

MATTHEW SZULIK
CEO, Red Hat



Date of birth: **NOVEMBER 29, 1956**

Hometown: **NEW BEDFORD, MA**

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“By the year 2005 there will be two credible operating systems. One will be Linux, and the other will be a Microsoft operating system.”

—Red Hat CEO Matthew Szulik

Taking Red Hat beyond geek chic

Matthew Szulik defied critics by bringing in cash for a Linux-based business. Now he must prove his company's viability to the wider business market in a hostile high-tech economy.

By Robert Lemos, Staff Writer

Two months after settling in as CEO in November 1999, Matthew Szulik watched Red Hat's stock price begin a free fall that would unnerve investors, drive away disillusioned employees, and raise questions about the company's very existence.

Critics of Linux—an operating system created by volunteer programmers and licensed for free—said it couldn't create a profitable business as Red Hat had promised. But Szulik made a full-court press on Wall Street and successfully hurried through a secondary offering that left the company's coffers flush.

“The \$300 million in the bank on the balance sheet was key,” said Peter von Schilling, a senior analyst at Merrill Lynch. “It removed any kind of doubt that Red Hat is sustainable.”

It was a successful baptism by fire for Szulik. But that was only the first test at Red Hat for the 45-year-old New Englander, who must still prove that the Linux seller can survive as a profitable company in a field dominated by such industry heavyweights as Microsoft and Sun Microsystems.

A hard-charging executive who does not suffer fools gladly, Szulik has won wide praise among Linux supporters for his fierce loyalty to a cause sometimes described as high-tech socialism. Now the software veteran must find a way to turn a profit on

this grassroots alternative-operating-system movement, taking Red Hat beyond its geek-chic origins to the wider business market in a hostile high-tech economy.

As the galloping momentum behind Linux has slowed, Red Hat's quarterly revenue has seesawed. The company's “open source” model allows Red Hat to benefit from work done by a wider community of programmers and Linux software makers, but that arrangement also makes the operating system essentially a free commodity because everyone has access to the software code.

Despite such obstacles, Red Hat has made progress. Three years ago, the company had only one way to make money: a distribution package that brings together a variety of Linux programs and components available from open-source projects into an integrated operating system.

Now it has at least two-dozen sources of revenue, including support services and systems integration. Red Hat makes sure all the software works as a cohesive whole, which is no

Matthew Szulik | CEO, Red Hat

small feat with a current distribution that contains hundreds of software applications, such as Web servers, mail programs and office applications.

On the horns of a dilemma

Linux customers save money because they can theoretically buy a single copy of software and install it everywhere. Google, for instance, uses Red Hat across all 10,000 of its servers and saves millions of dollars by buying only a handful of software copies, said Jim Reese, the Web company's chief operations engineer.

If his company had gone with Windows software, Reese said, "the seat licenses alone would be prohibitive."

Yet such devotion does little to help Red Hat's bottom line. Because the company can't profit from selling core software, it's unclear how much of Linux's popularity will translate into revenue.

"That presents Matt with a particularly difficult challenge," said Dan Kusnetzky, a vice president at market researcher IDC. "He has to find many ways to find

money in a market where the software cannot be high cost."

Already, Szulik has seen the high-tech recession take its toll on Linux and open-source companies. Several highly touted upstarts went out of business in the past year after failing to find their way to profitability.

The list of casualties included Eazel, which concentrated on creating a desktop replacement; database maker Great Bridge; and the Linux division of software maker Corel. Others have canned the free-software approach in favor of proprietary applications, such as e-commerce company Ars Digita, Linux software maker VA Software (formerly VA Linux Systems) and file system creator Sistina.

Szulik, however, is not one to shy away from a challenge. As a teenager, he worked his way out of tough economic times in his hometown of New Bedford, Mass., by caddying at a local country club and learning enough to receive a golf scholarship to college.

While still in his 20s, Szulik started

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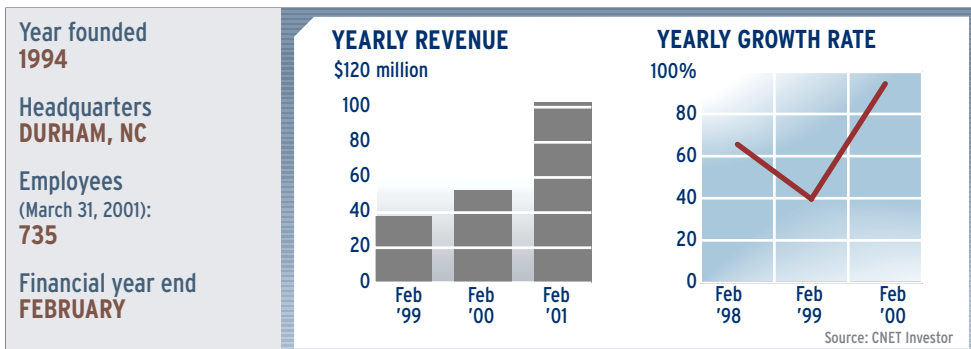
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RED HAT DURING AND AFTER THE BOOM



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at Exxon Office Systems, where he rose to become head of worldwide sales. After spending nine years at Interleaf, he then rocketed through several start-ups, including MapInfo, Sapiens International and Relativity Software.

