion of borrowings	37	34
	112	124

Note 25 Trade and Other Payables

	2006	2005
Suppliers	183	178
Prepayments by customers	11	17
Taxes and social security contributions	51	47
Amounts payable to employees	160	137
Bonuses and discounts to customers	62	44
Other accrued expenses	30	30
Fair value derivatives		1
Other liabilities	114	99
Total trade and other payables	611	553

Note 26 Financial Instruments

Foreign exchange risk management

The OBS Group enters into forward exchange contracts with Akzo Nobel to hedge the transaction risk on sales, purchases, and financing transactions denominated in currencies other than the functional currency of the subsidiary concerned. The purpose of these foreign currency hedging activities is to protect the OBS Group from the risk that the eventual functional currency net cash flows resulting from committed trade or financing transactions are adversely affected by changes in exchange rates. Most forward exchange contracts outstanding at year-end have a maturity of less than one year. Where necessary, the forward exchange contracts are rolled over at maturity. The OBS Group does not use financial instruments to hedge the translation risk related to equity, intercompany loans of a permanent nature, and earnings of foreign subsidiaries. Currency derivatives are not used for speculative purposes.

At December 31, 2006 and 2005, the notional value of outstanding contracts to buy currencies totaled EUR 21 million and EUR 43 million, respectively, while contracts to sell currencies totaled EUR 57 million and EUR 43 million, respectively. These contracts mainly relate to the US dollar,

Table of Contents

OBS GROUP

NOTES TO THE COMBINED FINANCIAL STATEMENTS (Continued)
(All amounts in millions of euros unless otherwise stated)

Australian dollar, Swiss franc, Swedish kronor, Norwegian kronor, Polish zloty, pounds sterling, and Japanese yen, all having maturities within one year.

Interest risk management

The subordinated loan to the Akzo Nobel Pension Fund is sensitive to changes in interest rates. The OBS Group s share of the face value of the loan is EUR 36 million and the expected maturity is subsequent to 2010 with an average interest rate of 3.5%. The OBS Group s share of the carrying value of the loan and estimated fair value is EUR 33 million with an effective interest rate of 5.1%.

Credit risk

The OBS Group has a credit risk management policy in place. The exposure to credit risk is monitored on an ongoing basis. Credit evaluations are performed on all customers requiring credit. Generally the OBS Group does not require collateral in respect of financial assets.

Investments in cash and cash equivalents are entered into with counterparties which have a high credit rating and limits per counterparty have been set. Transactions involving derivative financial instruments are with counterparties with sound credit ratings and with whom the OBS Group has contractual netting agreements. The OBS Group has no reason to expect nonperformance by the counterparties to these agreements.

Due to the geographical spread of the OBS Group and the diversity of its customers, at balance sheet date the OBS Group was not subject to any significant concentration of credit risks. The maximum exposure to credit risk is represented by the carrying amount of each financial asset, including derivative financial instruments, in the combined balance sheets.

Sensitivity analysis

By managing currency risks, the OBS Group aims to reduce the impact of short-term fluctuations on the OBS Group s earnings. Over the longer-term, however, permanent changes in foreign exchange and interest rates would have an impact on combined earnings.

At December 31, 2006, the decrease in the OBS Group s profit before tax as a result of a general increase of one percentage point in interest rates would be negligible. Cash and cash equivalent and current borrowings have been included in this assessment.

Fair value of financial instruments

The estimated fair values at December 31, 2006 of non-current borrowings and the subordinated loan to the Akzo Nobel Pension Fund approximate their carrying values. The fair value of the OBS Group s non-current borrowings was estimated based on the quoted market prices for the same or similar issues or on the current rates offered to the OBS Group for debt with similar maturities.

The fair value of forward exchange contracts is determined using quoted forward exchange rates at the balance sheet date. At December 31, 2006 and 2005 the OBS Group s forward exchange contracts were recognized at fair value. The OBS Group implemented IAS 32 and IAS 39 from January 1, 2005. The effect for the year ended December 31, 2004 of not applying IAS 32 and IAS 39 was not material. After implementing IAS 32 and IAS 39 from January 1, 2005, forward exchange contracts are carried at fair value.

The carrying amounts of cash and cash equivalents, receivables, current borrowings, and other current liabilities approximate fair value due to the short maturity period of those instruments.

Table of Contents

OBS GROUP

NOTES TO THE COMBINED FINANCIAL STATEMENTS (Continued)
(All amounts in millions of euros unless otherwise stated)

Note 27 Contingent Liabilities and Commitments

Environmental matters

The OBS Group is confronted with costs arising out of environmental laws and regulations, which include obligations to eliminate or limit the effects on the environment of the disposal or release of certain wastes or substances at various sites. Proceedings involving environmental matters, such as the alleged discharge of chemicals or waste materials into the air, water, or soil, are pending against the OBS Group in various countries.

It is the OBS Group s policy to accrue and charge against earnings environmental cleanup costs when it is probable that a liability has been incurred and an amount is reasonably estimable. These accruals are reviewed periodically and adjusted, if necessary, as assessments and cleanups proceed and additional information becomes available. Environmental liabilities can change substantially due to the emergence of additional information on the nature or extent of the contamination, the necessity of employing particular methods of remediation, actions by governmental agencies or private parties, or other factors of a similar nature. Cash expenditures often lag behind the period in which an accrual is recorded by a number of years.

The provisions for environmental costs accounted for in accordance with the aforesaid policies aggregated nil and EUR 2 million at December 31, 2006 and 2005, respectively. The provision has been discounted using an average discount rate of 5.25% and 5.0% for 2006 and 2005, respectively.

The OBS Group has certain asset retirement obligations for which the timing of settlement is conditional upon the closure of the related operating facility. At this time, there are no specific plans for the closure of these related facilities, and the OBS Group currently intends to make improvements to the assets as necessary that would extend their lives indefinitely. Furthermore, the settlement dates have not been specified by law, regulation or contract. As a result, the OBS Group is unable to estimate the fair value of the liability. If a closure plan for any of these facilities is initiated in the future, the settlement dates will become determinable, an estimate of the fair value will be made, and an asset retirement obligation will be recorded.

While it is not feasible to predict the outcome of all pending environmental exposures, it is reasonably possible that there will be a need for future provisions for environmental costs which, in Management s opinion, based on information currently available, would not have a material effect on the OBS Group s financial position and liquidity but could be material to the OBS Group s results of operations in any one accounting period.

Antitrust

In 1999, the Brazilian Consumer Authority commenced action against Hoechst Roussel Vet, a veterinary company acquired by Intervet in 1999. The Brazilian Consumer Authority demanded the OBS Group to justify the prices charged for FMD vaccines, asserting that such prices were abusive. On February 1, 2001, the Secretariat for Economic Monitoring issued a technical opinion recommending the dismissal of the proceeding, because there was no proof of the alleged conduct. An economic survey justifying the pricing and documentation was provided by Intervet to the Ministry of Justice in May 2005. However, no final report and opinion has been published at this time. The maximum fine the Brazilian Consumer Authority could impose on Intervet is 30% of the total gross revenue of the Brazilian subsidiary in the year before the alleged infraction, which would amount to less than EUR 10 million.

Also in 1999, the Brazilian Antitrust Authority commenced an investigation into Organon s Brazilian subsidiary and 20 other pharmaceutical companies to investigate alleged collusion on their

Table of Contents

OBS GROUP

NOTES TO THE COMBINED FINANCIAL STATEMENTS (Continued)
(All amounts in millions of euros unless otherwise stated)

part against generic manufacturers of pharmaceutical products in Brazil. A final administrative decision was issued in October 2005, and each pharmaceutical company, including our subsidiary, was convicted and fined an amount equal to 1% of total gross revenue (free from tax) in the year before the infraction. This amount has not yet been established, however, the OBS Group has made a provision in the amount of approximately EUR 0.8 million.

Litigation

During the years ended December 31, 2005 and 2004, the OBS Group paid EUR 64 million and EUR 87 million, respectively, to settle claims with respect to antitrust cases relating to the Company s Remeron® product. These amounts were accrued prior to 2004.

In December 2005, the OBS Group reached a settlement agreement with Duramed/Barr on its infringement of the OBS Group s rights to the Mircette® patent. Duramed/Barr paid the OBS Group EUR 109 million during the year ended December 31, 2005, for the transfer of the marketing rights to Mircette® and for damages connected to the OBS Group s claim. The OBS Group recognized EUR 70 million of these proceeds during the year ended December 31, 2005.

During 2005, the State of Alabama, the State of Mississippi, and 41 counties (now 42 counties) and New York City within the State of New York, separately brought claims against up to approximately 80 pharmaceutical manufacturers, including Organon Pharmaceuticals USA Inc., the predecessor of our United States subsidiary Organon Pharmaceuticals U.S.A Inc. LLC and Organon USA, Inc., alleging pricing fraud and, in the case of the State of Mississippi, conspiracy to commit such fraud, in violation of state, federal, and/or common law. The plaintiffs claim that the defendants committed fraud and were unjustly enriched by intentionally setting false and inflated average wholesale prices for their pharmaceutical products, which is the basis for Medicaid reimbursement. The plaintiffs further allege that such products were then marketed to pharmacists, physicians and/or pharmacy chain stores in such a way as to capitalize on the difference between the amount reimbursed by Medicaid for dispensing the products and the actual acquisition cost for the products. The allegations against our subsidiary have been pled with limited specificity and, although Remeron® sales are specifically mentioned in most complaints, in all cases except in Alabama, the allegations may extend to other products also. The complaints seek injunctive relief as well as actual, statutory, treble and punitive damages and, in some cases, disgorgements.

All but four of the New York county cases have been consolidated in the US District Court for the District of Massachusetts. Three of the remaining New York cases have been removed to federal district courts in New York and transfer to the US District Court for the District of Massachusetts pending a decision by the Judicial Panel on Multidistrict Litigation. A motion to dismiss the cases in the US District Court for the District of Massachusetts was partially granted in April 2007. Thereafter, plaintiffs have filed a First Amended Consolidated Complaint, in response to which defendants, including our subsidiaries, have filed a joint motion to dismiss. A decision on this motion is expected in the second half of 2007. A motion to dismiss the Erie County case (one of the cases pending transfer to the US District Court for the District of Massachusetts) was partially granted in September 2006. The Mississippi case has been dismissed. The proceedings in the State of Alabama are at an early stage, with discovery having commenced on April 13, 2005. The OBS Group does not believe to have been engaged in any improper conduct and are vigorously defending these matters.

Certain wholly owned operating subsidiaries of Organon and Intervet were named in the final report of the Independent Inquiry Committee into the United Nations Oil for Food Program for humanitarian support to Iraq. The report states that these entities made some improper payments in connection with four contracts (with a total value of USD 3.4 million) with the Iraqi Government to

Table of Contents

OBS GROUP

NOTES TO THE COMBINED FINANCIAL STATEMENTS (Continued)
(All amounts in millions of euros unless otherwise stated)

provide pharmaceuticals and vaccines. Akzo Nobel has been conducting an internal review of this matter and has voluntarily reported on that review to the US Securities and Exchange Commission and to the US Department of Justice. The Dutch FIOD/ECD also conducted an investigation into Organon s involvement in this matter; these investigations have been concluded in May 2007. The OBS Group is currently discussing a possible settlement with these authorities. While neither of the said authorities have taken any action against Akzo Nobel or its subsidiaries, this matter could expose Akzo Nobel and/or its subsidiaries to regulatory and/or criminal charges and sanctions.

In January 2006, Akzo Nobel Nederland B.V. and the Akzo Nobel Pension Fund in The Netherlands received a summons from the Association of Retired Akzo Nobel Employees (Vereniging van Gepensioneerden Akzo Nobel) with regard to the changed financing of Akzo Nobel s Dutch pension plan (relating to the change from a defined benefit plan to a defined contribution plan), as a consequence of which an alleged unconditional right to indexation became conditional. If the claim were to succeed, then, pursuant to the separation agreement, the OBS Group would be responsible to reimburse Akzo Nobel or any other member of its group for all losses actually incurred in connection therewith to the extent relating to any former employees that, at the time of ceasing their employment with the Akzo Nobel Group, worked primarily in any current or former human healthcare or animal healthcare activities of the Akzo Nobel Group. The claim was recently dismissed by the Court of First Instance. An appeal can be filed within three months after the court s judgment, which period expires in April 2007.

In July 2006, drug wholesaler RxUSA brought claims against 16 pharmaceutical manufacturers, including the OBS Group, as well as against five drug wholesalers, the Healthcare Management Distribution Association and certain individuals, alleging joint and several liability for, amongst other things, monopolization of the wholesale pharmaceutical market in violation of state and federal antitrust laws. The plaintiff claims that defendants willfully acquired and sought to maintain a monopoly and exclude competition by secondary wholesalers . The plaintiff further alleges that the 16 pharmaceutical manufacturers and other wholesale dealers wrongfully and illegally refused to deal directly with RxUSA, making it impossible for it to acquire products for sale. RxUSA is seeking injunctive relief, attorneys fees and treble damages. The proceedings are at an early stage. The OBS Group has filed motions to dismiss these claims and intend to contest them vigorously.

During 2006, the OBS Group lost key elements of patent protection for Livial® in the United Kingdom. Key protective claims under our chemical purity, crystalline purity and particle size patents have recently been revoked by U.K. courts. The OBS Group has decided to appeal the revocation of the crystalline purity patent, but not to appeal the decision regarding the chemical purity patent. Permission to appeal the decision regarding the particle size patent has been denied by the court in London. The OBS Group s chemical purity patent has been revoked by the European Patent Office. The OBS Group has appealed the decision to revoke this patent, and this appeal has had a suspensive effect on revocation. The OBS Group s particle size patent has also been challenged before the European Patent Office.

A number of the OBS Group subsidiaries are the subject of litigation or product liability claims arising out of the normal conduct of their business, as a result of which claims could be made against them which, in whole or in part, might not be covered by insurance. Provisions are established for the gross amount of any probable claim that can be reasonably estimated. Insurance receivables are recorded only in respect of amounts that are virtually certain to be recovered.

There are various remaining product liability claims pending against the OBS Group in various European countries, Brazil, Mexico and Australia by, in most cases, women claiming to have conceived while allegedly using the OBS

Group s contraceptive Implanon®. Other claims relate to

Table of Contents

OBS GROUP

NOTES TO THE COMBINED FINANCIAL STATEMENTS (Continued)
(All amounts in millions of euros unless otherwise stated)

problems in connection with the insertion or removal of Implanon® or to changes in bleeding patterns. Often, the physician who inserted the product is named as a co-defendant. Although these cases have all been brought by individual women, only in The Netherlands the competent court has decided to consolidate the cases. On June 15, 2005, a court in s-Hertogenbosch in The Netherlands issued a preliminary judgment to the effect that, pending allocation of responsibility between physicians and Organon, damages should be paid to women who unintentionally became pregnant while using Implanon®. The OBS Group appealed this decision in September 2005. Oral pleadings were presented for the court of appeal on May 14, 2007. A judgment is expected on August 28, 2007. No final judgments have been rendered. Any damages for which the OBS Group may be held liable in connection with these cases are expected to be covered by product liability insurance.

In 1999, an ex-freelance collaborator of Diosynth B.V./Moeders voor Moeders, commenced legal action with respect to alleged entitlements to retirement benefits against Diosynth B.V. (as per January 1, 2007, part of N.V. Organon). Entitlement to a retirement benefit requires an employment relationship; Diosynth believes that freelancers working for Moeders voor Moeders do not qualify as employees and are not entitled to receive a pension. The legal position in this case may create a precedent for a couple of hundred of ex-freelancers of Moeders voor Moeders. The deposition of witnesses in this case will be finalized on October 4, 2007.

Salmon producers in Chile have made claims for damages allegedly incurred because of the use of Intervet s fish vaccines in that country. The claims were filed in 2005, 2006 and 2007. The claims maintain that administration of Intervet s vaccine against vibriosis and infectious pancreatic necrosis caused death or injury to part of their salmon populations. No judgments have been rendered. At this time the OBS Group has no reason to believe that any damages for which the OBS Group may be held liable in connection with these claims would not be covered by the product liability insurance the OBS Group maintains.

A case from Intervet, Inc. against Merial Ltd. et al. is pending since December 23, 2005 in the United States District Court for the District of Columbia. This lawsuit is a declaratory judgment action seeking a declaration from the court that United States Patent No. 6,368,601 (titled Porcine Circovirus Vaccine and Diagnostics Reagents and referred to herein as the 601 patent) is invalid, unenforceable, and not infringed by Intervet s PCV-2 vaccine.

Merial Ltd, and Merial SAS have answered the Complaint by alleging that the 601 patent is valid, enforceable, and infringed by Intervet s PCV-2 vaccine. They also have brought a counterclaim for patent infringement against Intervet, Inc. Intervet has responded by asserting that the 601 patent is invalid, unenforceable, and not infringed by Intervet, Inc. Discovery is presently ongoing between Merial SAS, Merial Ltd, and Intervet Inc. Under the present schedule for the case, there will be a hearing to determine the meaning of the claims of the 601 patent early August, 2007. Trial of this matter likely will not occur until the second or third quarter of 2008.

A second case, Intervet, Inc. v. Merial Ltd. et al., is pending since March 20, 2007, in the United States District Court for the District of Columbia. This lawsuit is a declaratory judgment action seeking a declaration from the court that United States Patent No. 7,192,594 (titled Postweaning Multisystemic Wasting Syndrome and Porcine Circovirus from Pigs and referred to herein as the 594 patent) is invalid, unenforceable, and not infringed by Intervet s PCV-2 vaccine. Merial Ltd, and Merial SAS have filed and served a Complaint for patent infringement and demand for jury trial, alleging that the 594 patent is valid, enforceable, and infringed by Intervet s PCV-2 vaccine.

In November 2006, four trade unions together initiated proceedings in The Netherlands against Akzo Nobel Nederland B.V., a subsidiary of Akzo Nobel. The trade unions claim that Akzo Nobel

Table of Contents

OBS GROUP

NOTES TO THE COMBINED FINANCIAL STATEMENTS (Continued)
(All amounts in millions of euros unless otherwise stated)

Nederland B.V., allegedly as representative of all other parts of the Akzo Nobel Group , wrongfully terminated the future payment of an allowance to cover medical insurance costs of retirees in The Netherlands. These retirees also include persons who were employed in current or former human healthcare and animal healthcare activities of the Akzo Nobel Group.

The trade unions allege that the retirees, on the basis of a promise made by Akzo Nobel Nederland B.V., were entitled to receive the allowance indefinitely and that there was insufficient cause for termination of the obligation. Akzo Nobel Nederland B.V. has indicated that it had the right to terminate the arrangements subject to a transitional regime through June 30, 2009. Akzo Nobel Nederland B.V. has expressed the intention to defend the claim by the trade unions. The proceedings against Akzo Nobel Nederland B.V. are at an early stage. It is currently not clear what would be the financial consequences for the OBS Group if the claim would succeed. Pursuant to the separation agreement, the OBS Group will be responsible for all costs incurred by Akzo Nobel or any other member of its group in connection with the allowances mentioned above with respect to retirees that, at the time of ceasing their employment with the Akzo Nobel Group, worked primarily in any current or former human healthcare or animal healthcare activities of the Akzo Nobel Group. The maximum amount that the OBS Group could be required to reimburse would depend on a number of factors, which also include the arrangements with individual employees, any future changes in the arrangements, and the age to which the retirees will live.

On March 23, 2007 the University of Illinois filed a lawsuit against Organon Teknika Corporation for breach of contract of the revised Tice license agreement which dates back to 1986. The UOI claims USD 14.9 million of underpaid royalties (which is UOI s calculation of the present value of the alleged royalty underpayment), based on an audit on the period January 1, 2002, through December 31, 2004. The difference relates to a different interpretation of what the correct arms length price should be. Organon Teknika is of the opinion that it paid the correct amount of royalties.

There have been various lawsuits filed against several US entities relating to the use of NuvaRing. With the exception of three cases, the lawsuits contain little information about the claimed injuries. It should be noted that Organon does not yet have medical or other records to corroborate the allegations. The remaining cases do not contain any information other than the allegation that the women used NuvaRing and sustained injuries thereby . Other general allegations of the thrombogenicity of the product suggest that the claimants intend to allege that they sustained a thromboembolic event.

