MICROSTRATEGY INC
Form 10-Q
November 04, 2008
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the Quarterly Period Ended September 30, 2008

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from to

Commission File Number 000-24435

MICROSTRATEGY INCORPORATED

(Exact name of registrant as specified in its charter)

Delaware

(State of incorporation)

51-0323571

(I.R.S. Employer Identification Number)

1861 International Drive, McLean, VA

(Address of Principal Executive Offices)

22102

(Zip Code)

Registrant s telephone number, including area code: (703) 848-8600

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer	x	Accelerated filer	¨
Non-accelerated filer	¨ (Do not check if a smaller reporting company)	Smaller reporting company	¨

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

The number of shares of the registrant s class A common stock and class B common stock outstanding on October 24, 2008 was 9,118,521 and 2,770,244, respectively.

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FORM 10-Q

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

MICROSTRATEGY INCORPORATED

CONSOLIDATED BALANCE SHEETS

(in thousands, except per share data)

	September 30, 2008 (unaudited)	December 31, 2007 (audited)
Assets		
Current assets:		
Cash and cash equivalents	$ 127,287	$ 85,194
Restricted cash and investments	514	2,982
Accounts receivable, net	45,196	49,392
Prepaid expenses and other current assets	11,553	12,106
Deferred tax assets, net	24,535	29,652
Assets held-for-sale	7,663	4,272
	216,748	183,598
Property and equipment, net	8,543	9,473
Capitalized software development costs, net	9,573	2,340
Deposits and other assets	37,313	11,433
Deferred tax assets, net	26,710	35,347
Total assets	$ 298,887	$ 242,191
Liabilities and Stockholders Equity		
Current liabilities:		
Accounts payable and accrued expenses	$ 50,130	$ 22,083
Accrued compensation and employee benefits	35,969	38,604
Deferred revenue and advance payments	69,757	64,234
Liabilities held-for-sale	7,338	3,436
Total current liabilities	163,194	128,357
Deferred revenue and advance payments	1,569	1,368
Other long-term liabilities	9,647	9,137
Total liabilities	174,410	138,862
Commitments and Contingencies		
Stockholders Equity		
Preferred stock undesignated, $0.001 par value; 5,000 shares authorized; no shares issued or outstanding		
Class A common stock, $0.001 par value; 330,000 shares authorized; 14,165 shares issued and 9,118 shares outstanding, and 14,113 shares issued and 9,184 shares outstanding, respectively	14	14
Class B common stock, $0.001 par value; 165,000 shares authorized; 2,770 issued and outstanding	3	3
Additional paid-in capital	450,622	448,229
Treasury stock, at cost, 5,047 and 4,929 shares, respectively	(366,191)	(357,804)

Accumulated other comprehensive income		2,523		2,929
Retained earnings		37,506		9,958
Total stockholders equity		124,477		103,329
Total liabilities and stockholders equity	$	298,887	$	242,191

The accompanying notes are an integral part of these Consolidated Financial Statements.

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MICROSTRATEGY INCORPORATED

CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share data)

	Three Months Ended September 30, 2008 (unaudited)	Three Months Ended September 30, 2007 (unaudited)
Revenues:		
Product licenses	$ 24,787	$ 30,210
Product support and other services	65,841	61,022
Total revenues	90,628	91,232
Cost of revenues:		
Product licenses	422	713
Product support and other services	16,304	11,784
Total cost of revenues	16,726	12,497
Gross profit	73,902	78,735
Operating expenses:		
Sales and marketing	35,888	28,544
Research and development	5,922	9,279
General and administrative	14,744	12,170
Total operating expenses	56,554	49,993
Income from continuing operations before financing and other income and income taxes	17,348	28,742
Financing and other income:		
Interest income, net	623	927
Other income (expense), net	694	(828)
Total financing and other income	1,317	99
Income from continuing operations before taxes	18,665	28,841
Provision for income taxes	7,593	9,439
Income from continuing operations	11,072	19,402
Income (loss) from discontinued operations, net of tax provision (benefit) ($53 and $(54), respectively)	52	(67)
Net Income	$ 11,124	$ 19,335
Basic earnings (loss) per share (1):		
From continuing operations	$ 0.93	$ 1.58
From discontinued operations	$ 0.01	$ (0.01)
Basic earnings per share	$ 0.94	$ 1.57

Weighted average shares outstanding used in computing basic earnings per share		11,887		12,286
Diluted earnings (loss) per share (1):				
From continuing operations	$	0.90	$	1.52
From discontinued operations	$	0.00	$	(0.01)
Diluted earnings per share	$	0.90	$	1.51
Weighted average shares outstanding used in computing diluted earnings per share		12,306		12,771

(1) Basic and fully diluted earnings per share for class A and class B common stock are the same.

The accompanying notes are an integral part of these Consolidated Financial Statements.