Szulik might have stayed at Relativity had he not been a rare fish: a seasoned software executive in the small pond of North Carolina. "It isn't the easiest place to recruit senior talent to," recalled William Kaiser, a partner with venture firm Greylock and a board member who led the executive search for Red Hat's CEO.

True believer

Kaiser found what he was looking for in Szulik. And perhaps just as important, he got a true believer.

Szulik says he has not touched a Windows product in more than four years. He has even brought home copies of Linux and the GNOME desktop interface to his children, who have been using it since last year.

"Matthew sees this not as just a job, but a mission," said an admiring Billy Marshall, who works alongside Szulik as vice president of enterprise sales and marketing for Red Hat.

While other companies have abandoned the open-source model, Szulik's insistence on keeping Red Hat rooted in Linux has won him

support well beyond the company's headquarters at Research Triangle Park, N.C., outside Durham.

"He's doing good things for the community," said Bruce Perens, a well-known Linux developer and the open-source strategist for Hewlett-Packard. "It's great that Red Hat made the switch to a different management without doing away with what makes the company great."

Still, with all driven leaders comes controversy. While keenly aware of the importance of rewarding talent, Szulik prides himself on being independent-minded and even stubborn at times—traits that have occasionally backfired among some of his 600 employees.

For those who fail to produce to his satisfaction, the 6-foot-4-inch CEO can be a harsh taskmaster, according to some who have worked with him. Vivek Wadhwa, who was Szulik's boss at Relativity, recalls that differences in opinion did not always end amicably: "We've had yelling matches in the middle of the hallway," he said.

Others say Szulik is simply doing what is required of a chief executive, especially in tough times that call for tough measures.

"He has a very strong personality. If he rolls over you, then he doesn't

respect you," said one employee who spoke on condition of anonymity. At the same time, the source added, "if you are not a pain in the ass, you wouldn't get the job done."

Indeed, Szulik's accomplishments at Red Hat are many. Since he has taken the helm, the company has expanded beyond software sales, charging for support through the Red Hat Network. It also makes money from books, training and custom installations for large customers.

From a broader perspective, Red Hat has taken advantage of weak economic times to snap up smaller companies and enter new markets. Through such mergers, it has acquired the expertise to create a pint-sized Linux operating system to run handheld devices and communications equipment, drawing such customers as mobile-phone maker Ericsson and hardware maker Intel.

Red Hat has not been immune to the industry's recession, but Szulik has resisted blaming the company's problems on the economy. Co-founder Bob Young said Red Hat's top brass had every right to make excuses.

"But they didn't," Young stressed. "Instead, they have used a great amount of financial discipline."

That discipline has helped Red Hat's

Matthew Szulik | CEO, Red Hat

bottom line. In the latest quarter, for example, the company reduced the costs of subscription revenue and of delivering services. As a result, gross margins edged up to 60 percent from an average of 53 percent in 2001.

With only \$68 million in sales for the first three quarters, Red Hat is likely to see revenue fall from the previous year's total of \$103 million. Szulik says profits won't come until the next fiscal year, ending in February 2003.

Red Hat won't displace competitors like Microsoft anytime soon, but its success is a relative measure. Because Red Hat has only \$100 million in revenue, becoming a billion-dollar company can be considered an enormous achievement.

This is not to say that Red Hat is afraid to compete with the industry's leaders. It is taking on Sun with Linux, which is an open-source variant of the Unix operating system and is compatible with most Unix applications, but much less expensive.

A recent IDC study found that companies that switch from Unix to Linux can save up to 82 percent on messaging and collaboration applications and up to 45 percent on Internet and intranet applications. Amazon.com recently acknowledged that it has saved as much as \$17 million by switching to Linux from Sun's Solaris Unix.

Winning over Microsoft's customers is a different matter. Moving from Unix to Linux is relatively easy because of their similarities, but converting systems based on Windows takes an entirely different set of skills and knowledge.

However, companies looking for new systems will be much more likely to seriously consider Linux as opposed to Windows, IDC's Kusnetzky said.

"It's a mainstream choice in very few markets right now, but it will be a mainstream choice in every market by 2005," Kusnetzky said. More than a third of core Windows customers had

Linux software installed somewhere in their company, according to an IDC report.

Linux even has the backing of computing titan IBM, which pledged to spend \$1 billion on the open-source technology in 2001. Red Hat has also logged several high-profile customers, including Morgan Stanley and Cisco Systems.

Although those sales were scored by replacing older, and more expensive, Unix systems, Szulik sees the biggest battle against today's dominant operating system.

"By the year 2005 there will be two credible operating systems," he said. "One will be Linux, and the other will be a Microsoft operating system."

The question is whether Red Hat has enough time to pull that off before the money runs out. ■

REPORT CARD
MATT SZULIK
CEO, Red Hat

Overall grade:



LEADERSHIP: Leads by example, but his hard-nosed style has caused occasional ripples with intimidated subordinates.



VISION: Szulik has focused Red Hat on services, but questions remain whether the new plan is the right plan. Still, it's a bold move to offset the company's reliance on software.



EXECUTION: Szulik helped secure funding for the long term, wisely partnered with giants such as IBM, and pushed the company to embrace a services-oriented strategy.



STAR POWER: Although he often defers to co-founder Bob Young for high-profile speeches, he's begun to raise his profile—including a recent appearance in front of the U.S. Senate.