A number of other claims are pending against the OBS Group, all of which are contested. The OBS Group is also involved in disputes with tax authorities in several jurisdictions. Furthermore, in the context of the divestitures of certain businesses by Akzo Nobel, our sole shareholder, prior to the creation of our company, the relevant Akzo Nobel Group companies have agreed to indemnify and/or provide guarantees to the buyers (and/or their successors and assignees) regarding certain representations and warranties or developments. To the extent that these relate to the current or former human pharmaceutical or animal health business activities of Akzo Nobel, the OBS Group agreed under the Separation Agreement to indemnify Akzo Nobel in respect of claims arising therefrom.

While the outcome of these claims and disputes cannot be predicted with certainty, the OBS Group believes, based upon legal advice and information received, that the final outcome will not materially affect the combined financial position of the OBS Group but could be material to the OBS Group s result of operations or cash flows in any one accounting period.

Other contingent liabilities

At December 31, 2006 and 2005, guarantees related to contracts with third parties totaled EUR 3 million and EUR 7 million, respectively.

Table of Contents

OBS GROUP

NOTES TO THE COMBINED FINANCIAL STATEMENTS (Continued)
(All amounts in millions of euros unless otherwise stated)

A majority of the OBS Group businesses do not file separate tax returns since these entities were included in the tax groupings of other Akzo Nobel entities within their respective entity s tax jurisdiction. Certain tax authorities have the right to hold an individual entity within the tax grouping liable for any and all liabilities outstanding of the group. Management of the OBS Group believes that the chances are remote that the OBS Group will be held responsible for tax liabilities incurred by other Akzo Nobel entities.

The OBS Group is a party in several research and development collaborations and licensing agreements. These agreements have various compensation elements that can contain periodic payments, payments related to sales of certain products and milestone payments. The periodic payments are expensed in the period they relate to and the payments related to sales of certain products are expensed in the period the corresponding sales were recognized. Milestone payments are expensed in the period in which the recognition criteria related to the milestone are met.

Some of the licenses and collaboration, co-development, co-marketing and other agreements and instruments to which the OBS Group is a party, contain change of control provisions that may be triggered by a change in the controlling interest in our business. See Note 31 for further discussion of potential impacts related to the separation of the OBS Group.

Pfizer terminated the asenapine license and collaboration agreement on November 27, 2006. The termination took effect on May 27, 2007. If and when we are successful in bringing asenapine to the market, we will be obliged to reimburse Pfizer for its out-of-pocket expenses (plus 10% interest) for development, marketing and manufacturing, by paying it a royalty at the rate of 5% on net asenapine sales.

Commitments

Purchase commitments for property, plant and equipment aggregated EUR 69 million and EUR 35 million at December 31, 2006 and 2005 respectively. The OBS Group also has purchase commitments for materials and other supplies incident to the ordinary conduct of business for a total of EUR 358 million and EUR 320 million at December 31, 2006 and 2005, respectively.

Long-term liabilities contracted in respect of leasehold, rental, operating leases, research, etc., aggregated EUR 287 million and EUR 261 million at December 31, 2006 and 2005, respectively. Payments due within one year amounted to EUR 93 million and EUR 78 million at December 31, 2006 and 2005, respectively; payments between one and five years EUR 158 million and EUR 159 million, respectively, and payments due after more than five years amount to EUR 36 million and EUR 24 million, respectively.

Note 28 Cash Flow Information

The OBS Group paid cash for income taxes of EUR 41 million, EUR 57 million and EUR 70 million for the years ended December 31, 2006, 2005 and 2004, respectively. During the periods presented, some entities of the OBS Group businesses did not file separate tax returns as these entities were included in the tax grouping of other Akzo Nobel entities within the respective entity s tax jurisdiction, and the OBS Group s tax obligations for these entities are paid by other Akzo Nobel entities.

The OBS Group paid cash for interest of EUR 11 million, EUR 7 million and EUR 6 million for the years ended December 31, 2006, 2005 and 2004, respectively.

The OBS Group s financing requirements are primarily met by cash transfers with Akzo Nobel and are reflected in the financing section of the combined statements of cash flows. This represents

Table of Contents

OBS GROUP

NOTES TO THE COMBINED FINANCIAL STATEMENTS (Continued)
(All amounts in millions of euros unless otherwise stated)

net cash transfers to and from Akzo Nobel for the settlement of various intercompany transactions and financing requirements with Akzo Nobel.

Note 29 Accounting Estimates and Judgments

In preparing the financial statements, management makes estimates and judgments that affect the reported amounts of assets and liabilities, revenues and expenses, and related disclosures of contingent liabilities at the date of the OBS Group s combined financial statements. The most critical accounting policies involving a higher degree of judgment and complexity are described below.

Impairment of intangible assets and property, plant and equipment

The OBS Group reviews long-lived assets for impairment when events or circumstances indicate carrying amounts may not be recoverable. Assets subject to this review include intangible and tangible fixed assets. In determining impairments of intangible and tangible fixed assets, management must make significant judgments and estimates to determine if the future cash flows expected to be generated by those assets are less than their carrying value. Determining cash flows requires the use of judgments and estimates that have been included in the OBS Group s strategic plans and long-range planning forecasts. The data necessary for the execution of the impairment tests are based on management s estimates of future cash flows, which require estimating revenue growth rates and profit margins. Assets are written down to their recoverable amount. This recoverable amount of impaired assets is determined by taking into account these estimated cash flows and using a net present value technique based on discounting these cash flows with business-specific discount rates.

Changes in assumptions and estimates included in the impairment reviews could result in significantly different earnings than those recorded in the combined financial statements.

Internally generated research and development

Under IAS 38, *Intangible Assets*, an intangible asset is recognized when it is probable that the expected future economic benefits that are attributable to the asset will flow to the OBS Group and when the cost of the asset can be measured reliably. Internally generated research expenditure does not satisfy these criteria, and therefore is expensed as incurred under research and development expenses.

Internally generated development expenses are recognized as an intangible asset if, and only if, all the following can be demonstrated: (a) the technical feasibility of completing the development project; (b) the OBS Group s intention to complete the project; (c) the OBS Group s ability to use the project; (d) the probability that the project will generate future economic benefits; (e) the availability of adequate technical, financial and other resources to complete the project; and (f) the ability to measure the development expenditure reliably. Due to the risks and uncertainties relating to regulatory approval and to the research and development process, the criteria for capitalization are considered not to have been met until marketing approval has been obtained from the regulatory authorities.

Accounting for income taxes

As part of the process of preparing the combined financial statements, the OBS Group is required to estimate income taxes in each of the jurisdictions in which the OBS Group operates. This process involves estimating actual current tax expenses and temporary differences between tax and financial reporting. Temporary differences result in deferred tax assets and liabilities, which are included in the combined balance sheet. The OBS Group must then assess whether it is probable that deferred tax assets will be recovered from future taxable income.

Table of Contents

OBS GROUP

NOTES TO THE COMBINED FINANCIAL STATEMENTS (Continued)
(All amounts in millions of euros unless otherwise stated)

Provisions

By their nature, provisions for contingent liabilities are dependent upon estimates and assessments whether the criteria for recognition have been met, including estimates as to the outcome and the amount of the potential cost of resolution. Contingent liabilities are recognized by a charge against income when it is probable that a liability has been incurred and the amount of such liability can be reasonably estimated.

Contingent liabilities and provisioning for environmental matters, litigation, and tax disputes are discussed in Note 27. Provisions for environmental matters are based on the nature and seriousness of the contamination as well as on the technology required for cleanup. Provisions for litigation and tax disputes are also based on an estimate of the costs, taking into account legal advice and information currently available.

Should the actual outcome differ from the assumptions and estimates, revisions to the estimated provisions would be required, which could impact the OBS Group s financial position and results from operations.

Also provisions for termination benefits and exit costs involve management s judgment in estimating the expected cash outflows for severance payments and site closure or other exit costs. Should the actual cash outflows differ from the assumptions and estimates, additional charges would be required, which could impact the OBS Group s financial position and results from operations.

Accounting for pensions and other postretirement benefits

Retirement benefits represent obligations that will be settled in the future and require assumptions to project benefit obligations and fair values of plan assets. Retirement benefit accounting is intended to reflect the recognition of future benefit costs over the employee s approximate service period, based on the terms of the plans and the investment and funding decisions made by the OBS Group. The accounting requires management to make assumptions regarding variables such as discount rate, rate of compensation increase, return on assets, mortality rates, and future healthcare costs. Periodically, management consults with external actuaries regarding these assumptions. Changes in these key assumptions can have a significant impact on the projected benefit obligations, funding requirements and periodic costs incurred. For details on key assumptions and policies, see Note 21.

It should be noted that when discount rates decline or rates of compensation increase due to e.g. increased inflation pension and postretirement benefit obligations will increase. Net periodic pension and postretirement costs might also increase, but that depends on the actual relation between the unrecognized loss and the so-called corridor (10% of the greater of benefit obligations and plan assets) as well as on the relative change of the discount rate versus the change of the benefit obligation.

Note 30 Subsequent Events

Loan from Akzo Nobel

On February 28, 2007, Akzo Nobel and the OBS Group entered into a EUR 1.15 billion loan. Under the loan agreement, the maturity date of the loan is December 31, 2007, and the interest rate is the 6-month EURIBOR + 0.15% that accrues on the amount owed from March 1, 2007 to the date of payment (both days inclusive). The entire

principal amount of the loan not yet repaid to Akzo Nobel shall be due for immediate payment without any further notification or formality being required should, amongst others, any other indebtedness of the OBS Group becomes due and payable prior to its

Table of Contents

OBS GROUP

NOTES TO THE COMBINED FINANCIAL STATEMENTS (Continued)
(All amounts in millions of euros unless otherwise stated)

specified maturity by reason of any default by the OBS Group in the due performance or observance of any obligation relating thereto, unless such indebtedness shall not be material in the context of the loan agreement.

Schering-Plough proposal to purchase the OBS Group

On March 12, 2007, Schering-Plough announced its intention to acquire the OBS Group from Akzo Nobel for EUR 11 billion in cash.

Note 31 Incorporation and Separation

Incorporation

Following the announcement of Akzo Nobel that it intends to separate its healthcare activities from the Akzo Nobel Group, Akzo Nobel incorporated OBS N.V. on September 1, 2006 as a public company with limited liability (naamloze vennootschap) incorporated under the laws of The Netherlands with an authorized share capital of EUR 225 thousand and an issued share capital of EUR 45 thousand. The OBS N.V. s corporate seat is in Oss, The Netherlands.

On September 30, 2006 Akzo Nobel contributed to OBS N.V., through a contribution in kind, the shares of the two subholding companies, Organon BioSciences International B.V. and Organon BioSciences Nederland B.V., in exchange for 24,955,000 ordinary shares of OBS N.V. with a nominal value of EUR 1.00 (one euro) per share. As per the date of this contribution, the Company had an authorized share capital of EUR 125 million and an issued share capital of EUR 25 million.

The combined financial statements for the year ended December 31, 2006, include invested equity amounting to EUR 2,311 million. The invested equity included certain allocated balances, which legally were not part of the aforesaid contribution in kind to OBS N.V. on September 30, 2006. Consequently, the shareholders equity in the legal company balance sheet of OBS N.V. as of December 31, 2006 differs from the invested equity in the combined financial statements as of December 31, 2006. The main differences relate to a different classification of the Akzo Nobel related funding (presented as invested equity in the combined financial statements and as intercompany debt in the legal company balance sheet), provisions for tax liabilities related to allocated balances which will be settled by Akzo Nobel as these tax liabilities were incurred by the OBS entities when those were part of an Akzo Nobel fiscal unity, and to certain other items which are allocated to the OBS Group which will not be transferred to the OBS Group.

Separation

In February 2006, Akzo Nobel announced its intention to separate the OBS Group. In March 2007, Akzo Nobel announced that it had subsequently received an offer from Schering-Plough to acquire the OBS Group. The works council advice procedure in the Netherlands is still to be completed. Subject thereto, the intended closing is further subject to certain conditions precedent, including the obtaining of merger clearances in certain jurisdictions. The proceeds from the sale of the OBS Group will not be received by the OBS Group but will be received by Akzo Nobel.

Akzo Nobel and the OBS Group have identified certain issues and areas that, in preparation of and following the separation, required mutually agreeable arrangements between them. These issues and areas have been included in a separation agreement, entered into between Akzo Nobel and the OBS Group. The separation agreement was signed on February 28, 2007, and was subsequently amended on March 11, 2007.

Table of Contents

OBS GROUP

NOTES TO THE COMBINED FINANCIAL STATEMENTS (Continued)
(All amounts in millions of euros unless otherwise stated)

The amended separation agreement addresses, amongst others, the separation of liabilities and obligations, health, safety, and environmental indemnities, release of guarantees, pending litigation, provisions and accruals, claimant s insurance and employee benefit related matters.

The terms of the intended transaction between Akzo Nobel and Schering-Plough include that, subject to certain limitations and procedural provisions, Akzo Nobel indemnifies Schering-Plough for (i) all taxes for which a member of the OBS Group becomes liable, relating to the period prior to January 1, 2007 and that are not provided for in the combined financial statements of the OBS Group for the period ended as of December 31, 2006, and (ii) taxes for which a member of the OBS Group becomes liable relating to the period starting on January 1, 2007 and ending on the closing date of the intended transaction, unless and to the extent the member of the OBS Group concerned retains the benefit of the underlying income, profit or gain at closing, or such income, profit, gain or event has arisen in the ordinary course of business of the member of the OBS Group concerned.

The terms of the intended transaction further include Schering-Plough will indemnify Akzo Nobel against any increase of taxes incurred by Akzo Nobel or a member of Akzo Nobel as a consequence of any pre-closing transactions, requested by Schering-Plough and consented by Akzo Nobel, which would allow for a direct sale by Akzo Nobel of the shares in one or more members of the OBS Group to Schering-Plough.

The separation agreement also contains provisions dealing with the retirement benefits of relevant participants in various applicable pension arrangements based on an agreed upon division of the rights, obligations, assets and liabilities relating to, on the one hand, the retirement benefits of the relevant (current and former) employees in the (current and former) human healthcare or animal healthcare activities of the OBS Group and, on the other hand, retirement benefits of other participants in Akzo Nobel plans. It should be noted that a number of these provisions are dependent on the approval of relevant third parties, for example pension fund trustees, employee representative bodies and relevant authorities. The separation agreement thus also provides that in the event that the OBS Group and Akzo Nobel have not been able to give effect to the agreed (basis for) division, they will use their reasonable best efforts to procure that the parties are placed in the same position as they would have had the division been affected on the agreed basis.

OBS N.V. has undertaken in the separation agreement to procure that, for services rendered on or after January 1, 2007, relevant participants under the OBS Group s retirement benefit plans are offered retirement benefits which are substantially equivalent (or such other measure as may be required under applicable law) to their current retirement benefits.

The financial implications of a future split as defined above, for example on assets, liabilities and future pension premiums, if any, cannot be determined yet. However, it is the intention of Akzo Nobel and the OBS Group to limit the financial implications for the companies, arising out of the split of rights, obligations and assets. Furthermore, the subordinated loan to the Akzo Nobel Pension Fund of which the OBS Group s portion (EUR 33 million) was allocated in the combined financial statements for the year ending December 31, 2006, will remain with Akzo Nobel since Akzo Nobel holds the legal title.

The terms of the intended transaction between Akzo Nobel and Schering-Plough further include that (i) Akzo Nobel will transfer to the purchaser, at closing of the intended transaction, its claim against OBS N.V. under the related party loan of EUR 1.15 billion plus accrued interest and ii) all other intra-group indebtedness between OBS N.V. on the one

hand and the other members of the Akzo Nobel Group on the other hand (including several loans made by OBS N.V. to Akzo Nobel in 2007 on terms substantially equivalent to the aforesaid related party loan), and subsequently will be

Table of Contents

OBS GROUP

NOTES TO THE COMBINED FINANCIAL STATEMENTS (Continued)
(All amounts in millions of euros unless otherwise stated)

paid immediately after closing. Under the loan agreement between Akzo Nobel (as lender) and OBS N.V. (as borrower) the maturity date of the loan is December 31, 2007 and the interest rate is the 6-month EURIBOR + 0.15%, that accrues on the amount owed, from March 1, 2007 to the date of payment (both days inclusive). The entire principal amount of the loan not yet repaid to Akzo Nobel shall be due for immediate payment without any further notification or formality being required should, amongst others, any other indebtedness of OBS N.V. becomes due and payable prior to its specified maturity by reason of any default by OBS N.V. in the due performance or observance of any obligation relating thereto, unless such indebtedness shall not be material in the context of the loan agreement.

OBS N.V. has undertaken to replace the statement of joint and several liability (verklaring van hoofdelijke aansprakelijkheid) as provided by Akzo Nobel in respect of the members of the OBS Group in The Netherlands under article 2:403 section 1(f) Netherlands Civil Code as soon as reasonably practicable, but in any event within 6 months after closing of the intended transaction between Akzo Nobel and Schering-Plough.

Note 32 Application of Generally Accepted Accounting Principles in the United States of America

The OBS Group s combined financial statements have been prepared in accordance with IFRS which, as applied by the OBS Group, differs in certain significant respects from US GAAP. The effects of the application of US GAAP to combined net income, as determined under IFRS, are set out in the table below:

	For the Year Ended December 31,	
	2006	**2005**
IFRS profit for the period attributable to equity holders of OBS Group	393	566
US GAAP adjustments:		
(a) Business combinations	1	1
(b) Pensions and other postretirement benefits	(32)	(71)
(c) Impairment of goodwill		15
(d) Research and development	5	(26)
(e) Subsequent events	132	(39)
(f) Tax on elimination of intercompany profits	3	(7)
(g) Deferred income taxes	11	31
Total US GAAP adjustments	120	(96)
Net income, as reported under US GAAP	513	470

Table of Contents

OBS GROUP

NOTES TO THE COMBINED FINANCIAL STATEMENTS (Continued)
(All amounts in millions of euros unless otherwise stated)

The effects of the application of US GAAP to total invested equity, as determined under IFRS, are set out in the table below:

	As of December 31,	
	2006	**2005**
Invested equity, as reported under IFRS	2,311	2,186
Less: minority interests, as reported under IFRS		(1)
Invested equity excluding minority interests, as reported under IFRS	2,311	2,185
US GAAP adjustments:		
(a) Business combinations	361	363
(b) Pensions and other postretirement benefits	33	103
(c) Impairment of goodwill	15	15
(d) Research and development	(27)	(32)
(e) Subsequent events	(15)	(138)
(f) Tax on elimination of intercompany profits	(37)	(40)
(g) Deferred income taxes	2	(21)
Total US GAAP adjustments	332	250
Invested equity, as determined under US GAAP	2,643	2,435

(a) Business combinations

The aggregate adjustment for business combinations presented in the tables above consists of the following adjustments:

	For the Year Ended December 31,		As of December 31,	
	2006	**2005**	**2006**	**2005**
US GAAP adjustments:				
(1) Acquired in-process research and development	1	1	(5)	(6)
(2) Application of IFRS 1			366	369
Total US GAAP adjustments	1	1	361	363

(1) Acquired in-process research and development

Under IFRS, in-process research and development acquired in connection with a business combination is eligible for capitalization under IFRS 3, *Business Combinations*, and IAS 38. Under US GAAP, the attributable fair value of in-process research and development acquired in a business combination, and which has no alternative future use, is expensed as of the acquisition date in accordance with SFAS No. 141, *Business Combinations*, FIN No. 4, *Applicability of FASB Statement No. 2 to Business Combinations to be Accounted for by the Purchase Method*, and/or SFAS No. 2, *Accounting for Research and Development Costs*.

The adjustment to invested equity included in the tables above reflects the invested equity impact of immediate write-off of acquired in-process research and development-related assets (EUR 5 million and EUR 6 million, respectively, as of the years ended December 31, 2006 and 2005) for US GAAP purposes. The tables also reflect the reversal of amortization expense and/or impairments

Table of Contents

OBS GROUP

NOTES TO THE COMBINED FINANCIAL STATEMENTS (Continued)
(All amounts in millions of euros unless otherwise stated)

(EUR 1 million and EUR 1 million, respectively, for each of the years ended December 31, 2006 and 2005) recorded for IFRS purposes in subsequent periods.

(2) Application of IFRS 1

IFRS 1, *First-Time Adoption of International Financial Reporting Standards*, has been applied by the OBS Group in preparing its combined financial statements. IFRS 1 generally requires retrospective application of all IFRS standards that are effective at the reporting date. However, IFRS 1 permits certain exemptions and exceptions to this requirement. In particular, IFRS 1 permits companies who consummated business combinations prior to the date of their transition to IFRS (for the OBS Group as of January 1, 2004) to retain the accounting applied under the accounting principles applied prior to the adoption of IFRS.