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MICROSTRATEGY INCORPORATED

CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share data)

	Nine Months Ended September 30, 2008 (unaudited)	Nine Months Ended September 30, 2007 (unaudited)
Revenues:		
Product licenses	$ 67,966	$ 68,608
Product support and other services	197,422	171,539
Total revenues	265,388	240,147
Cost of revenues:		
Product licenses	1,442	2,156
Product support and other services	45,898	34,925
Total cost of revenues	47,340	37,081
Gross profit	218,048	203,066
Operating expenses:		
Sales and marketing	100,060	79,223
Research and development	24,449	25,126
General and administrative	47,055	37,176
Total operating expenses	171,564	141,525
Income from continuing operations before financing and other income and income taxes	46,484	61,541
Financing and other income:		
Interest income, net	2,081	2,782
Other expense, net	(269)	(791)
Total financing and other income	1,812	1,991
Income from continuing operations before taxes	48,296	63,532
Provision for income taxes	20,365	22,797
Income from continuing operations	27,931	40,735
Income (loss) from discontinued operations, net of tax provision (benefit) ($176 and $46, respectively)	(383)	58
Net Income	$ 27,548	$ 40,793
Basic earnings (loss) per share (1):		
From continuing operations	$ 2.35	$ 3.28
From discontinued operations	$ (0.03)	$ 0.01
Basic earnings per share	$ 2.32	$ 3.29

Weighted average shares outstanding used in computing basic earnings per share		11,890		12,416
Diluted earnings (loss) per share (1):				
From continuing operations	$	2.26	$	3.14
From discontinued operations	$	(0.03)	$	0.01
Diluted earnings per share	$	2.23	$	3.15
Weighted average shares outstanding used in computing diluted earnings per share		12,332		12,953

(1) Basic and fully diluted earnings per share for class A and class B common stock are the same.

The accompanying notes are an integral part of these Consolidated Financial Statements.

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MICROSTRATEGY INCORPORATED

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(unaudited)

	Nine Months Ended September 30, 2008	Nine Months Ended September 30, 2007
Operating activities:		
Net income	$ 27,548	$ 40,793
Plus: Loss (income) from discontinued operations, net	383	$ (58)
Income from continuing operations	27,931	$ 40,735
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	4,825	5,710
Bad debt expense	1,074	1,447
Deferred taxes	13,655	18,559
Stock-based compensation	45	413
Excess tax benefits from stock-based payment arrangements	(241)	(2,269)
Other, net	49	116
Changes in operating assets and liabilities:		
Accounts receivable	3,617	5,710
Prepaid expenses and other current assets	176	(258)
Deposits and other assets	(218)	(1,414)
Accounts payable and accrued expenses, compensation and employee benefits, accrued interest	294	(8,447)
Deferred revenue and advance payments	6,071	6,579
Other long-term liabilities	568	37
Net cash provided by operating activities from continuing operations	57,846	66,918
Net cash provided by (used in) operating activities from discontinued operations	1,399	(2,184)
Net cash provided by operating activities	59,245	64,734
Investing activities:		
Advance deposits on purchases of property and equipment		(7,500)
Purchases of property and equipment	(2,972)	(2,819)
Capitalized software development costs	(8,078)	(2,650)
Decrease in restricted cash and investments	1,062	997
Net cash used in investing activities from continuing operations	(9,988)	(11,972)
Net cash used in investing activities from discontinued operations	(158)	(49)
Net cash used in investing activities	(10,146)	(12,021)
Financing activities:		
Proceeds from sale of class A common stock under exercise of employee stock options	2,073	2,013
Excess tax benefits from stock-based payment arrangements	241	2,269
Purchases of treasury stock	(8,387)	(62,634)
Net cash used in financing activities from continuing activities	(6,073)	(58,352)

Net cash used in financing activities from discontinued activities		
Net cash used in financing activities	(6,073)	(58,352)
Effect of foreign exchange rate changes on cash and cash equivalents	(933)	2,384
Net increase (decrease) in cash and cash equivalents	42,093	(3,255)
Cash and cash equivalents, beginning of period	85,194	78,980
Cash and cash equivalents, end of period	$ 127,287	$ 75,725

The accompanying notes are an integral part of these Consolidated Financial Statements.

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MICROSTRATEGY INCORPORATED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

(1) Basis of Presentation

Except for the consolidated balance sheet of MicroStrategy Incorporated (MicroStrategy or the Company) as of December 31, 2007, which is derived from audited financial statements, the accompanying consolidated financial statements are unaudited. In the opinion of management, all adjustments necessary for a fair statement of such financial position and results of operations have been included. All such adjustments are of a normal recurring nature unless otherwise disclosed. Interim results are not necessarily indicative of results for a full year.

The consolidated financial statements and notes are presented as required by Form 10-Q and do not contain certain information included in the Company s annual financial statements and notes. These financial statements should be read in conjunction with the Company s audited financial statements and the notes thereto filed with the Securities and Exchange Commission (SEC) in the Company s Annual Report on Form 10-K for the year ended December 31, 2007.