Specifically, for certain business combinations consummated prior to January 1, 2000, the OBS Group recorded goodwill resulting from the business combinations directly in invested equity. From January 1, 2000 through the adoption of changes in accounting rules prior to the adoption of IFRS, the OBS Group amortized goodwill. Under US GAAP, for all periods presented, goodwill is required to be recorded as an asset, initially subject to periodic amortization (through December 31, 2001) and subsequently periodic (at least annual) impairment tests.

Accordingly, this adjustment reflects the reinstatement of goodwill, net of applicable accumulated amortization and impairments, for US GAAP purposes as of each of the balance sheet dates presented.

(b) Pensions and other postretirement benefits

The aggregate adjustment for pensions and postretirement benefits presented in the tables above consists of the following adjustments:

	For the Year Ended December 31,		As of December 31,	
	2006	**2005**	**2006**	**2005**
US GAAP adjustments:				
(1) Definition of defined contribution plan	(10)	(68)	94	159
(2) Additional minimum pension liability				(74)
(3) Application of IFRS 1 and other differences	(22)	(3)	(61)	18
Total US GAAP adjustments	(32)	(71)	33	103

(1) Definition of defined contribution plan

Under IAS 19 (Revised), *Employee Benefits*, an arrangement qualifies as a defined contribution plan if a company s legal or constructive obligation is limited to the amount contributed by it into a separate entity (generally, a fund).

This is the case regardless of whether the fund holds sufficient assets to pay all employee benefits laid out in the plan agreement relating to employee service in the current and prior periods. This definition focuses on the contributions to be made by the company to the plan as a whole and does not require individual participant accounts to which contributions would be made.

Under US GAAP, SFAS No. 87, *Employers Accounting for Pensions*, states that a defined contribution plan is any arrangement that provides benefits in return for services rendered, establishes an individual account for each participant, and specifies how recurring periodic contributions to the

Table of Contents

OBS GROUP

NOTES TO THE COMBINED FINANCIAL STATEMENTS (Continued)
(All amounts in millions of euros unless otherwise stated)

individual s account are to be determined. Moreover, the benefits a participant in a defined contribution plan will receive depend solely on the amount contributed to the participant s account, the return earned on those contributions, and forfeitures of other participants benefits that may be allocated to the remaining participant accounts.

During 2005, Akzo Nobel reached an agreement with the unions on a change of its pension plan in the Netherlands, in which OBS Group employees and former employees participate, so that effective December 31, 2005, it changed from a defined benefit plan to a defined contribution plan under IFRS, as the actuarial risks related to the Dutch plan no longer rested with the OBS Group. However, under US GAAP, SFAS No. 87 specifically prescribes for a defined contribution plan that the plan provides an individual account for each participant. The Dutch plan does not provide such individual accounts per participant as it is a collective defined contribution plan. Accordingly for US GAAP, under SFAS No. 87 the Dutch pension plan is still accounted for as a defined benefit plan.

The adjustment to invested equity included in the table above as of December 31, 2006 and 2005 reflects the re-instatement of the US GAAP liability for the pension plan in accordance with SFAS No. 87. The adjustment to net income included in the tables above for the year ended December 31, 2006 reflects the excess of US GAAP expense calculated in accordance with SFAS No. 87 over contributions made to plan during the year. For the year ended December 31, 2005, the adjustment to net income in the table above reflects the excess of SFAS No. 87 expense over contributions, offset in 2005 by the gain on termination of EUR 59 million (before income taxes) recognized upon modification of the plan in 2005 that caused it to be accounted for as a defined contribution plan for IFRS purposes.

(2) Additional minimum pension liability

Prior to adoption of SFAS No. 158, *Employers Accounting for Defined Benefit Pension and Other Postretirement Plans an amendment of FASB Statements No. 87, 88, 106, and 132(R),* SFAS No. 87 required employers to report a minimum pension liability in certain circumstances. Under SFAS No. 87, if the accumulated benefit obligation (ABO) exceeded the fair value of the plan s assets, the employer was required, at a minimum, to recognize a liability for that difference. Where required, an additional minimum pension liability was recognized by recording an intangible pension asset to the extent of any unrecognized prior service cost, with a charge through other comprehensive income, net of any deferred tax benefits, for any excess. The concept of a minimum pension liability does not exist in IFRS. Following adoption of SFAS No. 158 (as of December 31, 2006), which requires employers to recognize in full an asset or a liability for the funded status of its defined benefit plans, additional minimum pension liabilities are no longer required.

(3) Application of IFRS 1 and other difference

Under IFRS, the OBS Group accounts for its pension and other postretirement benefit plans in accordance with IAS 19 (Revised), *Employee Benefits*. In addition, upon transition to IFRS as of January 1, 2004 (and in accordance with IFRS 1), all unrecognized actuarial gains and losses as of that date were recognized immediately in invested equity, with an offset to the pension liability. Accordingly, under IFRS, as of January 1, 2004, the OBS Group had no deferred actuarial gains or losses. Subsequently, in accordance with IAS 19 (Revised), the OBS Group applied a corridor policy whereby actuarial gains and losses are deferred when they initially arise (for those arising after January 1, 2004). Thereafter, to the extent that unrealized actuarial gains or losses exceed 10% of the greater of (i) the present value of the defined benefit obligation and (ii) the fair value of plan assets, they are recognized in the combined statements of income through periodic amortization over the expected remaining working lives of the

employees participating in the plan. Otherwise, they continue to be deferred until they exceed the corridor described above.

Table of Contents

OBS GROUP

NOTES TO THE COMBINED FINANCIAL STATEMENTS (Continued)
(All amounts in millions of euros unless otherwise stated)

Under US GAAP, the OBS Group accounts for its pension and postretirement benefit plans in accordance with SFAS No. 87, SFAS No. 106, *Employers Accounting for Postretirement Benefits Other than Pensions* and, as from December 31, 2006, SFAS No. 158. Prior to the adoption of SFAS No. 158, the OBS Group applied a corridor policy also under US GAAP. Following adoption of SFAS No. 158 from December 31, 2006, the OBS Group continues to apply a corridor policy with respect to determination of the income statement charge for any particular period, but the full funded status of the plan (defined benefit obligation less plan assets) is now recognized as a liability in the balance sheet with actuarial gains and losses recognized directly in invested equity.

In addition to the differences described above (principally related to the recognition of deferred actuarial gains and losses directly in invested equity as of January 1, 2004 pursuant to IFRS 1), the OBS Group has also identified differences related to the measurement date for certain of its plans. Under IFRS, IAS 19, requires that the calculation of the pension obligation, as well as the fair value of plan assets, be determined as of the company s balance sheet date. Under US GAAP, SFAS No. 87, requires that the plan s assets and obligations be measured either as of the date of the financial statements or, if used consistently from year to year, as of a date not more than three months prior to that date. Certain of the OBS Group s defined benefit plans utilize a September 30 measurement date for US GAAP purposes and a December 31 measurement date for IFRS purposes.

In the United States, the Medicare Prescription Drug Improvement and Modernization Act of 2003 introduced prescription drug benefits for retirees as well as a federal subsidy to sponsors of postretirement healthcare plans, which both began on January 1, 2006. This reimbursement right under IFRS has been recognized as an asset under other financial noncurrent assets in the combined balance sheets and is measured at fair value. At December 31, 2006 and 2005, these amounts were EUR 9 million and EUR 12 million, respectively. Under US GAAP, this reimbursement right is netted with the postretirement healthcare benefit liability.

In connection with the change in the pension plan in the Netherlands in 2005, the OBS Group was allocated a portion of the subordinated loan and loans that are to be redeemed by retaining employee pension premiums, which have been recorded at their fair value in other assets under IFRS. For US GAAP purposes, these items are included in the pension assets at their nominal value, and accordingly the assets in the IFRS balance sheet have been reversed. Any difference between the fair value and the nominal value of the loans has been reversed for US GAAP.

(c) Impairment of goodwill

Under IFRS, goodwill is required to be tested for impairment at least annually (and, more frequently, upon the occurrence of a triggering event) at the cash generating unit (or group of cash generating units, if that is how goodwill is monitored internally) level. A cash generating unit is the smallest identifiable group of assets that generates cash inflows from continuing use and that are largely independent of the cash inflows from other assets or groups of assets. The goodwill impairment test is a one-step test that compares the recoverable amount (higher of the fair value less costs to sell or value in use) of the cash generating unit to its carrying amount, with any excess of carrying amount over recoverable amount recognized as an impairment loss. Impairment losses are allocated first to reduce the carrying amount of any goodwill allocated to the cash-generating unit (or group of units) and then to the other assets of the unit (or group of units) pro rata on the basis of the carrying amount of each asset in the unit (or group of units). Impairment losses related to goodwill can not be reversed.

Under US GAAP, goodwill is required to be tested for impairment at least annually (and, more frequently, upon the occurrence of a triggering event) at the reporting unit level. A reporting unit is an operating segment or one level below an operating segment (referred to as a component). The

Table of Contents

OBS GROUP

NOTES TO THE COMBINED FINANCIAL STATEMENTS (Continued)
(All amounts in millions of euros unless otherwise stated)

goodwill impairment test is a two-step test that compares the fair value of the reporting unit to its carrying amount. If the fair value of the reporting unit exceeds its carrying amount, goodwill of the reporting unit is considered not impaired. If the carrying amount of the reporting unit exceeds its fair value, the second step of the goodwill impairment test is performed to measure the amount of impairment loss, if any. The second step of the goodwill impairment test compares the implied fair value of reporting unit goodwill, which is determined by performing a hypothetical purchase price allocation as of the impairment testing date, to the carrying amount of that goodwill, with any excess of carrying amount over the implied fair value recognized as an impairment loss. Impairment losses related to goodwill can not be reversed.

The cash generating unit is at a lower level in the operation than the reporting unit and, accordingly, under IFRS an impairment was recorded that is not reflected under US GAAP. The adjustment included in the tables above reflects the reversal for US GAAP of the impairment loss recognized for IFRS purposes that was not recognized for US GAAP purposes due to this differing level at which goodwill is tested for impairment (cash generating unit under IFRS vs. reporting unit under US GAAP).

(d) Research and development

Under IFRS, payments made to acquire research and development-related assets outside of a business combination, and patents or licenses for products that are still in the research or development stage, are eligible for capitalization under IAS 38 when all of the following conditions are met: (i) the project meets the definition of an asset, (ii) the project is identifiable and (iii) the fair value of the project can be measured reliably. Accordingly, under IFRS, certain up-front payments made in connection with collaboration agreements were capitalized and are being amortized over their estimated useful lives.

Under US GAAP, payments to acquire research and development-related assets that have no alternative future use are expensed as of the acquisition date in accordance with SFAS No. 2.

The adjustment included in the tables above reflects the immediate write-off of acquired research and development-related assets in the period of acquisition (EUR 4 million and EUR 28 million, respectively, for the years ended December 31, 2006 and 2005) and for US GAAP purposes offset by the reversal of amortization expense and/or impairments (EUR 9 million and EUR 2 million, respectively, for each of the years ended December 31, 2006 and 2005) recorded for IFRS purposes in subsequent periods.

(e) Subsequent events

The aggregate adjustment for subsequent events presented in the tables above consists of the following adjustments:

	For the Year Ended December 31,		As of December 31,	
	2006	**2005**	**2006**	**2005**
US GAAP adjustments:				

(1) Subsequent events other than taxes	(4)	(7)	4	8
(2) Subsequent events tax-related	136	(32)	(19)	(146)
Total US GAAP adjustments	132	(39)	(15)	(138)

Table of Contents

OBS GROUP

NOTES TO THE COMBINED FINANCIAL STATEMENTS (Continued)
(All amounts in millions of euros unless otherwise stated)

Under IFRS, the OBS Group has applied IAS 10, *Events after the Balance Sheet Date*, and has adjusted its combined financial statements for adjusting events identified between the time the parent company financial statements were issued and the date on which the OBS Group s combined financial statements were issued.

Under US GAAP, practice with respect to the preparation of carve-out financial statements is to reflect subsequent events on a consistent basis with the parent company, as the carve-out financial statements are an extraction of the parent company accounts, unless the adjustment represents a correction of an error. The subsequent events other than tax-related adjustments noted above primarily relate to reversals of legal settlements. More significantly, under IAS 10, through January 1, 2004, the OBS Group recorded an aggregate provision of EUR 153 million with respect to various court cases related to its Remeron® product that had been ongoing since 2002. During 2004, the OBS Group settled certain of these court cases (EUR 89 million). During 2005, the OBS Group settled all remaining Remeron® court cases (EUR 64 million) which were approved in November 2005 by the United States District Court for the District of New Jersey. Under US GAAP, the Remeron® settlements were recorded in periods consistent with Akzo Nobel. The subsequent events for the tax-related adjustments primarily relate to tax settlements received by the OBS Group for transfer pricing.

Under US GAAP, the amounts have been recognized in periods consistent with Akzo Nobel. Accordingly, the subsequent event adjustments reflected in the IFRS combined financial statements have been reversed under US GAAP.

(f) Tax on the elimination of intercompany profits

In accordance with IFRS (IAS 12, *Income Taxes*), the deferred tax effect of the elimination of intercompany profit in inventory is calculated using the purchaser s tax rate. Under US GAAP (SFAS 109, *Accounting for Income Taxes*), no deferred tax asset is recorded for the difference between the tax base in the buyer s jurisdiction and the amount reported in the combined financial statements; additionally, taxes payable on intercompany transfers recognized by the seller are deferred in consolidation, hence eliminating the income tax effects of intercompany transfers in the combined statements of income.

For the year ended December 31, 2006, this resulted in an increase in net income of EUR 3 million and a decrease in invested equity at December 31, 2006 of EUR 37 million. For the year ended December 31, 2005, this resulted in a decrease in net income of EUR 7 million and a decrease in invested equity at December 31, 2005 of EUR 40 million.

(g) Deferred income taxes

The aggregate adjustment for income taxes presented in the tables above consists of the following adjustments:

	For the Years Ended December 31,		As of December 31,	
	2006	**2005**	**2006**	**2005**
US GAAP adjustments:				

(1) Deferred tax on in-process research and development			1	2
(2) Other deferred income tax impacts	11	31	1	(23)
Total US GAAP adjustments	11	31	2	(21)

Table of Contents

OBS GROUP

NOTES TO THE COMBINED FINANCIAL STATEMENTS (Continued)
(All amounts in millions of euros unless otherwise stated)

(1) Deferred income tax on in-process research and development

Under IFRS, a deferred tax asset or liability is recognized for differences in the financial reporting basis and tax basis of acquired in-process research and development, similar to other identifiable intangible assets, irrespective of whether the acquired in-process research and development has basis for tax purposes. Under US GAAP (EITF 96-7, *Accounting for Deferred Taxes on In-Process Research and Development activities acquired in a Business Combination*), in circumstances where there is no tax basis in the acquired in-process research and development deferred taxes are not provided on the initial difference between the amount assigned for financial reporting and tax purposes and the in-process research and development is charged to expense on a gross basis (without tax benefit) at acquisition. In circumstances where a tax basis exists for the acquired in-process research and development, upon consummation of the business combination, the in-process research and development is immediately charged to expense, a deferred tax asset is recognized to the extent that realizability is more likely than not.

The deferred tax liability recorded under IFRS results in a corresponding increase to goodwill. Although this difference does not affect invested equity (between IFRS and US GAAP) at the acquisition date, a reclassification adjustment is necessary under US GAAP to reduce goodwill by the amount of the deferred tax liability recorded under IFRS in relation to acquired in-process research and development and to reduce deferred tax liabilities by a corresponding amount (EUR 8 million). The impact on income tax expense of this difference when the acquired in-process research and development is amortized or impaired for IFRS purposes is reversed under US GAAP.

(2) Other deferred income tax impacts

This adjustment reflects the deferred tax effects attributable to the aforementioned pre-tax adjustments.

(h) Other presentation differences

Deferred income taxes

Under IFRS, deferred tax assets and liabilities are classified as non-current on the balance sheet based on the timing of their expected reversal.

Under US GAAP, deferred tax assets and liabilities are classified as current or non-current on the balance sheet based on the nature of the balance sheet item to which they relate (e.g. deferred taxes related to fixed assets are classified as non-current irrespective of when the underlying temporary difference is expected to reverse). Where no related asset or liability exists (e.g. for net operating losses), deferred tax assets or liabilities are classified as current or non-current on the balance sheet based on the timing of their expected reversal.

Oss, July 30, 2007
The Board of Management
Toon Wilderbeek

Table of Contents

Independent Auditors Report

The Board of Management
Organon BioSciences N. V.

We have audited the accompanying combined balance sheets of the OBS Group, as defined in Note 1 to the combined financial statements, as of December 31, 2006 and 2005, and the related combined statements of income, invested equity and cash flows for each of the years in the three-year period ended December 31, 2006. These combined financial statements are the responsibility of the Organon BioSciences N.V. s management. Our responsibility is to express an opinion on these combined financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (U.S .). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the OBS Group s internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting policies used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the combined financial statements referred to above present fairly, in all material respects, the financial position of the OBS Group as of December 31, 2006 and 2005, and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2006 in conformity with International Financial Reporting Standards as adopted by the European Union (E.U .).

International Financial Reporting Standards as adopted by the E.U. vary in certain significant respects from U.S. generally accepted accounting principles. Information relating to the nature and effect of such differences is presented in Note 32 to the combined financial statements.

KPMG Accountants N.V.

KPMG Accountants N. V.
Eindhoven, the Netherlands
July 30, 2007

Table of Contents

OBS Group

UNAUDITED CONDENSED COMBINED INTERIM STATEMENTS OF INCOME
(Amounts in millions of euros)

	Note	For the Six Months Ended June 30, 2007	2006
Revenues		1,859	1,870
Cost of sales		(561)	(580)
Gross profit		1,298	1,290
Selling and distribution expenses		(557)	(571)
Research and development expenses		(307)	(316)
General and administrative expenses		(114)	(127)
Other operating (expense)/income	5	3	7
Operating income		323	283
Financial expense	6	(27)	(19)
Financial income	6	6	1
		(21)	(18)
Operating income less net financing costs		302	265
Share of profit of associates		1	
Profit before tax		303	265
Income tax expense	7	(80)	(72)
Profit for the period		223	193
Attributable to:			
Equity holders of the OBS Group		223	193
Minority interest			
Profit for the period		223	193

The accompanying notes are an integral part of these unaudited condensed combined interim financial statements.

Table of Contents

OBS Group

UNAUDITED CONDENSED COMBINED INTERIM BALANCE SHEETS
(Amounts in millions of euros)

	Note	As of June 30, 2007		As of December 31, 2006	
ASSETS					
Property, plant and equipment, net			1,109		1,097
Intangible assets, net			156		145
Financial non-current assets:					
deferred tax assets	7	282		281	
investments in associates		13		13	
other investments		116		118	
			411		412
Total non-current assets			1,676		1,654
Inventories, net	8	874		851	
Income tax receivable		26		74	
Receivables from related parties, net	3	377		11	
Trade and other receivables, net	9	784		735	
Cash and cash equivalents		114		239	
Total current assets			2,175		1,910
Total assets			3,851		3,564
Invested Equity					
Owners net investment (including cumulative translation reserves)	10	1,423		2,311	
Minority interest					
Total invested equity			1,423		2,311
LIABILITIES					
Borrowings	14	56		45	
Deferred tax liabilities	7	26		25	
Provisions	12	280		267	
Total non-current liabilities			362		337
Borrowings	15	138		112	
Deferred income	13			10	
Income tax payable		131		133	
Payables to related parties	3	1,163		5	
Trade and other payables		596		611	

Provisions	12	38	45	
Total current liabilities		2,066		916
Total liabilities		2,428		1,253
Total invested equity and liabilities		3,851		3,564

The accompanying notes are an integral part of these unaudited condensed combined interim financial statements.

Table of Contents

OBS Group

UNAUDITED CONDENSED COMBINED INTERIM STATEMENTS OF CASH FLOWS
(Amounts in millions of euros)

	For the Six Months Ended June 30,	
	2007	**2006**
Profit for the period	223	193
Adjustments to reconcile earnings to cash generated from operating activities:		
Depreciation and amortization	89	92
Gains on divestments		(7)
Share of profits of associates	(1)	
Changes in deferred taxes (non-cash recognized in income)	(2)	(1)
Provisions expense (non-cash recognized in income)	5	30
Interest expense funded by Akzo Nobel		15
Corporate overhead costs funded by Akzo Nobel		14
Insurance expense funded by Akzo Nobel		14
Share-based payment costs funded by Akzo Nobel	3	2
Other	2	1
Operating cash flows before changes in working capital and provisions		
(Increase) in trade and other receivables	(32)	(82)
(Increase)/decrease in inventories	(20)	(34)
(Increase)/decrease in other non-current assets	2	14
Increase/(decrease) in trade and other payables and provisions	(5)	15
Increase/(decrease) income tax payable and receivable, net	77	19
Cash generated from operating activities	341	285
Purchase of intangible assets	(27)	(4)
Purchase of property, plant and equipment	(94)	(62)
Proceeds from sale of interests		8
Investments in associates and repayments of loans by associates		(3)
Net cash used in investing activities	(121)	(61)
Dividends paid to Akzo Nobel		
Share premium repayment	(350)	
Cash transfers (to)/from Akzo Nobel, net	(24)	(225)
Bank overdrafts		(8)
Increase in borrowings	30	2
Net cash from financing activities	(344)	(231)
Net decrease in cash and cash equivalents	(124)	(7)
Effect of exchange rate changes on cash and cash equivalents	(1)	(2)
Net decrease in cash and cash equivalents	(125)	(9)

Cash and cash equivalents at January 1	239	59
Cash and cash equivalents at June 30	114	50

The accompanying notes are an integral part of these unaudited condensed combined interim financial statements.

Table of Contents

OBS Group

UNAUDITED CONDENSED COMBINED INTERIM STATEMENTS OF CHANGES IN INVESTED EQUITY
(Amounts in millions of euros)

	Owners Net Investment	Cumulative Translation Reserves	Minority Interest	Total Invested Equity
Balance as of January 1, 2006	2,139	46	1	2,186
Changes in exchange rates in respect of foreign operations		(26)	(1)	(27)
Net income/(expense) recognized directly in equity		(26)	(1)	(27)
Profit for the period	193			193
Total income/(expenses)	193	(26)	(1)	166
Contributions attributed to:				
Share-based payment costs funded by Akzo Nobel	2			2
Interest expense funded by Akzo Nobel	15			15
Corporate overhead costs funded by Akzo Nobel	14			14
Insurance expense funded by Akzo Nobel	14			14
Tax transfers from Akzo Nobel, net	50			50
Employee benefits and other non-cash transfers, net	(3)			(3)
Cash transfers to Akzo Nobel, net	(225)			(225)
Balance as of June 30, 2006	2,199	20		2,219
Balance as of January 1, 2007	2,313	(2)		2,311
Changes in exchange rates in respect of foreign operations		(3)		(3)
Net income/(expense) recognized directly in equity		(3)		(3)
Profit for the period	223			223
Total income/(expenses)	223	(3)		220
Share premium repayment	(350)			(350)
Contributions attributed to:				
Share-based payment costs funded by Akzo Nobel	3			3
Employee benefits and other non-cash transfers, net	(2)			(2)
Cash transfers to Akzo Nobel, net	1			1

Non-cash transfers to Akzo Nobel, net	(760)		(760)
Balance as of June 30, 2007	1,428	(5)	1,423

The accompanying notes are an integral part of these unaudited condensed combined interim financial statements.

Table of Contents

OBS GROUP

NOTES TO THE UNAUDITED CONDENSED COMBINED INTERIM FINANCIAL STATEMENTS
(All amounts in millions of euros unless otherwise stated)

Note 1 Business and Basis of Presentation

Business

In these combined interim financial statements, the human healthcare business and animal healthcare business activities of Akzo Nobel N.V. (Akzo Nobel) are together referred to as the healthcare activities and references to the OBS Group or Company mean those operating companies and other subsidiaries of Akzo Nobel that undertook the human and animal healthcare activities during the relevant period covered by the combined financial statements.

The OBS Group is headquartered in Oss, The Netherlands.

The human healthcare business, Organon, specializes in the discovery, development, manufacturing and marketing of prescription medicines and products. Its core therapeutic areas of expertise are contraception, fertility, hormone therapy, mental health and anesthesia. Additionally, the Organon business includes Nobilon, a biotechnology company dedicated to exploring opportunities in the field of human vaccines.

The animal healthcare business, Intervet, offers a full range of veterinary vaccines and pharmaceuticals for a variety of animal species including poultry, pigs, cattle, sheep, goats, horses, cats, dogs and fish.

Following the announcement by Akzo Nobel that it intends to separate its healthcare activities from the Akzo Nobel Group, Akzo Nobel incorporated Organon BioSciences N.V. (OBS N.V.) on September 1, 2006 as a public company with limited liability (naamloze vennootschap) incorporated under the laws of The Netherlands with an authorized share capital of EUR 225 thousand and an issued share capital of EUR 45 thousand.

On September 30, 2006 Akzo Nobel contributed to OBS N.V., through a contribution in kind, the shares of the two subholding companies, Organon BioSciences International B.V. and Organon BioSciences Nederland B.V., in exchange for 24,955,000 ordinary shares of OBS N.V. with a nominal value of EUR 1.00 (one euro) per share. As per the date of this contribution, OBS N.V. had an authorized share capital of EUR 125 million and an issued share capital of EUR 25 million.

On March 12, 2007, Schering-Plough Corporation (Schering-Plough) announced that its board of directors approved a transaction under which it will acquire OBS N.V. from Akzo Nobel.

These combined financial statements were authorized on July 30, 2007 by the Board of Directors of OBS N.V.

Basis of Presentation

These combined financial statements reflect all of the assets, liabilities, revenues, expenses, and cash flows of the OBS Group. The significant legal entities forming part of the OBS Group are as follows:

Legal Entity	Country of Incorporation	Ownership

Organon BioSciences N.V.	The Netherlands	100.00%
Organon BioSciences Nederland B.V.(*)	The Netherlands	100.00%
Organon BioSciences International B.V. (**)	The Netherlands	100.00%
Intervet International B.V	The Netherlands	100.00%
Intervet Inc.	USA	100.00%
Intervet International GmbH	Germany	100.00%
Intervet UK Ltd	U.K.	100.00%

Table of Contents

OBS GROUP

NOTES TO THE UNAUDITED CONDENSED COMBINED INTERIM FINANCIAL STATEMENTS (Continued)
(All amounts in millions of euros unless otherwise stated)

Legal Entity	Country of Incorporation	Ownership
Laboratories Intervet S.A.	Spain	100.00%
Hydrochemie GmbH	Germany	100.00%
Intervet Australia Pty Ltd	Australia	100.00%
Intervet Deutschland GmbH	Germany	100.00%
Intervet Innovation GmbH	Germany	100.00%
Intervet do Brasil Veterinaria Ltda(***)	Brazil	100.00%
Intervet Mexico S.A. de CV	Mexico	100.00%
Intervet S.A.	France	100.00%
Intervet Productions S.A.	France	100.00%
Intervet Pharma R&D S.A.	France	100.00%.
Intervet (Italia) S.r.l	Italy	100.00%
Intervet UK Production Ltd	UK	100.00%
Intervet Holding B.V	The Netherlands	100.00%
Intervet Nederland B.V	The Netherlands	100.00%
Intervet KK	Japan	100.00%
Nobilon International B.V	The Netherlands	100.00%
N.V. Organon	The Netherlands	100.00%
Organon (Ireland) Ltd. (****)	Ireland	100.00%
Organon International Inc.	USA	100.00%
Organon USA Inc.	USA	100.00%
Organon S.A.	France	100.00%
Nippon Organon KK	Japan	100.00%
Organon GmbH	Germany	100.00%
Organon Laboratories Ltd.	UK	100.00%
Organon Espanola S.A.	Spain	100.00%
Organon Italia S.p.A.	Italy	100.00%
Organon do Brasil Indústria e Comercio Ltda	Brazil	100.00%
Organon Ilaclari A.S	Turkey	100.00%
Organon Holding B.V	The Netherlands	100.00%
Organon Nederland B.V	The Netherlands	100.00%
Organon Canada Ltd.	Canada	100.00%
Multilan AG	Switzerland	100.00%
Diosynth RTP Inc.	USA	100.00%

(*) Formerly Akzo Nobel Pharma B.V.

(**) Formerly Akzo Nobel Pharma International B.V.

(***) Represent the Intervet division of Akzo Nobel Ltda, the combined financial statements only include those assets, liabilities, revenues, expenses and cash flows of this legal entity that pertain directly to healthcare activities. In June 2006 the Intervet division of this legal entity was incorporated in a separate entity (Intervet do Brasil Veterinaria Ltda), which is indirectly 100% owned by OBS N.V. The remaining business of Akzo Nobel Ltda is not related to healthcare activities and are not part of the spin-off healthcare activities.

(****) Including Organon Ireland Swiss Branch

These combined financial statements exclude the assets, liabilities, revenues, expenses and cash flows of Akzo Nobel legal entities (and divisions thereof) not relating to the healthcare activities.

Table of Contents

OBS GROUP

NOTES TO THE UNAUDITED CONDENSED COMBINED INTERIM FINANCIAL STATEMENTS (Continued)
(All amounts in millions of euros unless otherwise stated)

During the six months ended June 30, 2006, the OBS Group divested Crina S.A., one of the remaining feed additives businesses held in the portfolio. These combined interim financial statements reflect the revenues, expenses, and cash flows of this business up to the date of divestment.

The OBS Group has historically operated as an integrated part of Akzo Nobel and within the Akzo Nobel infrastructure. However, these combined interim financial statements have been prepared on a carve-out basis from the consolidated financial statements of Akzo Nobel to represent the financial position and performance of the OBS Group as if the OBS Group has existed, as of and during the six months ended June 30, 2007 and 2006, and as if International Accounting Standard (IAS) 27, *Consolidated and Separate Financial Statements* have been applied through out. The combined financial statements included herein may not necessarily be indicative of the OBS Group s financial position, results of operations, or cash flows had the OBS Group operated as a separate entity during the periods presented or for future periods.

As described above, these combined interim financial statements reflect the assets, liabilities, revenues, expenses, and cash flows of the OBS Group. Under the carve-out basis of preparation, these combined interim financial statements as of and for the six months ended June 30, 2006 include allocations for various expenses, including corporate administrative expenses, as well as an allocation of certain assets and liabilities historically maintained by Akzo Nobel, but not recorded in the accounts of the OBS Group. These include, among other things, corporate overhead, interest expense, certain deferred and current income tax assets and liabilities, liabilities for certain compensation plans and contingent liabilities. The various allocation methodologies for corporate expenses, insurance, interest expense, share based payments, and pension and postretirement expenses are discussed in Notes 3, 3, 6, 11, and 12, respectively. Management of the OBS Group considers that such allocations have been made on a reasonable basis, but may not necessarily be indicative of the costs that could have been incurred if the OBS Group had operated on a stand-alone basis. After January 1, 2007, some of the finance and supporting corporate activities are no longer being provided by Akzo Nobel. As a result, only those expenses relating to issues maintained at Akzo Nobel are included in the combined financial statements as of and for the six months ended June 30, 2007.

Through December 2006, Akzo Nobel used a centralized approach to manage cash and to finance the OBS Group s operations. As a result, certain debt and cash and cash equivalents maintained at Akzo Nobel are not included in the combined interim balance sheet at December 31, 2006. The combined statement of income for the six months ended June 30, 2006 includes an allocation of Akzo Nobel s interest expense as discussed in Note 6. The OBS Group s financing requirements are represented by cash transactions with Akzo Nobel and are reflected in invested equity in the combined balance sheet at December 31, 2006.

The invested equity balance in these combined interim financial statements of the OBS Group constitutes Akzo Nobel s investment in the OBS Group and represents the excess of total assets over total liabilities until December 31, 2006. Invested equity includes the effects of carve-out allocations from Akzo Nobel and the funding of the OBS Group s operations through the in-house banking and cash pooling arrangements and loans to and from related parties with Akzo Nobel, and the OBS Group s cumulative net income, including income directly recognized in equity. After February 28, 2007, Akzo Nobel no longer provided financing support for the OBS Group s operations, other than via the related party loan and as a result, there are no cash transactions with Akzo Nobel reflected in invested equity in the combined balance sheet as of June 30, 2007. Invested equity does not constitute any contract that evidences a

residual interest in the assets after deducting liabilities to which reference is made in IAS 32, *Financial Statements: Disclosure and Presentation*.

Table of Contents

OBS GROUP

NOTES TO THE UNAUDITED CONDENSED COMBINED INTERIM FINANCIAL STATEMENTS (Continued)
(All amounts in millions of euros unless otherwise stated)

Prior to January 1, 2007 certain OBS Group companies were located in countries where they were included in the tax grouping of other Akzo Nobel entities within the respective entity s tax jurisdiction. The current tax payable or receivable of these OBS Group companies represents the income tax amount to be paid to or to be received from the country tax leading holding company of Akzo Nobel. For the purpose of these combined interim financial statements it is assumed that only the current period is outstanding.

The combined statements of cash flows have been prepared under the indirect method in accordance with the requirements of IAS 7 *Cash Flow Statements*. The combined statement of cash flows exclude currency translation differences, which arise as a result of translating the assets and liabilities of non-Euro companies to euros at period-end exchange rates (except for those arising on cash and cash equivalents) and have been adjusted for non-cash transactions.

Akzo Nobel and the OBS Group have identified certain issues and areas that in preparation of and following the separation require mutually agreeable arrangements between them. These issues and areas have been included in a separation agreement, which was signed on February 28, 2007. Note 20 provides further explanation on the separation agreement.

As a result of the foregoing, among other things, the combined financial statements included herein may not necessarily be indicative of the OBS Group s financial position, results of operations, or cash flows had the OBS Group operated on a stand-alone basis during the periods presented, or for future periods. Further, the combined financial statements do not reflect the financial impact of the actual separation of the OBS Group from Akzo Nobel on a stand alone basis.

The combined interim financial statements of the OBS Group have been prepared in accordance with IAS 34, *Interim Financial Reporting*. The combined financial statements as of and for the six months ended June 30, 2007 and 2006 are unaudited; however, in the opinion of the OBS Group s management, the unaudited combined interim financial statements reflect all normal recurring adjustments necessary for a fair presentation of the combined financial position, the combined results of operations and the combined cash flows of the OBS Group as of the dates and for the periods presented. Certain information and footnote disclosures normally included in financial statements prepared in accordance with International Financial Reporting Standards as adopted by the European Union (IFRS) have been condensed or omitted. IFRS as applied by the OBS Group does not differ from IFRS as provided by the International Accounting Standards Board (IASB). Although the OBS Group believes that the disclosures are adequate to make the information presented not misleading, these unaudited combined financial statements should be read in conjunction with the audited combined interim financial statements and the notes thereto for the years ended December 31, 2006, 2005 and 2004.

The OBS Group s business is not significantly impacted by seasonality. However, the results of operations for the six months ended June 30, 2007 and 2006 should not be taken as indicative of the results of operations that may be expected for the full year.

These combined interim financial statements are presented in euro, which is the functional currency of OBS N.V. and the OBS Group. All amounts are in millions of euros except headcount or unless otherwise stated. IFRS as applied by the OBS Group differs in certain significant respects from accounting principles generally accepted in the United

States of America (US GAAP). The effects of the application of US GAAP are disclosed in Note 21.

Note 2 Significant Accounting Policies

The accounting policies applied by the OBS Group in the preparation of the accompanying combined interim financial statements are the same as those applied by the OBS Group in its

Table of Contents

OBS GROUP

NOTES TO THE UNAUDITED CONDENSED COMBINED INTERIM FINANCIAL STATEMENTS (Continued)
(All amounts in millions of euros unless otherwise stated)

combined financial statements as of and for the year ended December 31, 2006. The OBS Group has not implemented any new IFRS accounting standards for the six months ended June 30, 2007.

Foreign currency translation

The main exchange rates against euros used in the preparation of the combined balance sheets and the combined statements of income are:

	Combined Balance Sheets		Combined Statements of Income For the Six-Months Ended June 30,	
	June 30, 2007	December 31, 2006	2007	2006
USD	1.345	1.317	1.328	1.229
GBP	0.672	0.671	0.675	0.689
CHF	1.657	1.607	1.635	1.567

Note 3 Related Parties

The combined interim financial statements include transactions with related parties. The OBS Group entered into transactions with Akzo Nobel and its subsidiaries. Furthermore, Akzo Nobel provided corporate services for the combined financial statements periods presented. Management believes that product transfers between OBS Group and Akzo Nobel Group were made at arm s length prices. On February 28, 2007, Akzo Nobel and the OBS Group entered into a EUR 1.150 billion loan. Under the loan agreement, the maturity date of the loan is December 31,2007 and the loan bears an interest rate of 6-months EURIBOR + 0.15% that accrues on the amount owed, from March 1, 2007 to the date of payment (both days inclusive). The entire principal amount of the loan not yet repaid to Akzo Nobel shall be due for immediate payment without any further notification or formality being required should, amongst other matters any other indebtedness of the OBS Group become due and payable prior to its specified maturity by reason of any default by the OBS Group in the due performance or observance of any obligation relating thereto, unless such indebtedness is not material in the context of the loan agreement. The loan is included in payables to related parties in the combined balance sheet as of June 30, 2007.

In the six month period ended June 30 2007, the OBS Group made several cash loans to Akzo Nobel totalling EUR 376 million on terms substantially equivalent to the terms of the aforesaid related party loan. These cash loans are included in receivables from related parties in the combined balance sheet as of June 30, 2007.

Sales and purchases of goods and services to and from Akzo Nobel and its subsidiaries were not significant for the six months ended June 30, 2007 and 2006. At June 30, 2007 and December 31, 2006, the OBS Group had receivables from Akzo Nobel and its subsidiaries of EUR 377 million and EUR 11 million, respectively. These amounts are reflected in receivables from related parties in the combined balance sheets. At June 30, 2007 and December 31, 2006,

the OBS Group had payables to Akzo Nobel and its subsidiaries of EUR 1,163 million and EUR 5 million, respectively. These amounts are reflected in payables to related parties in the combined balance sheets.

Table of Contents

OBS GROUP

NOTES TO THE UNAUDITED CONDENSED COMBINED INTERIM FINANCIAL STATEMENTS (Continued)
(All amounts in millions of euros unless otherwise stated)

In addition, the OBS Group purchases and sells goods and services to and from two other related parties in which the OBS Group holds less than a 50% equity interest (associates). Such transactions were not significant on an individual or aggregate basis for the six months ended June 30, 2007 and 2006. These transactions were conducted at arm s length with terms comparable to transactions with third parties.

General and administrative expenses for the six months ended June 30, 2006 include allocated corporate and regional costs from Akzo Nobel approximating EUR 14 million. These costs are primarily related to Akzo Nobel s corporate administrative services to the OBS Group, and are generally allocated based on a combination of the ratio of the OBS Group s annual revenues, gross profit, and property, plant, and equipment, to Akzo Nobel s comparable consolidated revenues, gross profit, and property, plant, and equipment. Management considers that such allocations have been made on a reasonable basis, but may not necessarily be indicative of the costs had the OBS Group operated as a separate entity during the periods presented. In addition, Akzo Nobel has incurred specific costs that are directly related to the OBS Group. These costs have been allocated to the OBS Group based upon actual costs incurred by Akzo Nobel. For the six months ended June 30, 2007 and 2006, these direct related expenses amounted to nil and EUR 1 million respectively.

Through December 31, 2006, Akzo Nobel incurred certain insurance costs on behalf of the OBS Group. These costs primarily included insurance premiums, costs related to insurance claims and certain administrative (insurance) services. Akzo Nobel s in-house insurance department acts as an in-house insurer that incurs the risk partially by themselves as well as insuring the risk partially with third party insurance companies. For the six months ended June 30, 2006, Akzo Nobel had allocated EUR 14 million to the OBS Group for total insurance expenses. These costs have been allocated based on the risk profiles of the OBS Group compared to the risk profiles of other Akzo Nobel businesses. The risk profiles used were based on the nature and operations of the various subsidiaries that are included in the OBS Group. Management considers that such allocations have been made on a reasonable basis, but may not necessarily be indicative of the costs had the OBS Group operated as a separate entity. As of January 1, 2007, the OBS Group has its own insurance department which acts as an in-house insurer as well as insures risks partially with third party insurance companies and Akzo Nobel s in-house insurance department acts as an insurance broker on behalf of the OBS Group for an annual fixed fee.

Through December 31, 2006, some of the OBS Group entities formed part of a fiscal unity headed by another Akzo Nobel company. In these instances, the Akzo Nobel tax leading company filed the tax return and settled the taxes with the respective OBS Group in that country. The income tax provisions related to the these OBS Group companies were calculated using a method as if these OBS Group companies had filed a separate tax return. As of January 1, 2007, the OBS is solely responsible for the filing and settlement of its companies tax returns. See Note 20, Incorporation and Separation, for tax settlements of the OBS Group for prior years which have been indemnified by Akzo Nobel.