The Company must classify a business line as discontinued operations once the Company has committed to a plan to sell the business, as determined pursuant to Statement of Financial Accounting Standard No. 144, Accounting for the Impairment of Long-Lived Assets , or SFAS 144. In March 2008, the Company committed to a plan to sell its Alarm.com business, which focuses outside of the business intelligence software and services market. Alarm.com is a provider of web-enabled residential and commercial security and activity monitoring technology. Historical financial information presented in the consolidated financial statements and notes to consolidated financial statements have been reclassified to conform to the current year presentation.

(2) Recent Accounting Standards

In December 2007, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 141 (Revised 2007), Business Combinations (SFAS 141R). SFAS 141R will change the accounting for business combinations. Under SFAS 141R, an acquiring entity will be required to recognize all the assets acquired and liabilities assumed in a transaction at the acquisition-date fair value with limited exceptions. SFAS 141R will change the accounting treatment and disclosure for certain specific items in a business combination. SFAS 141R applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. SFAS 141R will have an impact on the Company s accounting for business combinations once adopted, but the effect on its consolidated results of operations and financial position will be dependent upon the acquisitions, if any, that the Company makes on or after December 15, 2008.

In December 2007, the FASB issued SFAS No. 160, Noncontrolling Interests in Consolidated Financial Statements An Amendment of ARB No. 51 (SFAS 160). SFAS 160 establishes new accounting and reporting standards for the non-controlling interest in a subsidiary and for the deconsolidation of a subsidiary. SFAS 160 is effective for fiscal years beginning on or after December 15, 2008. The Company is currently evaluating the impact of SFAS 160 on its consolidated results of operations and financial position.

In March 2008, the FASB issued SFAS No. 161, Disclosures About Derivative Instruments and Hedging Activities an amendment of FASB Statement No. 133 (SFAS 161). SFAS 161 expands quarterly disclosure requirements in SFAS No. 133 about an entity s derivative instruments and hedging activities. SFAS 161 is effective for fiscal years beginning after November 15, 2008. The Company is currently evaluating the impact of SFAS 161 on its consolidated financial position and results of operations.

In May 2008, the FASB issued SFAS No. 162, The Hierarchy of Generally Accepted Accounting Principles (SFAS 162). SFAS 162 identifies the sources of accounting principles and the framework for

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(unaudited)

selecting the principles to be used in the preparation of financial statements of nongovernmental entities that are presented in conformity with generally accepted accounting principles. SFAS 162 is effective 60 days following the SEC s approval of the Public Company Accounting Oversight Board amendments to Interim Auditing Standards Section 411, The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles. SFAS 162 will not have an impact on the Company s consolidated financial position and results of operations.

(3) Restricted Cash and Investments

Restricted cash and investments consists of cash and investment balances restricted in use by contractual obligations with third parties.

On March 15, 2005, the Company entered into a security agreement with a bank under which the Company posted cash to secure existing letters of credit. These letters of credit are used as security deposits for office leases, including the office lease for the Company s corporate headquarters, as well as collateral for performance bonds. The Company may invest the cash collateral under the security agreement in certain permitted investments. As of September 30, 2008 and December 31, 2007, the Company had $1.0 million and $1.9 million, respectively, in cash collateral posted under the security agreement, all invested in money market funds that are included in restricted cash and investments or deposits and other assets in the accompanying balance sheets depending on whether the contractual obligation for which the collateral is posted is short term or long term, respectively.

(4) Accounts Receivable

Accounts receivable, net of allowances, consisted of the following, as of (in thousands):

	September 30, 2008	December 31, 2007
Billed and billable	$ 89,741	$ 106,605
Less: billed and unpaid deferred revenue	(41,352)	(55,434)
	48,389	51,171
Less: allowance for doubtful accounts	(3,193)	(1,779)
	$ 45,196	$ 49,392

The Company offsets accounts receivable and deferred revenue for any billed and unpaid items included in deferred revenue and advance payments.

MICROSTRATEGY INCORPORATED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

(5) Deferred Revenue and Advance Payments

Deferred revenue and advance payments from customers consisted of the following, as of (in thousands):

	September 30, 2008	December 31, 2007
Current:		
Deferred product licenses revenue	$ 4,524	$ 3,523
Deferred product support revenue	92,321	99,885
Deferred other services revenue	13,345	15,692
	110,190	119,100
Less: billed and unpaid deferred revenue	(40,433)	(54,866)
	$ 69,757	$ 64,234
Non-current:		
Deferred product licenses revenue	$ 713	$ 290
Deferred product support revenue	1,595	1,587
Deferred other services revenue	180	59
	2,488	1,936
Less: billed and unpaid deferred revenue	(919)	(568)
	$ 1,569	$ 1,368

The Company offsets accounts receivable and deferred revenue for any billed and unpaid items included in deferred revenue and advance payments.