Through December 31, 2006, Akzo Nobel used a centralized approach to manage cash and to finance the OBS Group s operations. As a result, certain debt and cash and cash equivalents maintained at Akzo Nobel were not included in the combined balance sheet as of December 31, 2006. The OBS Group s funding from Akzo Nobel through in-house banking and cash pooling and loans to and from related parties with Akzo Nobel were reflected in invested equity in the combined balance sheet at December 31, 2006. As of January 1, 2007, Akzo Nobel no longer provides financing support for the OBS Group s operations other than via the related party loan, and therefore there are no such cash transactions reflected in invested equity in the combined balance sheet as of

Table of Contents

OBS GROUP

NOTES TO THE UNAUDITED CONDENSED COMBINED INTERIM FINANCIAL STATEMENTS (Continued)
(All amounts in millions of euros unless otherwise stated)

June 30, 2007. All cash and cash equivalents reflected in these combined financial statements at June 30, 2007 belong to legal entities of the OBS Group.

The combined statement of income for the six months ended June 30, 2006 includes an allocation of Akzo Nobel s interest expense of EUR 15 million. The allocation was principally based on the daily average outstanding cash balance funded to the OBS Group through Akzo Nobel s cash accounts using a rate applicable to the underlying currency. While interest expense has been allocated, there was no debt specific to the OBS Group; therefore, no allocation of Akzo Nobel s general corporate debt has been made in the combined balance sheet at December 31, 2006 as all transactions with Akzo Nobel were settled via invested equity. There were no such interest allocations for the six months ended June 30, 2007 as Akzo Nobel no longer finances the OBS Group s operations other than via the related party loan. The combined statement of income for the six months ended June 30, 2007 includes EUR 18 million of interest expense related to the aforementioned related party loan provided by Akzo Nobel on February 28, 2007.

Prior to January 1, 2007, the OBS Group entered into derivative contracts with Akzo Nobel to manage the OBS Group s foreign currency risk. At December 31, 2006 the outstanding contracts with Akzo Nobel to buy currencies had notional values of EUR 21 million while contracts with Akzo Nobel to sell currencies had notional values of EUR 57 million. As of January 1, 2007, the OBS Group s treasury department enters into its own derivative contracts with third parties.

The OBS Group had various net loan receivables with Akzo Nobel which amounted to EUR 289 million and were included in invested equity in the combined balance sheet at December 31, 2006. These loans had interest at rates ranging from 3.9% to 4.0% in 2006. There were no such loans included in invested equity as of June 30, 2007.

In the ordinary course of business, the OBS Group has transactions with various organizations with which certain of the members of its Board of Management are associated, but no transactions were conducted in 2006 or for the six months ended June 30, 2007. Likewise, there have been no transactions with members of the Board of Management, any other senior management personnel or any family member of such persons. Also, no loans have been extended to members of the Board of Management, any other senior management personnel or any family member of such persons. Certain members of the OBS Group s Board of Management are also members of Akzo Nobel s Board of Management.

Guarantees

Through December 31, 2006, Akzo Nobel was jointly and severally liable for contractual debts of certain Dutch OBS Group companies included in these combined financial statements. These debts, provisions, and payables, at December 31, 2006, aggregated to EUR 221 million and are included in the combined balance sheet as of December 31, 2006. In addition, Akzo Nobel issued guarantees on behalf of the OBS Group companies in the amount of EUR 221 million and EUR 252 million as of June 30, 2007 and December 31, 2006, respectively including guarantees issued by Akzo Nobel in relation to the filing exemption for certain Irish companies under section 5(c) of the Companies (Amendment) Act 1986 Ireland.

As of January 1, 2007, Akzo Nobel established an umbrella facility of EUR 80 million on behalf of the OBS Group for guarantees issued by the OBS Group. The OBS Group issued guarantees of EUR 71 million to third parties during the six months ended June 30, 2007.

Note 4 Segment Information

Segment information is presented in respect of the OBS Group s business segments. The primary segment reporting is based on the business segments of the OBS Group, whereby the business

Table of Contents

OBS GROUP

NOTES TO THE UNAUDITED CONDENSED COMBINED INTERIM FINANCIAL STATEMENTS (Continued)
(All amounts in millions of euros unless otherwise stated)

segments are engaged in providing products or services which are subject to risks and rewards which differ from the risks and rewards of the other segments. In determining whether products and services are related, aspects such as the nature of the products or services, the nature of the production processes, and the type or class of customers and end users, for the products or services are taken into consideration. Segments reported are Organon and Intervet which also reflects the management structure of the OBS Group. The secondary segment reporting is based on the geographical areas in which the OBS Group operates, whereby segment revenue is based on the geographical location of customers and segment assets are based on the geographical location of the assets.

The identification of segments is based on the way the business units are currently managed (composition of management teams and responsibilities) as well as the content of management information used to allocate resources within the business units. The risks and rates of return are affected predominately by differences in its businesses, Organon and Intervet, and not by the fact that the OBS Group operates in different countries.

Segment revenues and results include items directly attributable to a segment as well as those that can be allocated on a reasonable basis.

	For the Six Months Ended June 30,									
	Revenues from Third Parties		Group Revenues		Operating Income		Share of Profit of Associates		Depreciation and Amortization	
	2007	2006	2007	2006	2007	2006	2007	2006	2007	2006
Organon	1,253	1,308	1,267	1,321	195	174	1		59	63
Intervet	606	562	606	562	128	109			30	29
	1,859	1,870	1,873	1,883	323	283	1		89	92
Inter-segment revenues			(14)	(13)						
			1,859	1,870						

Note 5 Other Operating (Expense) Income

	For the Six Months Ended June 30,	
	2007	2006
Results on sale of redundant assets	1	
Currency exchange differences	1	1

impairment charges		
Legal charges		
Results on divestments		6
Other income/(expense)	1	
	3	7

In 2006, the results on divestments of EUR 6 million relate to the gain on Intervet s divestment of one of its feed additives businesses, Crina.

Note 6 Financial Expense and Income

Through December 31, 2006, Akzo Nobel used a centralized approach for cash management and to finance its operations. Through December 31, 2006, cash deposits were remitted to Akzo Nobel on

Table of Contents

OBS GROUP

NOTES TO THE UNAUDITED CONDENSED COMBINED INTERIM FINANCIAL STATEMENTS (Continued)
(All amounts in millions of euros unless otherwise stated)

a regular basis and reflected within invested equity in the combined balance sheet. Similarly, the OBS Group s cash disbursements were funded through Akzo Nobel s cash accounts.

As a result, certain debt and cash and cash equivalents maintained by Akzo Nobel were not included in the combined balance sheet as of December 31, 2006. The OBS Group s financing requirements were represented by cash transactions with Akzo Nobel and were reflected in invested equity in the combined balance sheet at December 31, 2006.

Through December 31, 2006, interest expense allocations from Akzo Nobel were allocated principally based on the daily average outstanding cash balance funded to the OBS Group through Akzo Nobel s cash accounts using a rate applicable to the underlying currency, which ranged from 1.0% to 7.7% for the six months ended June 30, 2006. For the six months ended June 30, 2006 interest expense of EUR 15 million had been allocated to the OBS Group and is included in the combined interim statement of income.

In addition through December 31, 2006, management had determined that no debt maintained at the Akzo Nobel group level related specifically or entirely to the OBS Group businesses, nor did the OBS Group guarantee or pledge its assets as collateral for Akzo Nobel s debt. As such, management felt that there was no need to push down debt to the combined financial statements of the OBS Group at December 31, 2006. Nevertheless, as described above, interest expense had been allocated and reflected in the combined financial statements of the OBS Group because the OBS Group did receive cash advances from Akzo Nobel.

As of February 28, 2007, Akzo Nobel no longer provides financing to the OBS Group other than via the related party loan and as such, there are no longer any loans from/to Akzo Nobel included in invested equity in the combined balance sheet as of June 30, 2007. The OBS Group enters into financing arrangements with third parties on its own behalf and reflects those as liabilities in the combined balance sheet. The actual interest expense incurred in conjunction with these borrowings has been reflected in the combined interim statement of income. Interest expense of EUR 22 million for the six months ended June 30, 2007 is related to the aforementioned EUR 1.150 billion loan with Akzo Nobel.

Financial expense and income consist of the following:

	2007	2006
For the six months ended June 30,		
Financial expenses		
Interest expense related parties	(22)	(15)
Interest expenses other	(5)	(4)
Financial income		
Interest income related parties	3	
Interest income other	3	1
	(21)	(18)

Interest expense is reduced by EUR 1 million and nil for the six months ended June 30, 2007 and 2006, respectively, due to interest capitalized on capital investment projects under construction.

Table of Contents

OBS GROUP

NOTES TO THE UNAUDITED CONDENSED COMBINED INTERIM FINANCIAL STATEMENTS (Continued)
(All amounts in millions of euros unless otherwise stated)

Note 7 Taxes

Profit before tax amounted to EUR 303 million and EUR 265 million for the six months ended June 30, 2007 and 2006 respectively. Tax (charges)/benefits are included in the combined interim statement of income as follows:

	2007	2006
For the six months ended June 30,		
Tax on operating income less financing costs	(80)	(72)
Tax associates		
	(80)	(72)

The classification of current and deferred tax (charges)/benefits in the combined statement of income is as follows:

	2007		2006	
For the six months ended June 30,				
Current tax:				
for the six month period	(82)		(71)	
adjustments for prior periods			(2)	
		(82)		(73)
Deferred tax:				
origination and reversal of temporary differences	2		1	
tax losses not recognized				
		2		1
		(80)		(72)

The reconciliation of the statutory tax rate in the Netherlands to the effective combined tax rate is as follows:

	2007	2006
For the six months ended June 30,		
Statutory tax rate in The Netherlands	26%	30%
Effect of different rates in foreign countries		(2)%
Adjustments for prior years		(1)%

	26%	27%

In assessing the realizability of the deferred tax assets, management considers whether it is probable that some portion or all of the deferred tax assets will not be realized. The ultimate realization of the deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income, and tax planning strategies in making this assessment. The amount of the deferred tax assets considered realizable, however, could change in the near term if future estimates of projected taxable income during the carry-forward period are revised.

Deferred tax assets and liabilities are offset only when there is a legally enforceable right to set off tax assets against tax liabilities and when the deferred tax assets and liabilities relate to the same tax authority.

Table of Contents

OBS GROUP

NOTES TO THE UNAUDITED CONDENSED COMBINED INTERIM FINANCIAL STATEMENTS (Continued)
(All amounts in millions of euros unless otherwise stated)

The movement in deferred tax assets and liabilities during the periods are as follows:

	Balance December 31, 2006	Changes in Exchange Rates	Recognized in Income	Other	Balance June 30, 2007
Intangible assets	26		(1)		25
Property, plant and equipment	8	(1)	(2)		5
Inventories	98				98
Trade and other receivables	4				4
Provisions:					
restructuring	1		(1)		
other provisions	85	(1)	11		95
Other items	21		(5)		16
Net operating loss carry-forwards	13				13
Net deferred tax asset/liabilities	256	(2)	2		256

	Balance December 31, 2005	Changes in Exchange Rates	Recognized in Income	Other	Balance June 30, 2006
Intangible assets	61	(3)	(19)		39
Property, plant and equipment	12	(2)	8		18
Inventories	86		20		106
Trade and other receivables	8				8
Provisions:					
restructuring					
other provisions	128	(2)	(13)	(1)	112
Other items	14	(2)	14		26
Net operating loss carry-forwards	22	(1)	(9)		12
Net deferred tax asset/liabilities	331	(10)	1	(1)	321

Classification of the deferred tax assets and liabilities in the combined balance sheets, which is determined at the fiscal entity level, is as follows:

	June 30, 2007	December 31, 2006

Deferred tax assets	282	281
Deferred tax liabilities	(26)	(25)
	256	256

Income tax receivable and payable have been offset in cases where there is a legally enforceable right to set off current tax asset against current tax liability and when the intention exists to settle on a net basis or to realize the receivable and payable simultaneously.

Income tax receivable of EUR 26 million and EUR 74 million at June 30, 2007 and December 31, 2006, respectively, represents the amount of income taxes recoverable in respect of current and prior

Table of Contents

OBS GROUP

NOTES TO THE UNAUDITED CONDENSED COMBINED INTERIM FINANCIAL STATEMENTS (Continued)
(All amounts in millions of euros unless otherwise stated)

periods. As of June 30, 2007 and December 31, 2006, income tax receivable from Akzo Nobel entities of nil and EUR 15 million respectively are included in the income tax receivable in the combined balance sheets.

Income tax payable of EUR 131 million and EUR 133 million at June 30, 2007 and December 31, 2006, respectively, relates to the amount of taxes payable for current and prior periods to the tax authorities.

Note 8 Inventories, net

For the six months ended June 30, 2007 and 2006, EUR 2 million and EUR 11 million, respectively, were recognized in the combined interim statements of income for the write-down of inventories to its net realizable value, while EUR 1 million and EUR 4 million, respectively, of write-downs were reversed in the period of sale. There are no inventories subject to retention or title clauses.

Additionally, for the six-months ended June 30, 2007 and 2006, the OBS Group recorded an expense in the combined interim statements of income of EUR 30 million and EUR 26 million, respectively, related to the impairment of obsolete inventories.

Note 9 Trade and Other Receivables, net

Trade receivables are shown net of impairment losses of EUR 12 million and EUR 15 million at June 30, 2007 and December 31, 2006, respectively. In the six months ended June 30, 2007 and 2006, the OBS Group recorded net additions and reversals of impairment losses of nil and EUR 2 million in the combined interim statements of income, respectively.

Note 10 Invested Equity

Prior to January 1, 2007, the invested equity balance in the combined financial statements of the OBS Group constitutes Akzo Nobel s investment in the OBS Group and represent the excess of total assets over total liabilities. Invested equity includes the effects of carve-out allocations from Akzo Nobel and the funding of the OBS Group activities through the in-house banking and cash pooling and loans from and to related parties with Akzo Nobel, and the OBS Group s cumulative net income, including income directly recognized in invested equity. As of February 28, 2007, Akzo Nobel no longer provides financing support for the OBS Group s operations other than via the related party loan and as a result, there are no such cash transactions with Akzo Nobel nor allocations from Akzo Nobel reflected in the invested equity in the combined balance sheet as of June 30, 2007. Invested equity does not constitute any contract that evidences a residual interest in the assets after deducting liabilities.

Cumulative translation reserves

The cumulative translation reserves comprise all foreign currency differences arising from the translation of the OBS Group s financial statements of net investments in foreign subsidiaries.

Assets and liabilities of foreign subsidiaries are translated into euros at exchange rates on the balance sheet date. Revenues and expenses are translated into euros at rates approximating the foreign exchange rates ruling at the dates

of the transactions. Exchange differences resulting from translation into euros of invested equities and of intercompany loans of a permanent nature with respect to subsidiaries outside the Euro region are recorded within invested equity. Upon disposal or liquidation of a foreign entity, these cumulative translation adjustments are recognized as income or expense.

Table of Contents

OBS GROUP

NOTES TO THE UNAUDITED CONDENSED COMBINED INTERIM FINANCIAL STATEMENTS (Continued)
(All amounts in millions of euros unless otherwise stated)

A description of the amounts recorded in invested equity is as follows:

Share-based payment costs funded by Akzo Nobel

The share-based payment costs funded by Akzo Nobel represent share-based payment expenses, allocated to the OBS Group, based on the actual OBS Group employees who participate in the Akzo Nobel share plans. See Note 11.

Interest expense funded by Akzo Nobel

The interest expense funded by Akzo Nobel represents interest charges allocated to the OBS Group based on average levels of funding provided to the OBS Group by Akzo Nobel. See Note 3 and Note 6.

Corporate overhead costs funded by Akzo Nobel

The corporate overhead costs funded by Akzo Nobel represents an allocation of charges to the OBS Group incurred by Akzo Nobel for various corporate administrative costs, on behalf of the business units of the OBS Group. See Note 3.

Insurance expense funded by Akzo Nobel

The insurance expense funded by Akzo Nobel represents insurance expenses incurred by Akzo Nobel on behalf of the OBS Group that have been allocated to the OBS Group. See Note 3.

Tax transfers from/(to) Akzo Nobel

The tax transfers from/(to) Akzo Nobel represent intercompany tax payments and settlements, from and to the OBS Group and the Akzo Nobel tax leading holding companies.

Employee benefits and other non-cash transfers

These amounts primarily represent allocations of employee benefit related assets and liabilities in regard of pension plans accounted for by Akzo Nobel on behalf of the OBS Group.

Cash transfers from/(to) Akzo Nobel

The cash transfers from/(to) Akzo Nobel consist of group contributions from or to Akzo Nobel, capital contributions funded by Akzo Nobel, the net movement of funding by Akzo Nobel and intra group movements. As of December 31, 2006, invested equity includes EUR 1,049 million of funding by Akzo Nobel which does not have the characteristics of debt. Also, as of December 31, 2006, invested equity includes EUR 289 million of net loans due from and due to related parties.

Note 11 Share-Based Payments

Akzo Nobel sponsors the following stock options plans and share plans in which certain employees of the OBS Group participate. As the share-based payment plans are Akzo Nobel plans, amounts have been recognized through invested equity.

Stock Option Plans

Akzo Nobel grants options to all members of the Board of Management, senior vice presidents and executives. Stock options granted cliff-vest and are exercisable after three years. The options granted to senior vice presidents and executives expire after five years and options granted from 2002 onwards expire after seven years. Options granted to members of the Board of Management from 2000 expire after ten years and options granted from 2003 onwards expire after seven years. All

Table of Contents

OBS GROUP

NOTES TO THE UNAUDITED CONDENSED COMBINED INTERIM FINANCIAL STATEMENTS (Continued)
(All amounts in millions of euros unless otherwise stated)

outstanding options issued from 1999 cannot be exercised during the first three years. One option entitles the holder thereof to buy one Akzo Nobel N.V. common share or one American Depository Share (ADS). The exercise price is the Euronext Amsterdam opening price on the first day that the Akzo Nobel share is quoted ex dividend or the opening price for an ADS on NASDAQ/NMS on the first day that the Akzo Nobel ADS is quoted ex dividend. Also, for the options granted since 2005, certain economic value added performance criteria are included in the vesting conditions. Through June 30, 2005, the option holder could also request that the option be cash settled.

Since 2005, Akzo Nobel grants performance related stock options to executives. Under this plan, executives are granted a conditional number of options, under shareholder approval, whose vesting is conditional on the achievement of financial performance targets, expressed as Economic Value Added on Invested Capital (EOI). The percentage of granted, contingent options that vest depends on Akzo Nobel s average EOI over a three-year period. One option entitles the holder thereof to buy one Akzo Nobel N.V. common share or one ADS. The option holder can also request that the option be cash settled.

These option plans could be cash settled through July 1, 2005, and were modified as of this date to be share settled. The fair value of employee service received in return for share options granted are measured by reference to the fair value of share options granted. Until July 1, 2005, the OBS Group recognized at each balance sheet the fair value of the options outstanding per that date, taking into account the passage of time of the three-year vesting period. The change in this fair value was recognized in income. Compensation expense of EUR 1 million and EUR 1 million has been recognized under these plans for the six months ended June 30, 2007 and 2006, respectively.

Performance Share Plan (Executives and Board of Management)

In 2004, Akzo Nobel introduced a conditional performance stock option plan for the Board of Management and on January 1, 2005 for executives. Under this plan, members of the Board of Management and executives were granted a conditional number of shares. The vesting of the shares is conditional on the achievement of performance targets, expressed as Total Shareholder Return (TSR) of Akzo Nobel, relative to the TSR of a group of competitors during the relative performance period. The percentage of granted, contingent shares that vest depends on Akzo Nobel s TSR, relative to those of competitors, achieved during the three-year vesting period. The awards will be satisfied by the delivery of Akzo Nobel N.V. shares, or in exceptional cases, by means of a cash payment.

Due to the performance criteria of the share plan, the OBS Group bases compensation expense on the best available estimate of the number of shares that are expected to vest and revises that estimate, if necessary, if subsequent information indicates that actual forfeitures are likely to differ from initial estimates. Management expects the conditional shares granted to vest based on available information. Expense of EUR 1 million and EUR 1 million has been recognized during the six months ended June 30, 2007 and 2006, respectively.

During the six months ended June 30, 2007, Akzo Nobel has conditionally decided to settle the outstanding 2006 and earlier awards based on the stock price of Akzo Nobel at the day of the closing of the transaction with Schering-Plough. The settlement of these awards is conditional on the closing of the transaction with Schering-Plough and will take place in the month after the closing date. Akzo Nobel remains as the administrator and sponsor of the plans, and any expenses related to the OBS Group will be accounted for by the OBS Group. Further, Akzo Nobel did not issue any new awards during 2007 to OBS Group employees, however, awards conditional on the closing of the

transaction,

Table of Contents

OBS GROUP

NOTES TO THE UNAUDITED CONDENSED COMBINED INTERIM FINANCIAL STATEMENTS (Continued)
(All amounts in millions of euros unless otherwise stated)

were granted to OBS Group executives. These awards will be settled in cash, subsequent to the closing, in June 2008.

Akzo Nobel has estimated that the total conditional settlement would approximate EUR 9 million, of which 50% will be paid by Schering-Plough, based on current factors. No cash payments will be made by Akzo Nobel until the close of the transaction with Schering-Plough. An additional expense of EUR 2 million has been recognized in the combined statement of income for this change for the six months ended June 30, 2007.

The following is a summary of activity pertaining to the OBS Group employees that participated in the various Akzo Nobel stock option and share plans:

Outstanding	Common Shares	American Depository Shares
Balance at December 31, 2005	1,217,079	158,020
Options granted	230,645	
Options exercised	(223,340)	(56,760)
Options forfeited	(93,632)	(3,640)
Balance at June 30, 2006	1,130,752	97,620
Balance at December 31, 2006	1,099,659	89,080
Options exercised	(446,451)	(64,140)
Options forfeited	(19,170)	
Balance at June 30, 2007	634,038	24,940

The following is a summary of activity pertaining to the OBS Group executives and Board of Management that participated in the Akzo Nobel performance share plan:

Outstanding	Performance Share Plan (Executives and Board of Management)
Balance at June 30, 2006	686,553
Balance at June 30, 2007	696,902

Fair value and assumptions used

The expected value of performance stock options for the Board of Management and executives is based on a binomial lattice option pricing model, using certain assumptions. These assumptions were used for these calculations only, and do not necessarily represent an indication of management s expectations of future developments. In addition, option valuation models require the input of highly subjective assumptions, including expected share price volatility. The OBS Group s employee stock options have characteristics significantly different from those of traded options and changes in the subjective assumptions used for the calculation can materially affect the fair value estimate.

Table of Contents

OBS GROUP

NOTES TO THE UNAUDITED CONDENSED COMBINED INTERIM FINANCIAL STATEMENTS (Continued)
(All amounts in millions of euros unless otherwise stated)

The fair value and the assumptions used for the options granted were as follows, for the six months ended June 30, 2006:

	2006
Fair value at measurement date	9.86
Share price at measurement date	46.46
Exercise price	46.46
Expected share price volatility (%)	24.8
Expected option life (years)	5
Expected dividend yield (%)	2.74
Risk free interest rate (%)	3.92

The expected volatility is based on the historic volatility (calculated based on the weighted average remaining life of the share options), adjusted for any expected changes to future volatility due to publicly available information. Share options are granted under a service condition and a non-market performance condition. Such conditions are not taken into account in the grant date fair value measurement. There are no market conditions associated with the share option grants.

The grant date fair value of the performance shares is amortized as an expense over the three-year vesting period. The fair value at grant date is based on the Monte Carlo simulation model taking market conditions into account. The value was calculated by external actuaries and amounted to EUR 16.80 for the performance shares conditionally granted during the six months ended June 30, 2006.

Note 12 Provisions

Provisions consist of the following at June 30, 2007 and December 31, 2006, including current portions:

	2007	2006
Pensions and other postretirement benefits	266	263
Restructuring of activities	4	6
Other	48	43
	318	312

Provisions for pensions and other postretirement benefits

The majority of the OBS Group employees participate in Akzo Nobel defined benefit pension plans, defined contribution pension plans and other postretirement benefit plans which provide benefits to employees and former employees of both the OBS Group and other Akzo Nobel businesses. In these plans, the assets and liabilities that

relate to employees (and former employees) of the OBS Group are combined with those related to employees (and former employees) of other Akzo Nobel businesses.

The OBS Group has obtained information about each of these Akzo Nobel plans measured in accordance with IAS 19 on the basis of assumptions that apply to each of the plans as a whole, and used a reasonable allocation method to determine the OBS Group s portion of each plan s assets, liabilities and benefit costs under IAS 19. For each of these plans, the defined benefit obligation (at each balance sheet date), and the service cost, contributions, benefit payments, and impact of special events (in each accounting period), relating to the OBS Group, have been determined using approximate

Table of Contents

OBS GROUP

NOTES TO THE UNAUDITED CONDENSED COMBINED INTERIM FINANCIAL STATEMENTS (Continued)
(All amounts in millions of euros unless otherwise stated)

actuarial techniques which take into account the membership profile of OBS Group participants compared to the membership profile for participants in the plan as a whole. Plan assets at each balance sheet date have generally been split in the same proportion as the defined benefit obligation.

Management believes that such allocations have been made on a reasonable basis, but may not necessarily be indicative of the actual separation of these pension plans in the future.

Furthermore, some OBS Group employees participate in stand-alone OBS Group pension and other postretirement benefit plans. The related expenses, assets and liabilities for these plans are accounted for in the OBS Group businesses in accordance with IAS 19.

The defined benefit pension plans in which the OBS Group s employees participate generally provide benefits based on years of service and employees compensation. The funding policies for the plans are consistent with local requirements in the countries of establishment. Obligations under the plans are systematically provided for by depositing funds with trustees or separate foundations, under insurance policies, or by balance sheet provisions. Plan assets principally consist of long-term interest-earning investments, quoted equity securities, and real estate.

A number of OBS Group s current and former employees participate in Akzo Nobel postretirement healthcare and life assurance plans. The OBS Group has accrued for the expected costs of providing such postretirement benefits during the years that the employee rendered the necessary services.

Valuations of the obligations under the pension and other postretirement benefit plans are carried out by independent actuaries. The discount rates applied are based on yields available on high quality corporate bonds that have currencies and terms consistent with the currencies and estimated terms of the OBS Group s obligations.

During 2006, Akzo Nobel closed their US and Canadian defined benefit pension plans in which OBS Group employees and former employees participate to further accrual and implemented defined contribution plans for future benefit provision. During 2006, Akzo Nobel also altered the qualification requirements and changed the existing level of benefits in its US postretirement welfare plan in which OBS Group employees and former employees participate. Due to these changes, the OBS Group s provision for pensions and other postretirement benefits decreased by EUR 29 million, which was recorded in the combined statements of income during the year ended December 31, 2006.

During 2005, Akzo Nobel reached agreement with the unions on a change of its pension plan in The Netherlands, so that, effective December 31, 2005, it changed from a defined benefit plan to a defined contribution plan. In connection with this change during 2005, Akzo Nobel paid a one-time nonrefundable contribution of EUR 151 million, prepaid EUR 50 million in July 2005 of loans which are to be repaid by retaining employee pension premiums, and granted a EUR 100 million subordinated loan in September 2005, that had a fair value of EUR 87 million. At June 30, 2007 and December 31, 2006, Akzo Nobel allocated EUR 4 million and EUR 8 million of the loans, respectively, which are to be redeemed by retaining employee pension premiums, and EUR 33 million and EUR 33 million, respectively, of the fair value of the subordinated loan to the OBS Group based on the ratio of the OBS Group s plan liabilities to the total Akzo Nobel Pension Fund liabilities. Management feels that the allocation method is reasonable.

At June 30, 2007 and December 31, 2006, the pension and postretirement provisions are EUR 266 million and EUR 263 million, respectively, which have been recorded as provisions in the combined balance sheets.

Table of Contents

OBS GROUP

NOTES TO THE UNAUDITED CONDENSED COMBINED INTERIM FINANCIAL STATEMENTS (Continued)
(All amounts in millions of euros unless otherwise stated)

In the United States, the Medicare Prescription Drug Improvement and Modernization Act of 2003 introduced prescription drug benefits for retirees as well as a federal subsidy to sponsors of postretirement healthcare plans, which both began at January 1, 2006. This reimbursement right has been recognized as an asset under other financial non-current assets in the combined balance sheets and is measured at fair value. At June 30, 2007 and December 31, 2006, this value was EUR 9 million and EUR 9 million, respectively.

The net periodic pension costs for the defined benefit pension plans for the six months ended June 30, 2007 and 2006 was EUR 15 million and EUR 21 million, respectively.

Provisions for restructuring of activities

Provisions for restructuring of activities comprise accruals for certain employee benefits and for costs that are directly associated with plans to exit specific activities and closing down of facilities. For all restructurings a detailed formal plan exists, and the implementation of the plan has started or the plan has been announced. Most restructuring activities relate to relatively smaller restructurings, and are expected to be completed within two years from the balance sheet date. However, for certain plans payments of termination benefits to former employees may take several years longer.

Other provisions

Other provisions relate to a great variety of risks and commitments, including provisions for other long-term employee benefits like long-service leave and jubilee payments, provisions for environmental costs, provision for returns, allowances and legal claims. At June 30, 2007 and December 31, 2006, the OBS Group has recorded a provision of EUR 11 million for returns and allowances. For details on environmental expenses, see Note 17.

The majority of the cash outflows related to other provisions are expected to be within 1 to 5 years. In calculating the other provisions a discount rate average of 5% has been used.

Note 13 Deferred Income

In December 2003, the OBS Group received an initial payment of EUR 88 million from Pfizer for the co-development and co-marketing agreement for asenapine. Such payments are to be reported as deferred income and to be recognized as revenue in subsequent years. For this payment, recognition is based on the estimated co-development costs expected to be incurred over the co-development period. Because the agreement terminated in May 2007, all amounts have been recognized in income as of June 30, 2007.

Note 14 Borrowings (Non-current)

	June 30, 2007	December 31, 2006
Debt to credit institutions	5	6

Other borrowings	51	39
	56	45

The weighted average effective interest rate approximated 5.9% for the six months ended June 30, 2007, and 5.9% in 2006.

At June 30, 2007 and December 31, 2006, none of the borrowings were secured by means of mortgages, etc.

Table of Contents

OBS GROUP

NOTES TO THE UNAUDITED CONDENSED COMBINED INTERIM FINANCIAL STATEMENTS (Continued)
(All amounts in millions of euros unless otherwise stated)

Note 15 Borrowings (Current)

	June 30, 2007	December, 31, 2006
Debt to credit institutions	107	75
Current portion of borrowings	31	37
	138	112

Note 16 Financial Instruments

Foreign exchange risk management

The OBS Group enters into forward exchange contracts with Akzo Nobel and with third parties to hedge the transaction risk on sales, purchases, and financing transactions denominated in currencies other than the functional currency of the subsidiary concerned. The purpose of these foreign currency hedging activities is to protect the OBS Group from the risk that the eventual functional currency net cash flows resulting from committed trade or financing transactions are adversely affected by changes in exchange rates. Most forward exchange contracts outstanding at year-end have a maturity of less than one year. Where necessary, the forward exchange contracts are rolled over at maturity. The OBS Group does not use financial instruments to hedge the translation risk related to equity, intercompany loans of a permanent nature, and earnings of foreign subsidiaries. Currency derivatives are not used for speculative purposes.

At June 30, 2007 and December 31, 2006, the notional value of outstanding contracts to buy currencies totalled EUR 41 million and EUR 21 million, respectively, while contracts to sell currencies totalled EUR 361 million and EUR 57 million, respectively. These contracts mainly relate to the U.S. dollar, Australian dollar, Swiss franc, Swedish kronor, Norwegian kronor, Polish zloty, pounds sterling, and Japanese yen, all having maturities within one year.

Interest risk management

The subordinated loan to the Akzo Nobel Pension Fund is sensitive to changes in interest rates. The OBS Group s share of the face value of the loan is EUR 36 million and the expected maturity is subsequent to 2010 with an average interest rate of 3.5%. The OBS Group s share of the carrying value of the loan and estimated fair value is EUR 33 million with an effective interest rate of 5.1%.

Credit risk

The OBS Group has a credit risk management policy in place. The exposure to credit risk is monitored on an ongoing basis. Credit evaluations are performed on all customers requiring credit. Generally the OBS Group does not require collateral in respect of financial assets.

Investments in cash and cash equivalents are entered into with counterparties which have a high credit rating and limits per counterparty have been set. Transactions involving derivative financial instruments are with counterparties with sound credit ratings and with whom the OBS Group has contractual netting agreements. The OBS Group has no reason to expect non-performance by the counterparties to these agreements.

Due to the geographical spread of the OBS Group and the diversity of its customers, at the balance sheet date the OBS Group was not subject to any significant concentration of credit risks. The maximum exposure to credit risk is represented by the carrying amount of each financial asset, including derivative financial instruments, in the combined balance sheet.

Table of Contents

OBS GROUP

NOTES TO THE UNAUDITED CONDENSED COMBINED INTERIM FINANCIAL STATEMENTS (Continued)
(All amounts in millions of euros unless otherwise stated)

Sensitivity analysis

By managing currency risks, the OBS Group aims to reduce the impact of short-term fluctuations on the OBS Group s earnings. Over the longer-term, however, permanent changes in foreign exchange and interest rates would have an impact on combined earnings.

At June 30, 2007 the decrease in the OBS Group s profit before tax as a result of a general increase of one percentage point in interest rates would not be significant. Cash and cash equivalent and short-term borrowings have been included in this assessment.

Fair value of financial instruments

The estimated fair values at June 30, 2007 of non-current borrowings and the subordinated loan to the Akzo Nobel Pension fund approximate their carrying values. The fair value of the OBS Group s non-current borrowings was estimated based on the quoted market prices for the same or similar issues or on the current rates offered to the OBS Group for debt with similar maturities.

The fair value of forward exchange contracts is determined using quoted forward exchange rates at the balance sheet date.

At June 30, 2007 and December 31, 2006 the OBS Group s forward exchange contracts were recognized at fair value.

The carrying amounts of cash and cash equivalents, receivables, current borrowings, and other current liabilities approximate fair value due to the short maturity period of those instruments.

Note 17 Contingent Liabilities and Commitments

Environmental matters

The OBS Group is confronted with costs arising out of environmental laws and regulations, which include obligations to eliminate or limit the effects on the environment of the disposal or release of certain wastes or substances at various sites. Proceedings involving environmental matters, such as the alleged discharge of chemicals or waste materials into the air, water, or soil, are pending against the OBS Group in various countries.

It is the OBS Group s policy to accrue and charge against earnings environmental cleanup costs when it is probable that a liability has incurred and an amount is reasonably estimable. These accruals are reviewed periodically and adjusted, if necessary, as assessments and cleanups proceed and additional information becomes available. Environmental liabilities can change substantially due to the emergence of additional information on the nature or extent of the contamination, the necessity of employing particular methods of remediation, actions by governmental agencies or private parties, or other factors of a similar nature. Cash expenditures often lag behind the period in which an accrual is recorded by a number of years.

The provisions for environmental costs accounted for in accordance with the aforesaid policies aggregated EUR 1.0 million and nil as of June 30, 2007 and as of December 31, 2006, respectively. The provision has been discounted using an average discount rate of 5.25%.

The OBS Group has certain asset retirement obligations for which the timing of settlement is conditional upon the closure of the related operating facility. At this time, there are no specific plans for the closure of these related facilities, and the OBS Group currently intends to make improvements to the assets as necessary that would extend their lives indefinitely. Furthermore, the settlement dates

Table of Contents

OBS GROUP

NOTES TO THE UNAUDITED CONDENSED COMBINED INTERIM FINANCIAL STATEMENTS (Continued)
(All amounts in millions of euros unless otherwise stated)

have not been specified by law, regulation or contract. As a result, the OBS Group is unable to estimate the fair value of the liability. If a closure plan for any of these facilities is initiated in the future, the settlement dates will become determinable, an estimate of the fair value will be made, and an asset retirement obligation will be recorded.

While it is not feasible to predict the outcome of all pending environmental exposures, it is reasonably possible that there will be a need for future provisions for environmental costs which, in management s opinion, based on information currently available, would not have a material effect on the OBS Group s financial position and liquidity but could be material to the OBS Group s results of operations in any one accounting period.

Antitrust

In 1999, the Brazilian Consumer Authority commenced action against Hoechst Roussel Vet, a veterinary company acquired by Intervet in 1999. The Brazilian Consumer Authority demanded the OBS Group to justify the prices charged for FMD vaccines, asserting that such prices were abusive. On February 1, 2001, the Secretariat for Economic Monitoring issued a technical opinion recommending the dismissal of the proceeding, because there was no proof of the alleged conduct. An economic survey justifying the pricing and documentation was provided by Intervet to the Ministry of Justice in May 2005. However, no final report and opinion has been published at this time. The maximum fine the Brazilian Consumer Authority could impose on Intervet is 30% of the total gross revenue of the Brazilian subsidiary in the year before the alleged infraction, which would amount to less than EUR 10 million.

Also in 1999, the Brazilian Antitrust Authority commenced an investigation into Organon s Brazilian subsidiary and 20 other pharmaceutical companies to investigate alleged collusion on their part against generic manufacturers of pharmaceutical products in Brazil. A final administrative decision was issued in October 2005, and each pharmaceutical company, including our subsidiary, was convicted and fined an amount equal to 1% of total gross revenue (free from tax) in the year before the infraction. This amount has not yet been established, the OBS Group have made a provision in the amount of approximately EUR 0.8 million.

Litigation

During 2005, the State of Alabama, the State of Mississippi, and 41 counties (now 42 counties) and New York City within the State of New York, separately brought claims against up to approximately 80 pharmaceutical manufacturers, including Organon Pharmaceuticals USA Inc., the predecessor of our United States subsidiary Organon Pharmaceuticals U.S.A Inc. LLC and Organon USA, Inc., alleging pricing fraud and, in the case of the State of Mississippi, conspiracy to commit such fraud, in violation of state, federal, and/or common law. The plaintiffs claim that the defendants committed fraud and were unjustly enriched by intentionally setting false and inflated average wholesale prices for their pharmaceutical products, which is the basis for Medicaid reimbursement. The plaintiffs further allege that such products were then marketed to pharmacists, physicians and/or pharmacy chain stores in such a way as to capitalize on the difference between the amount reimbursed by Medicaid for dispensing the products and the actual acquisition cost for the products. The allegations against our subsidiary have been pled with limited specificity and, although Remeron® sales are specifically mentioned in most complaints, in all cases except in Alabama, the allegations may extend to other products also. The complaints seek injunctive relief as well as actual, statutory, treble and punitive damages and, in some cases, disgorgements.

Table of Contents

OBS GROUP

NOTES TO THE UNAUDITED CONDENSED COMBINED INTERIM FINANCIAL STATEMENTS (Continued)
(All amounts in millions of euros unless otherwise stated)

All but four of the New York county cases have been consolidated in the U.S. District Court for the District of Massachusetts. Three of the remaining New York cases have been removed to federal district courts in New York and transfer to the U.S. District Court for the District of Massachusetts pending a decision by the Judicial Panel on Multidistrict Litigation. A motion to dismiss the cases in the U.S. District Court for the District of Massachusetts was partially granted in April 2007. Thereafter, plaintiffs have filed a First Amended Consolidated Complaint, in response to which defendants, including our subsidiaries, have filed a joint motion to dismiss. A decision on this motion is expected in the second half of 2007. A motion to dismiss the Erie County case (one of the cases pending transfer to the U.S. District Court for the District of Massachusetts) was partially granted in September 2006. The Mississippi case has been dismissed. The proceedings in the State of Alabama are at an early stage, with discovery having commenced on April 13, 2005. The OBS Group does not believe to have been engaged in any improper conduct and are vigorously defending these matters.

Certain wholly owned operating subsidiaries of Organon and Intervet were named in the final report of the Independent Inquiry Committee into the United Nations Oil for Food Program for humanitarian support to Iraq. The report states that these entities made some improper payments in connection with four contracts (with a total value of USD 3.4 million) with the Iraqi Government to provide pharmaceuticals and vaccines. Akzo Nobel has been conducting an internal review of this matter and has voluntarily reported on that review to the US Securities and Exchange Commission and to the US Department of Justice. The Dutch FIOD/ECD also conducted an investigation into Organon s involvement in this matter; these investigations have been concluded in May 2007. The OBS Group is currently discussing a possible settlement with these authorities. While neither of the said authorities have taken any action against Akzo Nobel or its subsidiaries, this matter could expose Akzo Nobel and/or its subsidiaries to regulatory and/or criminal charges and sanctions.