(6) Litigation

On November 8, 2007 Diagnostic Systems Corp. (DSC), a subsidiary of Acacia Technology Group, filed a complaint for patent infringement against MicroStrategy and a number of other unrelated defendants in the United States District Court for the Central District of California, Southern Division. The case has been consolidated with Case No. SA CV 07-896 AG (MLGx) pending against other unrelated defendants. The consolidated complaint accuses MicroStrategy of infringing U.S. Patent No. 5,537,590 directly, contributorily and by inducement by making, using, selling and offering for sale in the United States MicroStrategy 8 Business Intelligence Platform, when used with an appropriate database. The consolidated complaint accuses MicroStrategy of willful infringement and seeks damages, a finding that the case is exceptional and an award of attorneys fees, and preliminary and permanent injunctive relief. In its initial disclosures pursuant to Federal Rule of Civil Procedure 26(a) served on December 28, 2007, DSC declined to disclose the amount of its alleged damages, but disclosed that its alleged damages are based on a reasonable royalty theory. MicroStrategy answered the consolidated complaint on December 28, 2007, denied infringement, asserted affirmative defenses of non-infringement, invalidity and unenforceability, among others, and counter-claimed for declaratory judgment that the 590 patent is not infringed, is invalid, and is unenforceable. The Court has not yet set a trial date. This case has been stayed in its entirety pending resolution of a writ of mandamus filed by DSC in the United States Court of Appeals for the Federal Circuit challenging an order by the District Court compelling DSC to produce documents to defendants in discovery that DSC alleges are privileged. The outcome of this litigation is not presently determinable. Accordingly, no provision for this matter has been made in the accompanying consolidated financial statements.

On December 10, 2003, MicroStrategy filed a complaint for patent infringement against Crystal Decisions, Inc. in the United States District Court for the District of Delaware. The lawsuit alleged that Crystal Decisions willfully infringed three patents issued to MicroStrategy relating to: (i) asynchronous control of report generation using a web browser (the 033 patent); (ii) management of an automatic OLAP report broadcast system (the 796 patent); and (iii) providing business intelligence web content with reduced client-side processing (the 432 patent). Following the filing of the complaint, Crystal Decisions was acquired by Business Objects Americas, Inc. Business Objects Americas, Inc. answered the complaint,

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

denying infringement and seeking a declaration that the patents in suit are invalid and not infringed by Business Objects Americas, Inc. MicroStrategy filed a motion for summary judgment of infringement of the 432, 796, and 033 patents on October 13, 2005. Business Objects filed motions for summary judgment of non-infringement and invalidity of the 432, 796, and 033 patents on October 13, 2005. The Court granted Business Objects motions for summary judgment of non-infringement of the 033 patent and of invalidity of the 432 and 796 patents. The Court denied Business Objects motion for summary judgment of invalidity of the 033 patent and denied as moot Business Objects motion for summary judgment of non-infringement of the 432 and 796 patents. On February 23, 2006, the Court entered judgment in favor of Business Objects and against MicroStrategy. MicroStrategy filed a notice of appeal to the Federal Circuit on March 24, 2006. On June 25, 2007, the Federal Circuit affirmed the District Court s judgment in favor of Business Objects and against MicroStrategy on each of the 432, 796, and 033 patents. MicroStrategy did not file a request for rehearing before the Federal Circuit or file a petition for a writ of certiorari before the United States Supreme Court.

On March 9, 2006, Business Objects filed a motion seeking reimbursement from MicroStrategy of Business Objects attorneys fees and costs in the amount of approximately $4.7 million. On March 25, 2008, the Court issued a memorandum opinion and an order. The Court awarded partial fees and expenses to Business Objects as the prevailing party. Business Objects was awarded reasonable fees and expenses after March 14, 2005 defending against the 796 patent, the 033 patent and claims 1, 2, 4, and 5 of the 432 patent. Business Objects motion for fees and expenses related to claims 6, 9, 10 and 13 of the 432 patent was denied. Business Objects was required to submit a detailed summary of the hours spent after March 14, 2005, the hourly rate charged, and the expenses incurred defending against the 796 patent, the 033 patent, and claims 1, 2, 4 and 5 of the 432 patent. On April 15, 2008, Business Objects submitted its fee petition seeking $2.3 million. On May 15, 2008, MicroStrategy submitted its opposition to the petition. Both parties have filed additional briefings. The Court has not yet ruled on Business Objects fee petition. During the first quarter of 2008, the Company recorded a $2.3 million accrued liability related to this claim. The $2.3 million accrual is included in accounts payable and accrued expense in its consolidated balance sheets, and has been recorded as a general and administrative expense in the Company s consolidated statements of operations. The ultimate liability to the Company resulting from this proceeding may differ materially from the accrued amount.

On September 29, 2008, EON Corp IP Holdings, LLC (EON) filed a complaint for patent infringement against Alarm.com Incorporated, which is a majority-owned subsidiary of MicroStrategy, and a number of other unrelated defendants in the United States District Court for the Eastern District of Texas. The complaint accuses Alarm.com of infringing U.S. Patent Nos. 5,388,101 and 5,481,546 directly, contributorily and by inducement by making, using, selling and offering for sale two-way communication networks and/or data systems that fall within the scope of at least one claim of the referenced patents. The complaint seeks damages, an award of attorney s fees and the court costs, an award of pre-judgment and post-judgment interest on damages, and any other relief EON may justly be awarded. The outcome of this litigation is not presently determinable. Accordingly, no provision for this matter has been made in the accompanying consolidated financial statements.

The Company also is involved in various other legal proceedings arising in the normal course of business. Although the outcomes of these other legal proceedings are inherently difficult to predict, management does not expect the resolution of these other legal proceedings to have a material adverse effect on its financial position, results of operations or cash flows.

(7) Commitments and Contingencies

On January 31, 2007, the Company entered into an agreement to purchase a corporate aircraft for delivery in mid-2009, which it expects to begin operating during the 2009 calendar year. The aggregate purchase price for the aircraft is $46.0 million, payable in installments on various dates related to the completion of manufacturing of the aircraft and the delivery of the aircraft. The Company has the option to accelerate the delivery date under certain circumstances if the manufacturer is able to offer the aircraft prior to the scheduled delivery date. The Company expects to meet its payment obligations under this purchase commitment using funds from operations, but may consider using conventional aircraft financing or other borrowing arrangements.

The Company made payments of $5.0 million and $2.5 million with regards to this aircraft in January 2007 and September 2007, respectively, and recorded the amount of the payments in deposits and other assets. Additionally, the Company accrued $25.0 million in accounts payable and accrued expenses as of September 30, 2008 and recorded the accrual amount in deposits and other assets. In October 2008, the Company made an installment payment to the aircraft manufacturer of $25.0 million.

MICROSTRATEGY INCORPORATED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

From time to time, the Company enters into certain types of contracts that require it to indemnify parties against third party claims. These contracts primarily relate to agreements under which the Company has agreed to indemnify customers and partners for claims arising from intellectual property infringement. The conditions of these obligations vary and generally a maximum obligation is explicitly stated. Because the conditions of these obligations vary and the maximum is not always explicitly stated, the overall maximum amount of the Company s indemnification obligations cannot be reasonably estimated. Historically, the Company has not been obligated to make significant payments for these obligations, and as such has not recorded an indemnification liability on its balance sheets as of September 30, 2008 or December 31, 2007. The Company carries coverage under certain insurance policies for certain of these liabilities; however, this coverage may not be sufficient.

(8) Treasury Stock

On July 28, 2005, the Company announced that its Board of Directors had authorized the Company s repurchase of up to an aggregate of $300.0 million of its class A common stock from time-to-time on the open market (the 2005 Share Repurchase Program). On April 29, 2008, the Company s Board of Directors amended the 2005 Share Repurchase Program to increase the amount of class A common stock that the Company is authorized to repurchase from $300 million to $800 million in the aggregate. The term of the 2005 Share Repurchase Program was also extended to April 29, 2013, although the program may be suspended or discontinued by the Company at any time. The timing and amount of any shares repurchased will be determined by the Company s management based on its evaluation of market conditions and other factors. The 2005 Share Repurchase Program may be funded using the Company s working capital, as well as proceeds from any credit facilities and other borrowing arrangements which the Company may enter into in the future. During the three months ended September 30, 2008, the Company did not repurchase any shares of its class A common stock pursuant to the 2005 Share Repurchase Program. For the nine months ended September 30, 2008, the Company repurchased an aggregate of 118,408 shares of class A common stock at an average price per share of $70.83 and an aggregate cost of $8.4 million pursuant to the 2005 Share Repurchase Program. As of September 30, 2008, the Company had repurchased an aggregate of 2,469,473 shares of its class A common stock at an average price per share of $95.69 and an aggregate cost of $236.3 million pursuant to the 2005 Share Repurchase Program.

All of the amounts above relating to average price per share and aggregate cost include broker commissions.

(9) Income Taxes

The Company and its subsidiaries conduct business in the U.S. and various foreign countries and are subject to tax in numerous domestic and foreign jurisdictions. As a result of its business activities, the Company files tax returns that are subject to examination by various federal, state, local, and foreign tax authorities. With few exceptions, the Company is no longer subject to U.S. federal, state and local, or foreign income tax examination by tax authorities for years before 2000; however, due to its federal and state net operating loss (NOL) carryovers, the federal and state tax authorities may attempt to reduce or fully offset the amount of NOL or tax credit carryovers from tax years ending in 1999 forward that were used in later tax years. The Company is currently under tax audit in the UK and Germany.