In January 2006, Akzo Nobel Nederland B.V. and the Akzo Nobel Pension Fund in The Netherlands received a summons from the Association of Retired Akzo Nobel Employees (Vereniging van Gepensioneerden Akzo Nobel) with regard to the changed financing of Akzo Nobel s Dutch pension plan (relating to the change from a defined benefit plan to a defined contribution plan), as a consequence of which an alleged unconditional right to indexation became conditional. If the claim were to succeed, then, pursuant to the separation agreement, the OBS Group would be responsible to reimburse Akzo Nobel or any other member of its group for all losses actually incurred in connection therewith to the extent relating to any former employees that, at the time of ceasing their employment with the Akzo Nobel Group, worked primarily in any current or former human healthcare or animal healthcare activities of the Akzo Nobel Group. The claim was recently dismissed by the Court of First Instance. An appeal can be filed within three months after the court s judgment, which period expires in April 2007.

In July 2006, drug wholesaler RxUSA brought claims against 16 pharmaceutical manufacturers, including the OBS Group, as well as against five drug wholesalers, the Healthcare Management Distribution Association and certain individuals, alleging joint and several liability for, amongst other things, monopolization of the wholesale pharmaceutical market in violation of state and federal antitrust laws. The plaintiff claims that defendants willfully acquired and sought to maintain a monopoly and exclude competition by secondary wholesalers . The plaintiff further alleges that the 16 pharmaceutical manufacturers and other wholesale dealers wrongfully and illegally refused to deal directly with RxUSA, making it impossible for it to acquire products for sale. RxUSA is seeking injunctive relief, attorneys fees and treble damages. The proceedings are at an early stage. The OBS Group has filed motions to dismiss these claims and intend to contest them vigorously.

Table of Contents

OBS GROUP

NOTES TO THE UNAUDITED CONDENSED COMBINED INTERIM FINANCIAL STATEMENTS (Continued)
(All amounts in millions of euros unless otherwise stated)

During 2006 the OBS Group lost key elements of patent protection for Livial® in the United Kingdom. Key protective claims under our chemical purity, crystalline purity and particle size patents have recently been revoked by U.K. courts. The OBS Group has decided to appeal the revocation of the crystalline purity patent, but not to appeal the decision regarding the chemical purity patent. Permission to appeal the decision regarding the particle size patent has been denied by the Court in London. The OBS Group s chemical purity patent has been revoked by the European Patent Office; The OBS Group has appealed the decision to revoke this patent, and this appeal has had a suspensive effect on revocation. The OBS Group s particle size patent has also been challenged before the European Patent Office.

A number of the OBS Group subsidiaries are the subject of litigation or product liability claims arising out of the normal conduct of their business, as a result of which claims could be made against them which, in whole or in part, might not be covered by insurance. Provisions are established for the gross amount of any probable claim that can be reasonably estimated. Insurance receivables are recorded only in respect of amounts that are virtually certain to be recovered.

There are various remaining product liability claims pending against the OBS Group in various European countries, Brazil, Mexico and Australia by, in most cases, women claiming to have conceived while allegedly using the OBS Group s contraceptive Implanon®. Other claims relate to problems in connection with the insertion or removal of Implanon® or to changes in bleeding patterns. Often, the physician who inserted the product is named as a co-defendant. Although these cases have all been brought by individual women, only in The Netherlands the competent court has decided to consolidate the cases. On June 15, 2005, a court in s-Hertogenbosch in The Netherlands issued a preliminary judgment to the effect that, pending allocation of responsibility between physicians and Organon, damages should be paid to women who unintentionally became pregnant while using Implanon®. The OBS Group appealed this decision in September 2005. Oral pleadings were presented for the court of appeal on May 14, 2007. A judgment is expected on August 28, 2007. No final judgments have been rendered. Any damages for which the OBS Group may be held liable in connection with these cases are expected to be covered by product liability insurance.

In 1999 an ex-freelance collaborator of Diosynth B.V./Moeders voor Moeders, commenced legal action with respect to alleged entitlements to retirement benefits against Diosynth B.V. (as per January 1, 2007, part of N.V. Organon). Entitlement to a retirement benefit requires all employment relationship; Diosynth believes that freelancers working for Moeders voor Moeders do not qualify as employees and are not entitled to receive a pension. The legal position in this case may create a precedent for a couple of hundred of ex-freelancers of Moeders voor Moeders. The deposition of witnesses in this case will be finalized on October 4, 2007.

Salmon producers in Chile have made claims for damages allegedly incurred because of the use of Intervet s fish vaccines in that country. The claims were filed in 2005, 2006 and 2007. The claims maintain that administration of Intervet s vaccine against vibriosis and infectious pancreatic necrosis caused death or injury to part of their salmon populations. No judgments have been rendered. At this time the OBS Group has no reason to believe that any damages for which the OBS Group may be held liable in connection with these claims would not be covered by the product liability insurance the OBS Group maintains.

A case from Intervet, Inc. against Merial Ltd. et al., is pending since December 23, 2005 in the United States District Court for the District of Columbia. This lawsuit is a declaratory judgment action seeking a declaration from the court

that United States Patent No. 6,368,601 (titled Porcine

Table of Contents

OBS GROUP

NOTES TO THE UNAUDITED CONDENSED COMBINED INTERIM FINANCIAL STATEMENTS (Continued)
(All amounts in millions of euros unless otherwise stated)

Circovirus Vaccine and Diagnostics Reagents and referred to herein as the 601 patent) is invalid, unenforceable, and not infringed by Intervet s PCV-2 vaccine.

Merial Ltd, and Merial SAS have answered the Complaint by alleging that the 601 patent is valid, enforceable, and infringed by Intervet s PCV-2 vaccine. They also have brought a counterclaim for patent infringement against Intervet, Inc. Intervet has responded by asserting that the 601 patent is invalid,unenforceable, and not infringed by Intervet, Inc. Discovery is presently ongoing between Merial SAS, Merial Ltd, and Intervet Inc. Under the present schedule for the case, there will be a hearing to determine the meaning of the claims of the 601 patent early August, 2007. Trial of this matter likely will not occur until the second or third quarter of 2008.

A second case, Intervet, Inc. v. Merial Ltd. et al., is pending since March 20, 2007, in the United States District Court for the District of Columbia. This lawsuit is a declaratory judgment action seeking a declaration from the court that United States Patent No. 7,192,594 (titled Postweaning Multisystemic Wasting Syndrome and Porcine Circovirus from Pigs and referred to herein as the 594 patent) is invalid, unenforceable, and not infringed by Intervet s PCV-2 vaccine. Merial Ltd, and Merial SAS have filed and served a Complaint for patent infringement and demand for jury trial, alleging that the 594 patent is valid, enforceable, and infringed by Intervet s PCV-2 vaccine.

In November 2006, four trade unions together initiated proceedings in The Netherlands against Akzo Nobel Nederland B.V., a subsidiary of Akzo Nobel. The trade unions claim that Akzo Nobel Nederland B.V., allegedly as representative of all other parts of the Akzo Nobel Group , wrongfully terminated the future payment of an allowance to cover medical insurance costs of retirees in The Netherlands. These retirees also include persons who were employed in current or former human healthcare and animal healthcare activities of Akzo Nobel.

The trade unions allege that the retirees, on the basis of a promise made by Akzo Nobel Nederland B.V., were entitled to receive the allowance indefinitely and that there was insufficient cause for termination of the obligation. Akzo Nobel Nederland B.V. has indicated that it had the right to terminate the arrangements subject to a transitional regime through June 30, 2009. Akzo Nobel Nederland B.V. has expressed the intention to defend the claim by the trade unions. The proceedings against Akzo Nobel Nederland B.V. are at an early stage. It is currently not clear what would be the financial consequences for the OBS Group if the claim would succeed. Pursuant to the separation agreement, the OBS Group will be responsible for all costs incurred by Akzo Nobel or any other member of its group in connection with the allowances mentioned above with respect to retirees that, at the time of ceasing their employment with Akzo Nobel, worked primarily in any current or former human healthcare or animal healthcare activities of Akzo Nobel. The maximum amount that the OBS Group could be required to reimburse would depend on a number of factors, which also include the arrangements with individual employees, any future changes in the arrangements, and the age to which the retirees will live.

On March 23, 2007 the University of Illinois filed a lawsuit against Organon Teknika Corporation for breach of contract the revised Tice license agreement which dates back to 1986. The UOI claims USD 14.9 million of underpaid royalties (which is UOI s calculation of the present value of the alleged royalty underpayment), based on an audit on the period January 1, 2002, through December 31, 2004. The difference relates to a different interpretation of what the correct arms length price should be. Organon Teknika is of the opinion that it paid the correct amount of royalties.

There have been various lawsuits filed against several US entities relating to the use of NuvaRing. With the exception of three cases, the lawsuits contain little information about the claimed

Table of Contents

OBS GROUP

NOTES TO THE UNAUDITED CONDENSED COMBINED INTERIM FINANCIAL STATEMENTS (Continued)
(All amounts in millions of euros unless otherwise stated)

injuries. It should be noted that the OBS Group does not yet have medical or other records to corroborate the allegations. The remaining cases do not contain any information other than the allegation that the women used NuvaRing and sustained injuries thereby . Other general allegations of the thrombogenicity of the product suggest that the claimants intend to allege that they sustained a thromboembolic event.

A number of other claims are pending against the OBS Group, all of which are contested. The OBS Group is also involved in disputes with tax authorities in several jurisdictions. Furthermore, in the context of the divestitures of certain businesses by Akzo Nobel, our sole shareholder, prior to the creation of OBS NV, the relevant Akzo Nobel companies have agreed to indemnify and/or provide guarantees to the buyers (and /or their successors and assigns) regarding certain representations and warranties or developments. To the extent that these relate to the current or former human pharmaceutical or animal health business activities of Akzo Nobel, the OBS Group agreed under the Separation Agreement to indemnify Akzo Nobel in respect of claims arising therefrom.

While the outcome of these claims and disputes cannot be predicted with certainty, the OBS Group believes, based upon legal advice and information received, that the final outcome will not materially affect the combined financial position of the OBS Group but could be material to the OBS Group s result of operations or cash flows in any one accounting period.

Other contingent liabilities

At June 30, 2007 and December 31, 2006, guarantees related to contracts with third parties totalled EUR 5 million and EUR 3 million, respectively.

A majority of the OBS Group businesses do not file separate tax returns since these entities were included in the tax groupings of other Akzo Nobel entities within their respective entity s tax jurisdiction. Certain tax authorities have the right to hold an individual entity within the tax grouping liable for any and all liabilities outstanding of the group. Management of the OBS Group believes that the chances are remote that the OBS Group will be held responsible for tax liabilities incurred by other Akzo Nobel entities.

The OBS Group is a party in several research and development collaborations and licensing agreements. These agreements have various compensation elements that can contain periodic payments, payments related to sales of certain products and milestone payments. The periodic payments are expensed in the period they relate to and the payments related to sales of certain products are expensed in the period the corresponding sales were recognized. Milestone payments are expensed in the period in which the recognition criteria related to the milestone are met.

Some of the licenses and collaboration, co-development, co-marketing and other agreements and instruments to which the OBS Group is a party, contain change of control provisions that may be triggered by a change in the controlling interest in our business. See Note 20 for further discussion of potential impacts related to the Separation of the OBS group.

Pfizer terminated the asenapine license and collaboration agreement on November 27, 2006. The termination took effect on May 27, 2007. If and when the OBS Group is successful in bringing asenapine to the market, the OBS Group will be obliged to reimburse Pfizer for its out-of-pocket expenses (plus 10% interest) for development, marketing and

manufacturing, by paying it a royalty at the rate of 5% on net asenapine sales.

Table of Contents

OBS GROUP

NOTES TO THE UNAUDITED CONDENSED COMBINED INTERIM FINANCIAL STATEMENTS (Continued)
(All amounts in millions of euros unless otherwise stated)

Commitments

Purchase commitments for property, plant and equipment aggregated EUR 63 million and EUR 69 million at June 30, 2007 and December 31 2006, respectively. The OBS Group also has purchase commitments for materials and other supplies incident to the ordinary conduct of business for a total of EUR 355 million and EUR 358 million at June 30, 2007 and December 31 2006, respectively.

Long-term liabilities contracted in respect of leasehold, rental, operating leases, research, etc., aggregated EUR 241 million and EUR 287 million at June 30, 2007 and December 31, 2006, respectively. Payments due within one year amounted to EUR 66 million and EUR 93 million at June 30, 2007 and December 31, 2006, respectively; payments between one and five years EUR 152 million and EUR 158 million, respectively, and payments due after more than five years amount to EUR 23 million and EUR 36 million, respectively.

Note 18 Cash Flow Information

The OBS Group has paid cash for income taxes of EUR 57 million and EUR 67 million for the six months ended June 30, 2007 and 2006, respectively. For periods prior to 2007, some entities of the OBS Group businesses did not file separate tax returns as these entities were included in the tax grouping of other Akzo Nobel entities within the respective entity s tax jurisdiction, and OBS Group s tax obligations for these entities are paid by other Akzo Nobel entities.

The OBS Group paid cash for interest of EUR 10 million and EUR 4 million during the six months ended June 30, 2007 and 2006, respectively.

The OBS Group s financing requirements are primarily met by cash transfers with Akzo Nobel and are reflected in the financing section of the combined statement of cash flows. This represents net cash transfers to and from Akzo Nobel for the settlement of various intercompany transactions and financing requirements with Akzo Nobel.

Note 19 Accounting Estimates and Judgments

In preparing the financial statements management makes judgments and estimates that affect the reported amounts of assets and liabilities, revenues and expenses, and related disclosures of contingent liabilities as of the date of the OBS Group s combined financial statements.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimate is revised if the revision affects only that period or in the period of the revision and future periods if the revision affects both current and future periods.

In preparing these combined interim financial statements, the significant judgements made by management in applying the accounting policies and the key sources of estimation uncertainty were the same as those applied to the combined financial statements as of and for the year ended December 31, 2006. It should be noted that as of June 30, 2007, the OBS Group did not update its actuarial valuation for its pension and postretirement benefits; however, during the six months ended June 30, 2007, the discount rate assumption used in determining benefit costs increased

in the various countries by between .25% and .50%. When discount rates increase, pension and postretirement benefit obligations will decrease. Based on the increase during the six months ended June 30, 2006, the pension and postretirement benefit obligations would have decreased by approximately EUR 50 million. Future net periodic pension and postretirement costs might also

Table of Contents

OBS GROUP

NOTES TO THE UNAUDITED CONDENSED COMBINED INTERIM FINANCIAL STATEMENTS (Continued)
(All amounts in millions of euros unless otherwise stated)

change, but that depends on the actual relation between the unrecognized loss and the corridor (10% of the greater of benefit obligations and plan assets) as well as on the relative change of the discount rate versus the change of the benefit obligation. In addition, the change in discount rate will not immediately impact the pension expense as the gains or losses from the change in the discount rate would be reflected as an actuarial gain or loss and recognized over the expected average remaining working lives of the employees in the plan.

Current tax expense for the six months ended June 30, 2007 and 2006 has been calculated using the estimated average annual effective income tax applied to the pre-tax income for the six months ended June 30, 2007 and 2006, respectively.

Due to the risks and uncertainties relating to regulatory approval and to internally generated research and development, the criteria for capitalization are considered not to have been met until marketing approval has been obtained from the regulatory authorities.

Prior to January 1, 2007, management had also estimated the allocation of various expenses and certain assets and liabilities that have historically been maintained by Akzo Nobel as disclosed in Note 1 and throughout these combined interim financial statements.

Note 20 Incorporation and Separation

Incorporation

Following the announcement of Akzo Nobel that it intends to separate its healthcare activities from Akzo Nobel, Akzo Nobel incorporated Organon BioSciences N.V., on September 1, 2006 as a public company with limited liability (naamloze vennootschap) incorporated under the laws of The Netherlands with an authorized share capital of EUR 225 thousand and an issued share capital of EUR 45 thousand. OBS N.V. s corporate seat is in Oss, The Netherlands.

On September 30, 2006 Akzo Nobel contributed to OBS N.V., through a contribution in kind, the shares of the two subholding companies, Organon BioSciences International B.V. and Organon BioSciences Nederland B.V., in exchange for 24,955,000 ordinary shares of OBS N.V. with a nominal value of EUR 1.00 (one euro) per share. As per the date of this contribution, OBS N.V. had an authorized share capital of EUR 125 million and an issued share capital of EUR 25 million.

The combined interim financial statements for the six month period ended June 30, 2007, include invested equity amounting to EUR 1,423 million. The invested equity as of June 30, 2007 includes certain allocated balances, which legally were not part of the aforesaid contribution in kind to OBS. N.V. on September 30, 2006. Consequently, the shareholders equity in the legal company balance sheet of OBS N.V. as of June 30, 2007 differs from the invested equity in the combined interim financial statements as of June 30, 2007. The main differences relate to various items which are allocated to the OBS Group which will not be transferred to the OBS Group.

Separation

In February 2006, Akzo Nobel announced its intention to separate the OBS Group. In March 2007, Akzo Nobel announced that it had subsequently received an offer from Schering-Plough to acquire the OBS Group. The works council advice procedure in the Netherlands is still to be completed. Subject thereto, the intended closing is further subject to certain conditions precedent, including the obtaining of merger clearances in certain jurisdictions. The proceeds from the sale of the OBS Group will not be received by the OBS Group but will be received by Akzo Nobel.

Table of Contents

OBS GROUP

NOTES TO THE UNAUDITED CONDENSED COMBINED INTERIM FINANCIAL STATEMENTS (Continued)
(All amounts in millions of euros unless otherwise stated)

Akzo Nobel and the OBS Group have identified certain issues and areas that, in preparation of and following the separation, required mutually agreeable arrangements between them. These issues and areas have been included in a separation agreement, entered into between Akzo Nobel and the OBS Group. The separation agreement was signed on February 28, 2007 and was subsequently amended on March 11, 2007.

The amended separation agreement (which becomes effective on the intended closing of the transaction with Schering-Plough) addresses, amongst others, the separation of liabilities and obligations, health, safety, and environmental indemnities, release of guarantees, pending litigation, provisions and accruals, claimant s insurance and employee benefit related matters.

The terms of the intended transaction between Akzo Nobel and Schering-Plough, include that, subject to certain limitations and procedural provisions, Akzo Nobel indemnifies Schering-Plough for i) all taxes for which a member of the OBS Group becomes liable, relating to the period prior to January 1, 2007 and that are not provided for in the combined financial statements of the OBS Group for the period ended as of December 31, 2006 and (ii) taxes for which a member of the OBS Group becomes liable relating to the period starting on January 1, 2007 and ending on the closing date of the intended transaction, unless and to the extent the member of the OBS Group concerned retains the benefit of the underlying income, profit or gain at closing, or such income, profit, gain or event has arisen in the ordinary course of business of the member of the OBS Group concerned.

The terms of the intended transaction further include that Schering-Plough will indemnify Akzo Nobel against any increase of taxes incurred by Akzo Nobel or a member of Akzo Nobel as a consequence of any pre-closing transactions, requested by Schering-Plough and consented by Akzo Nobel, which would allow for a direct sale by Akzo Nobel of the shares in one or more members of the OBS Group to Schering-Plough.

The separation agreement also contains provisions dealing with the retirement benefits of relevant participants in various applicable pension arrangements based on an agreed upon division of the rights, obligations, assets and liabilities relating to, on the one hand, the retirement benefits of the relevant (current and former) employees in the (current and former) human healthcare or animal healthcare activities of the OBS Group and, on the other hand, retirement benefits of other participants in Akzo Nobel plans. It should be noted that a number of these provisions are dependent on the approval of relevant third parties, for example pension fund trustees, employee representative bodies and relevant authorities. The separation agreement thus also provides that in the event that the OBS Group and Akzo Nobel have not been able to give effect to the agreed (basis for) division, they will use their reasonable best efforts to otherwise achieve such division.

OBS N.V. has undertaken in the separation agreement to procure that, for services rendered on or after January 1, 2007, relevant participants under the OBS Group retirement benefit plans are offered retirement benefits which are substantially equivalent (or such other measure as may be required under applicable law) to their current retirement benefits.

The financial implications of a future split as defined above, for example on assets, liabilities and future pension premiums, if any, cannot be determined yet. However, it is the intention of Akzo Nobel and the OBS Group to limit the financial implications for the companies, arising out of the split of rights, obligations and assets. Furthermore, the subordinated loan to the Akzo Nobel Pension Fund of which the OBS Group s portion (EUR 33 million) was allocated

in the combined financial statements for the year ending December 31, 2006, will remain with Akzo Nobel since Akzo Nobel holds the legal title.