The Company recognizes estimated accrued interest related to unrecognized income tax benefits in the provision for income taxes account. Penalties relating to income taxes, if incurred, would also be recognized as a component of the Company s provision for income taxes. As of September 30, 2008, the amount of accrued interest expense on unrecognized income tax benefits was not material.

As of September 30, 2008, if recognized, $8.8 million of unrecognized tax benefits would impact the effective tax rate. The Company does not presently anticipate that the unrecognized tax benefits will materially increase or decrease prior to December 31, 2008; however, actual changes in unrecognized tax benefits could differ from those currently expected.

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MICROSTRATEGY INCORPORATED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

The following table summarizes the Company s deferred tax assets, net, and valuation allowance, as of (in thousands):

	September 30, 2008	December 31, 2007
Deferred tax assets, net of deferred tax liabilities	$ 57,570	$ 71,678
Valuation allowance	(6,325)	(6,679)
Deferred tax assets, net of valuation allowance	$ 51,245	$ 64,999
Short-term deferred tax assets, net	$ 24,535	$ 29,652
Long-term deferred tax assets, net	26,710	35,347
Total deferred tax assets, net	$ 51,245	$ 64,999

The valuation allowance as of September 30, 2008 and December 31, 2007 relates to foreign net operating loss carryforwards and other foreign deferred tax assets. The Company has determined that there is insufficient positive evidence that it is more likely than not that such deferred tax assets will be realized in accordance with the rules under SFAS No. 109, Accounting for Income Taxes.

The Company has estimated its annual effective tax rate for the full fiscal year 2008 and applied that rate to its income before income taxes in determining its provision for income taxes for the nine months ended September 30, 2008. The Company also records discrete items in each respective period as appropriate. For the nine months ended September 30, 2008 and 2007, the Company s consolidated annualized effective tax rate from continuing operations was 42.2% and 35.9%, respectively.

The Company intends to indefinitely reinvest its undistributed 2008 earnings of certain foreign subsidiaries, in accordance with APB 23, Accounting for Income-Taxes, Special Areas. Therefore, the annualized effective tax rate applied to the Company s pre-tax income for the nine months ended September 30, 2008 did not include any provision for U.S. federal and state income taxes on the projected amount of these undistributed 2008 foreign earnings. U.S. federal tax laws, however, require the Company to include in its U.S. taxable income certain investment income earned outside of the U.S. in excess of certain limits (Subpart F deemed dividends). Because Subpart F deemed dividends are already required to be recognized in the Company s U.S. federal income tax return, Subpart F deemed dividends are distributed currently; however, no additional tax is incurred on the distribution.

In determining the Company s provision for income taxes, net deferred tax assets, liabilities, valuation allowances, and uncertain tax positions, management is required to make judgments and estimates related to projections of domestic and foreign profitability, the timing and extent of the utilization of both net operating loss carryforwards and capital loss carryforwards, applicable tax rates, transfer pricing methods, expected tax authority positions on audit, and prudent and feasible tax planning strategies. As a multinational company, the Company is required to calculate and provide for estimated income tax liabilities in each of the tax jurisdictions in which it operates. This process involves estimating current tax obligations and exposures in each jurisdiction as well as making judgments regarding the future recoverability of deferred tax assets. Changes in the estimated level of annual pre-tax income, changes in tax laws particularly related to the utilization of net operating losses in various jurisdictions, and changes resulting from tax audits can all affect the overall effective income tax rate which, in turn, impacts the overall level of income tax expense and net income.

Judgments and estimates related to the Company s projections and assumptions are inherently uncertain; therefore, actual results could differ materially from projections. The timing and manner in which the Company will use the net operating loss carryforwards, research and development tax credit carryforwards, alternative minimum tax credit carryforwards, and foreign tax credit carryforwards in any year, or in total, may be limited by provisions of the Internal Revenue Code regarding changes in the Company s ownership. Currently, the Company expects to use the tax assets subject to Internal Revenue Code limitations within the carryforward periods. Valuation allowances have been established where the Company has concluded that it is not more likely than not that such deferred tax assets are realizable.

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(unaudited)

(10) Share-Based Compensation

The Company has share-based compensation plans under which directors, officers, employees and other eligible participants have previously received stock option awards. All stock options granted under the Company s stock plans have terms of five to ten years and generally vest ratably over five years. Upon exercise, the Company generally issues new shares in the amount of the award exercised. The Company had 2.4 million shares of class A common stock available for issuance under its share-based compensation plans as of September 30, 2008. The Company has not issued any material stock option or other share-based compensation awards since the first quarter of 2004.

In addition, a subsidiary of the Company maintains a share-based compensation plan for its employees that is based upon the equity of the subsidiary. The share-based awards and related expense for this subsidiary have not been significant through September 30, 2008.

Share-based compensation expense recognized during the three and nine months ended September 30, 2008 and 2007 was not significant.

(11) Comprehensive Income

Comprehensive income includes foreign currency translation adjustments and unrealized gains and losses on short-term investments, net of related tax effects that have been excluded from net income and reflected in stockholders equity as accumulated other comprehensive income.

The Company s comprehensive income consisted of the following for the periods indicated (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
Net income	$ 11,124	$ 19,335	$ 27,548	$ 40,793
Foreign currency translation adjustment	(1,213)	156	(404)	(337)
Unrealized loss on short-term investments, net of applicable taxes	(8)	(4)	(2)	(9)
Comprehensive income	$ 9,903	$ 19,487	$ 27,142	$ 40,447

(12) Common Equity and Earnings per Share

The Company has two classes of common stock: class A common stock and class B common stock. Holders of class A common stock generally have the same rights, including rights to dividends, as holders of class B common stock, except that holders of class A common stock have one vote per share while holders of class B common stock have ten votes per share. Each share of class B common stock is convertible at any time, at the option of the holder, into one share of class A common stock. As such, basic and fully diluted earnings per share for class A and class B common stock are the same. The Company has never declared or paid any cash dividends on either class A or class B common stock.

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Potential common shares are included in the diluted earnings per share calculation when dilutive. Potential common shares consisting of common stock issuable upon exercise of outstanding employee stock options and warrants are computed using the treasury stock method.

(13) Discontinued Operations

In March 2008, in connection with its consideration of strategic alternatives relating to its non-core Alarm.com business, the Company committed to a plan to sell this business. The Company made the decision to sell this business in order to focus its resources on its core competency of business intelligence software and services. Accordingly, the financial results for Alarm.com were reclassified as discontinued operations in the quarter ended March 31, 2008.

The Company remains committed to a plan to sell the Alarm.com business, and expects to complete the sale of the Alarm.com business within the next 12 months. The associated assets and liabilities of the Alarm.com business have been classified as held-for-sale in accordance with SFAS 144, and are presented in the following table.

(in thousands)	**September 30, 2008**	**December 31, 2007**
Assets:		
Accounts Receivable	$ 7,148	$ 3,625
Prepaid Expenses & Other Current Assets	331	576
Property and equipment, net	184	71
Total assets	$ 7,663	$ 4,272
Liabilities:		
Accounts payable and accrued expenses	$ 3,138	$ 1,385
Accrued compensation and employee benefits	843	610
Deferred revenue and advance payments	3,357	1,441
Total liabilities	$ 7,338	$ 3,436
Net assets and liabilities of disposal group	$ 325	$ 836

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MICROSTRATEGY INCORPORATED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

The following table summarizes the revenues and pre-tax income generated by the Alarm.com business during the three and nine months ended September 30, 2008 and 2007.

(in thousands)	Three Months Ended September 30, 2008	Three Months Ended September 30, 2007	Nine Months Ended September 30, 2008	Nine Months Ended September 30, 2007
Revenues	$ 5,941	$ 4,613	$ 16,391	$ 12,931
Pre-tax income (loss)	$ 105	$ (121)	$ (207)	$ 104

(14) Segment Information

The Company operates in one reportable segment with two business units business intelligence software and services, and other. The business unit Other includes the Company s Angel.com business unit. The following summary discloses total revenues and long-lived assets, excluding long-term investments and long-term deferred tax assets, according to geographic region (in thousands):

Geographic regions:	Business Intelligence Software and Services Domestic	EMEA	Other Regions	Other Domestic	Consolidated
Three months ended September 30, 2008					
Total revenues	$ 48,408	$ 31,460	$ 8,072	$ 2,688	$ 90,628
Long-lived assets	47,608	5,012	2,122	687	$ 55,429
Three months ended September 30, 2007					
Total revenues	$ 55,483	$ 28,152	$ 5,772	$ 1,825	$ 91,232
Long-lived assets	18,483	3,596	1,727	569	$ 24,375
Nine months ended September 30, 2008					
Total revenues	$ 147,974	$ 86,676	$ 22,945	$ 7,793	$ 265,388
Long-lived assets	47,608	5,012	2,122	687	$ 55,429
Nine months ended September 30, 2007					
Total revenues	$ 146,521	$ 72,102	$ 16,607	$ 4,917	$ 240,147
Long-lived assets	18,483	3,596	1,727	569	$ 24,375

The domestic region consists of the United States and Canada. The EMEA region includes operations in Europe, the Middle East and Africa. The other regions include all other foreign countries, generally comprising Latin America and the Asia Pacific region. For the three and nine months ended September 30, 2008 and 2007, no individual country outside the United States accounted for 10% or more of total consolidated revenues.

As of September 30, 2008, and September 30, 2007, no individual country outside the United States accounted for 10% or more of consolidated assets. For the three and nine months ended September 30, 2008 and 2007, no individual customer accounted for 10% or more of the Company s total consolidated revenues.