Table of Contents

OBS GROUP

NOTES TO THE UNAUDITED CONDENSED COMBINED INTERIM FINANCIAL STATEMENTS (Continued)
(All amounts in millions of euros unless otherwise stated)

The terms of the intended transaction between, Akzo Nobel and Schering-Plough further include that (i) Akzo Nobel will transfer to the purchaser, at closing of the intended transaction, its claim against the OBS Group under the related party loan of EUR 1.15 billion plus accrued interest and (ii) all other intra-group indebtedness between the OBS Group on the one hand and the other members of the Akzo Nobel Group on the other hand (including several loans made by the OBS Group to Akzo Nobel in 2007 on terms substantially equivalent to the aforesaid related party loan), will be paid immediately after closing. Under the loan agreement between Akzo Nobel (as lender) and the OBS Group (as borrower) the maturity date of the loan is December 31, 2007 and an interest rate of 6-months EURIBOR + 0.15%, that accrues on the amount owed, from March 1, 2007 to the date of payment (both days inclusive). The entire principal amount of the loan not yet repaid to Akzo Nobel shall be due for immediate payment without any further notification or formality being required should, amongst others, any other indebtedness of the OBS Group becomes due and payable prior to its specified maturity by reason of any default by the OBS Group in the due performance or observance of any obligation relating thereto, unless such indebtedness shall not be material in the context of the loan agreement.

The OBS Group has undertaken to replace the statement of joint and several liability (verklaring van hoofdelijke aansprakelijkheid) as provided by Akzo Nobel in respect of the members of the OBS Group in The Netherlands under article 2:403 section 1(f) Netherlands Civil Code as soon as reasonably practicable, but in any event within 6 months after closing of the intended transaction between Akzo Nobel and Schering-Plough.

Note 21 Application of Generally Accepted Accounting Principles in the United States of America

The OBS Group s combined interim financial statements have been prepared in accordance with IFRS which, as applied by the OBS Group, differs in certain significant respects from US GAAP. The effects of the application of US GAAP to combined net income, as determined under IFRS, are set out in the table below:

	For the Six Months Ended June 30,	
	2007	**2006**
IFRS profit for the period attributable to equity holders of the OBS Group	223	193
US GAAP adjustments:		
(a) Business combinations		
(b) Pensions and other postretirement benefits	8	(4)
(c) Impairment of goodwill		
(d) Research and development	(20)	3
(e) Subsequent events	14	128
(f) Tax on elimination of intercompany profits	2	(2)
(g) Deferred income taxes	4	(1)
Total US GAAP adjustments	8	124

Net income, as reported under US GAAP	231	317

Table of Contents

OBS GROUP

NOTES TO THE UNAUDITED CONDENSED COMBINED INTERIM FINANCIAL STATEMENTS (Continued)
(All amounts in millions of euros unless otherwise stated)

The effects of the application of US GAAP on total invested equity, as determined under IFRS, are set out in the table below:

	As of June 30, 2007	As of December 31, 2006
Invested equity, as reported under IFRS	1,423	2,311
Less: minority interests, as reported under IFRS		
Invested equity excluding minority interests, as reported under IFRS	1,423	2,311
US GAAP adjustments:		
(a) Business combinations	361	361
(b) Pensions and other postretirement benefits	47	33
(c) Impairment of goodwill	15	15
(d) Research and development	(48)	(27)
(e) Subsequent events		(15)
(f) Tax on elimination of intercompany profits	(35)	(37)
(g) Deferred income taxes	6	2
Total US GAAP adjustments	346	332
Invested equity, as determined under US GAAP	1,769	2,643

(a) Business combinations

The aggregate adjustment for business combinations presented in the tables above consists of the following adjustments:

	For the Six Months Ended June 30, 2007	2006	As of June 30, 2007	As of December 31, 2006
US GAAP adjustments:				
(1) Acquired in-process research and development			(5)	(5)

(2) Application of IFRS 1	366	366
Total US GAAP adjustments	361	361

(1) Acquired in-process research and development

Under IFRS, in-process research and development acquired in connection with a business combination is eligible for capitalization under IFRS 3, *Business Combinations*, and IAS 38, *Intangible Assets.* Under US GAAP, the attributable fair value of in-process research and development acquired in a business combination, and which has no alternative future use, is expensed as of the acquisition date in accordance with SFAS No. 141, *Business Combinations*, FIN No. 4, *Applicability of FASB Statement No. 2 to Business Combinations to be Accounted for by the Purchase Method*, and/or SFAS No. 2, *Accounting for Research and Development Costs*.

Table of Contents

OBS GROUP

NOTES TO THE UNAUDITED CONDENSED COMBINED INTERIM FINANCIAL STATEMENTS (Continued)
(All amounts in millions of euros unless otherwise stated)

The adjustment to invested equity included in the tables above reflects impact of immediate write-off of acquired in-process research and development-related assets (EUR 5 million and EUR 5 million as of the six months ended June 30, 2007 and as of the year ended December 31, 2006, respectively) for US GAAP purposes. There was no impact for the reversal of amortization expense and/or impairments for the six months ended June 30, 2007 and 2006 recorded under IFRS in subsequent periods.

(2) Application of IFRS 1

IFRS 1, *First-Time Adoption of International Financial Reporting Standards*, has been applied by the OBS Group in preparing its combined financial statements. IFRS 1 generally requires retrospective application of all IFRS that are effective at the reporting date. However, IFRS 1 permits certain exemptions and exceptions to this requirement. In particular, IFRS 1 permits companies that consummated business combinations prior to the date of their transition to IFRS (for the OBS Group, as of January 1, 2004) to retain the accounting applied under the accounting principles applied prior to the adoption of IFRS.

Specifically, for certain business combinations consummated prior to January 1, 2000, the OBS Group recorded goodwill resulting from the business combinations directly in invested equity. From January 1, 2000 through the adoption of changes in accounting rules applied prior to the adoption of IFRS, the OBS Group amortized goodwill. Under US GAAP, for all periods presented, goodwill is required to be recorded as an asset, initially subject to periodic amortization (through December 31, 2001) and subsequently periodic (at least annual) impairment tests.

Accordingly, this adjustment reflects the reinstatement of goodwill, net of applicable accumulated amortization and impairments, for US GAAP purposes as of each of the balance sheet dates presented.

(b) Pensions and other postretirement benefits

The aggregate adjustment for pensions and postretirement benefits presented in the tables above consists of the following adjustments:

	For the Six Months Ended June 30,		As of June 30,	As of December 31,
	2007	**2006**	**2007**	**2006**
US GAAP adjustments:				
(1) Definition of defined contribution plan	7	(2)	104	94
(2) Application of IFRS 1 and other differences	1	(2)	(57)	(61)
Total US GAAP adjustments	8	(4)	47	33

(1) Definition of defined contribution plan

Under IAS 19 (Revised), *Employee Benefits*, an arrangement qualifies as a defined contribution plan if a company s legal or constructive obligation is limited to the amount contributed by it into a separate entity (generally, a fund). This is the case regardless of whether the fund holds sufficient

Table of Contents

OBS GROUP

NOTES TO THE UNAUDITED CONDENSED COMBINED INTERIM FINANCIAL STATEMENTS (Continued)
(All amounts in millions of euros unless otherwise stated)

assets to pay all employee benefits laid out in the plan agreement relating to employee service in the current and prior periods. This definition focuses on the contributions to be made by the OBS Group to the plan as a whole and does not require individual participant accounts to which contributions would be made.

Under US GAAP, SFAS No. 87, *Employers Accounting for Pensions,* states that a defined contribution plan is any arrangement that provides benefits in return for services rendered, establishes an individual account for each participant, and specifies how recurring periodic contributions to the individual s account are to be determined. Moreover, the benefits a participant in a defined contribution plan will receive depend solely on the amount contributed to the participant s account, the return earned on those contributions, and forfeitures of other participants benefits that may be allocated to the remaining participant accounts.

During 2005, Akzo Nobel reached an agreement with the unions on a change of its pension plan in the Netherlands, part of which relates to the OBS Group, so that effective December 31, 2005, it changed from a defined benefit plan to a defined contribution plan under IFRS, as the actuarial risks related to the Dutch plan no longer rested with the OBS Group. However, under US GAAP, SFAS No. 87 specifically prescribes for a defined contribution plan that the plan provides an *individual account* for each participant. The Dutch plan does not provide such individual accounts per participant as it is a collective defined contribution plan. Accordingly for US GAAP, under SFAS No. 87 the Dutch pension plan is still accounted for as a defined benefit plan.

The adjustment to invested equity included in the table above as of the six months ended June 30, 2007 and as of the year ended December 31, 2006 reflects the re-instatement of the US GAAP liability for the pension and other postretirement plans in accordance with SFAS No. 87. The adjustment to net income included in the tables above for the six months ended June 30, 2007 and 2006 reflects the excess of US GAAP expense calculated in accordance with SFAS No. 87 over contributions made to the plan during the year.

(2) Application of IFRS 1 and other difference

Under IFRS, the OBS Group accounts for its pension and postretirement benefit plans in accordance with IAS 19 (Revised), *Employee Benefits*. In addition, upon transition to IFRS as of January 1, 2004 (and in accordance with IFRS 1, all unrecognized actuarial gains and losses as of that date were recognized immediately in invested equity, with an offset to the pension liability. Accordingly, under IFRS, as of January 1, 2004, the OBS Group had no deferred actuarial gains or losses. Subsequently, in accordance with IAS 19 (Revised), the OBS Group applied a corridor policy whereby actuarial gains and losses are deferred when they initially arise (for those arising after January 1, 2004). Thereafter, to the extent that unrealized actuarial gains or losses exceed 10% of the greater of (i) the present value of the defined benefit obligation and (ii) the fair value of plan assets, they are recognized in the income statement through periodic amortization over the expected remaining working lives of the employees participating in the plan. Otherwise, they continue to be deferred until they exceed the corridor described above.

Under US GAAP, the OBS Group accounts for its pension and postretirement benefit plans in accordance with SFAS No. 87, SFAS No. 106, *Employers Accounting for Postretirement Benefits Other than Pensions* and, from December 31, 2006, SFAS No. 158, *Employers Accounting for Defined Benefit Pension and Other Postretirement Plans an amendment of FASB Statements No. 87, 88, 106, and 132(R)*. Prior to the adoption of SFAS No. 158, the

OBS Group applied a corridor policy also under US GAAP. Following adoption of SFAS No. 158 from December 31, 2006,

Table of Contents

OBS GROUP

NOTES TO THE UNAUDITED CONDENSED COMBINED INTERIM FINANCIAL STATEMENTS (Continued)
(All amounts in millions of euros unless otherwise stated)

the OBS Group continues to apply a corridor policy with respect to determination of the income statement charge for any particular period, but the full funded status of the plan (defined benefit obligation less plan assets) is now recognized as a liability in the balance sheet with actuarial gains and losses recognized directly in invested equity.

In addition to the differences described above (principally related to the recognition of deferred actuarial gains and losses directly in invested equity as of January 1, 2004 pursuant to IFRS 1), the OBS Group has also identified differences related to the measurement date for certain of its plans. Under IFRS, IAS 19 requires that the calculation of the pension obligation, as well as the fair value of plan assets, be determined as of the company s balance sheet date. Under US GAAP, SFAS No. 87, requires that the plan s assets and obligations be measured either as of the date of the financial statements or, if used consistently from year to year, as of a date not more than three months prior to that date. Certain of the OBS Group s defined benefit plans utilize a September 30 measurement date for US GAAP purposes and a December 31 measurement date for IFRS purposes.

In the United States, the Medicare Prescription Drug Improvement and Modernization Act of 2003 introduced prescription drug benefits for retirees as well as a federal subsidy to sponsors of postretirement healthcare plans, which both began on January 1, 2006. This reimbursement right under IFRS has been recognized as an asset under other financial non-current assets in the combined balance sheets and is measured at fair value. Under US GAAP, this reimbursement right is netted with the postretirement healthcare benefit liability.

In connection with the change in the pension plan in the Netherlands in 2005, the OBS Group was allocated a portion of the subordinated loan and loans that are to be redeemed by retaining employee pension premiums, which have been recorded at their fair value in other assets under IFRS. For US GAAP purposes, these items are included in the pension assets at their nominal value, and accordingly the assets in the IFRS balance sheet have been reversed. Any difference between the fair value and the nominal value of the loans has been reversed for US GAAP.

(c) Impairment of goodwill

Under IFRS, goodwill is required to be tested for impairment at least annually (and, more frequently, upon the occurrence of a triggering event) at the cash generating unit (or group of cash generating units, if that is how goodwill is monitored internally) level. A cash generating unit is the smallest identifiable group of assets that generates cash inflows from continuing use and that are largely independent of the cash inflows from other assets or groups of assets. The goodwill impairment test is a one-step test that compares the recoverable amount (higher of the fair value less costs to sell or value in use) of the cash generating unit to its carrying amount, with any excess of carrying amount over recoverable amount recognized as an impairment loss. Impairment losses are allocated first to reduce the carrying amount of any goodwill allocated to the cash-generating unit (or group of units) and then to the other assets of the unit (or group of units) pro rata on the basis of the carrying amount of each asset in the unit (or group of units). Impairment losses related to goodwill cannot be reversed.

Under US GAAP, goodwill is required to be tested for impairment at least annually (and, more frequently, upon the occurrence of a triggering event) at the reporting unit level. A reporting unit is an operating segment or one level below an operating segment (referred to as a component). The goodwill impairment test is a two-step test that compares the fair value of the reporting unit to its carrying amount. If the fair value of the reporting unit exceeds its

carrying amount, goodwill of the reporting unit is considered not impaired. If the carrying amount of the reporting unit exceeds its fair

Table of Contents

OBS GROUP

NOTES TO THE UNAUDITED CONDENSED COMBINED INTERIM FINANCIAL STATEMENTS (Continued)
(All amounts in millions of euros unless otherwise stated)

value, the second step of the goodwill impairment test is performed to measure the amount of impairment loss, if any. The second step of the goodwill impairment test compares the implied fair value of reporting unit goodwill, which is determined by performing a hypothetical purchase price allocation as of the impairment testing date, to the carrying amount of that goodwill, with any excess of carrying amount over the implied fair value recognized as an impairment loss. Impairment losses related to goodwill cannot be reversed.

The cash generating unit is at a lower level in the operation, than the reporting unit and accordingly under IFRS an impairment was recorded that is not reflected under US GAAP. The adjustment included in the tables above reflects the reversal for US GAAP of the impairment loss recognized for IFRS purposes that was not recognized for US GAAP purposes due to this differing level at which goodwill is tested for impairment (cash generating unit under IFRS vs. reporting unit under US GAAP).

(d) Research and development

Under IFRS, payments made to acquire research and development-related assets outside of a business combination, and patents or licenses for products that are still in the research or development stage, are eligible for capitalization under IAS 38, when all of the following conditions are met: (i) the project meets the definition of an asset, (ii) the project is identifiable and (iii) the fair value of the project can be measured reliably. Accordingly, under IFRS, certain up-front payments made in connection with collaboration agreements were capitalized and are being amortized over their estimated useful lives.

Under US GAAP, payments to acquire research and development-related assets that have no alternative future use are expensed as of the acquisition date in accordance with SFAS No. 2.

The adjustment included in the tables above reflects the immediate write-off of acquired research and development-related assets in the period of acquisition (EUR 25 million and EUR 1 million, respectively, for the six-months ended June 30, 2007 and 2006, respectively) and for US GAAP purposes offset by the reversal of amortization expense and/or impairments (EUR 5 million and EUR 4 million, respectively, for the six months ended June 30, 2007 and 2006) recorded for IFRS purposes in subsequent periods.

(e) Subsequent events

The aggregate adjustment for subsequent events presented in the tables above consists of the following adjustments:

	For the Six Months Ended June 30,		As of June 30,	As of December 31,
	2007	2006	2007	2006
US GAAP adjustments:				
(1) Subsequent events other than taxes	(4)			4

(2) Subsequent events	tax-related	18	128	(19)
Total US GAAP adjustments		14	128	(15)

Table of Contents

OBS GROUP

NOTES TO THE UNAUDITED CONDENSED COMBINED INTERIM FINANCIAL STATEMENTS (Continued)
(All amounts in millions of euros unless otherwise stated)

Under IFRS, the OBS Group has applied IAS 10, *Events after the Balance Sheet Date*, and has adjusted its financial statements for adjusting events identified between the time the parent company financial statements were issued and the date on which these OBS Group s financial statements were issued.

Under US GAAP, practice with respect to the preparation of carve-out financial statements is to reflect subsequent events on a consistent basis with the parent company, as the carve-out financial statements are an extraction of the parent company accounts, unless the adjustment represents a correction of an error. The subsequent events for the tax related adjustments primarily relate to tax settlements received by the OBS group for transfer pricing.

Under US GAAP, the amounts have been recognized in periods consistent with Akzo Nobel. Accordingly, the subsequent event adjustments reflected in the IFRS financial statements have been reversed under US GAAP.

(f) Tax on the elimination of intercompany profits

In accordance with IFRS (IAS 12, *Income Taxes*), the deferred tax effect of the elimination of intercompany profit in inventory is calculated using the purchaser s tax rate. Under US GAAP (SFAS 109, *Accounting for Income Taxes*), no deferred tax assets are recorded for the difference between the tax base in the buyer s jurisdiction and the amount reported in the combined financial statements; additionally taxes payable on intercompany transfers recognized by the seller are deferred in consolidation, hence eliminating the effects of intercompany transfers in the combined statements of income.

For the six months ended June 30, 2007, this resulted in an increase in net income of EUR 2 million and a decrease in invested equity at June 30, 2007 of EUR 35 million. For the six months ended June 30, 2006, this resulted in a decrease in net income of EUR 2 million and a decrease in invested equity at December 31, 2006 of EUR 37 million.

(g) Deferred income taxes

The aggregate adjustment for income taxes presented in the tables above consists of the following adjustments:

	For the Six Months Ended June 30,		As of June 30,	As of December 31,
	2007	2006	2007	2006
US GAAP adjustments:				
(1) Deferred tax on in-process research and development			1	1
(2) Other deferred income tax impacts	4	(1)	5	1
Total US GAAP adjustments	4	(1)	6	2

Table of Contents

OBS GROUP

NOTES TO THE UNAUDITED CONDENSED COMBINED INTERIM FINANCIAL STATEMENTS (Continued)
(All amounts in millions of euros unless otherwise stated)

(1) Deferred income tax on in-process research and development

Under IFRS, a deferred tax asset or liability is recognized for differences in the financial reporting basis and tax basis of acquired in-process research and development, similar to other identifiable intangible assets, irrespective of whether the acquired in-process research and development has basis for tax purposes. Under US GAAP (EITF 96-7, *Accounting for Deferred Taxes on In-Process Research and Development activities acquired in a Business Combination*) in circumstances where there is no tax basis in the acquired in-process research and development deferred taxes are not provided on the initial difference between the amount assigned for financial reporting and tax purposes and the in-process research and development is charged to expense on a gross basis (without tax benefit) at acquisition. In circumstances where a tax basis exists for the acquired in-process research and development, upon consummation of the business combination, the in-process research and development is immediately charged to expense, a deferred tax asset is recognized to the extent that realisability is more likely than not.

The deferred tax liability recorded under IFRS results in a corresponding increase to goodwill. Although this difference does not affect invested equity (between IFRS and US GAAP) at the acquisition date, a reclassification adjustment is necessary under US GAAP to reduce goodwill by the amount of the deferred tax liability recorded under IFRS in relation to acquired in-process research and development and to reduce deferred tax liabilities by a corresponding amount (EUR 8 million). The impact on income tax expense of this difference when the acquired in-process research and development is amortized or impaired for IFRS purposes is reversed under US GAAP.

(2) Other deferred income tax impacts

This adjustment reflects the deferred tax effects attributable to the aforementioned pre-tax adjustments. The adoption of FIN 48, *Accounting for Uncertainty in Income Taxes*, during the six-months ended June 30, 2007, did not have an impact on the OBS Group.

(h) Other presentation differences

Deferred income taxes

Under IFRS, deferred tax assets and liabilities are classified as non-current on the balance sheet based on the timing of their expected reversal.

Under US GAAP, deferred tax assets and liabilities are classified as current or non-current on the balance sheet based on the nature of the balance sheet item to which they relate. Where no related asset or liability exists (e.g. for net operating losses), deferred tax assets or liabilities are classified as current or non-current on the balance sheet based on the timing of their expected reversal.

Oss, July 30, 2007
The Board of Management
Toon Wilderbeek

Table of Contents

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