Domestic intercompany software fee charges to international operations of $10.9 million and $9.3 million for the three months ended September 30, 2008 and 2007, respectively, and $32.3 million and $30.2 million for the nine months ended September 30, 2008 and 2007, respectively, have been excluded from the above tables and eliminated in the consolidated financial statements.

ITEM 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

FORWARD-LOOKING INFORMATION

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended. For this purpose, any statements contained herein that are not statements of historical fact, including without limitation, certain statements regarding industry prospects and our results of operations or financial position, may be deemed to be forward-looking statements. Without limiting the foregoing, the words believes, anticipates, plans, expects, and similar expressions are intended to identify forward-looking statements. The important factors discussed below under Item 1A. Risk Factors, among others, could cause actual results to differ materially from those indicated by forward-looking statements made herein. Such forward-looking statements represent management s current expectations and are inherently uncertain. Investors are warned that actual results may differ from management s expectations.

Overview

We are a worldwide provider of business intelligence software that enables companies to analyze the raw data stored across their enterprise to reveal the trends and insights needed to develop solutions to manage their business effectively. Our software delivers this information to workgroups, the enterprise and extranet communities via e-mail, web, fax, wireless and voice communication channels. Businesses can use our software platform to develop user-friendly solutions, proactively refine revenue-generating strategies, enhance cost-efficiency and productivity and improve customer relationships.

The MicroStrategy software platform enables users to query and analyze the most detailed, transaction-level databases, turning data into business intelligence and delivering boardroom quality reports and alerts about the users business processes. Our web-based architecture provides reporting, security, performance and standards that are critical for web deployment. With intranet deployments, our products provide employees with information to enable them to make better, more cost-effective business decisions. With extranet deployments, enterprises can use the MicroStrategy software platform to build stronger relationships by linking customers and suppliers via the Internet. We also offer a comprehensive set of consulting, education, technical support and technical advisory services for our customers and strategic partners.

Our core business intelligence (BI) business derives its revenues from product licenses and product support and other services. Product licenses revenues are derived from the sale of software licenses for our MicroStrategy 8 business intelligence platform and related products. We license our software to end users through our direct sales organization and through indirect sales channels, such as resellers, systems integrators and original equipment manufacturers, or OEMs. Our arrangements with customers typically include: (a) an end-user license fee paid for the use of our products in perpetuity or over a specified term; (b) an annual maintenance agreement that provides for software updates and upgrades and technical support for an annual fee; and (c) a services work order for implementation, consulting and training, generally for a fee determined on a time-and-materials basis or, in certain circumstances, a fixed-fee.

We also have two non-core businesses, Alarm.com and Angel.com, which focus outside of the BI software and services market. Alarm.com is a provider of web-enabled residential and commercial security and activity monitoring technology, and Angel.com is a provider of interactive voice response telephony systems. In March 2008, in connection with our consideration of strategic alternatives relating to our non-core Alarm.com and Angel.com businesses, we committed to a plan to sell these businesses. We made the decision to sell these businesses in order to focus our resources on our core competency of business intelligence software and services. Accordingly, the financial results for Alarm.com and Angel.com were reclassified as discontinued operations in the quarter ended March 31, 2008.

Although we continue to explore strategic alternatives for the Angel.com business, based on changes in market conditions that occurred in the quarter ended June 30, 2008, we determined that Angel.com no longer met the criteria to permit discontinued operations treatment and held-for-sale classification. Accordingly, amounts related to Angel.com were reclassified to continuing operations in the second quarter of 2008. This reclassification did not have a material impact on our financial results for any period presented.

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We remain committed to a plan to sell the Alarm.com business, and expect to complete the sale of the Alarm.com business within the next 12 months. Accordingly, on our Consolidated Balance Sheets, we classified the associated assets and liabilities of the Alarm.com business as held-for-sale in accordance with Statement of Financial Accounting Standard No. 144, Accounting for the Impairment of Long-Lived Assets , or SFAS 144. In our Consolidated Statement of Operations, we classified the operations of the Alarm.com business as Income (Loss) from Discontinued Operations, net of tax, because we do not expect to have significant continuing involvement or cash flows from this business after the divestiture. All assets and liabilities that are reported in these financial statements as held-for-sale are reported at the lower of the carrying cost or fair value less cost to sell.

The following table sets forth certain operating highlights for the three and nine months ended September 30, 2008 and 2007 (in thousands):

	Core BI Business Three Months Ended September 30		Angel.com Three Months Ended September 30		Consolidated Three Months Ended September 30	
	2008	2007	2008	2007	2008	2007
Revenues						
Product licenses	$ 24,787	$ 30,210	$	$	$ 24,787	$ 30,210
Product support and other services	63,153	59,197			63,153	59,197
Angel.com telephony services			2,688	1,825	2,688	1,825
Total revenues	**87,940**	**89,407**	**2,688**	**1,825**	**90,628**	**91,232**
Cost of revenues						
Product licenses	422	713			422	713
Product support and other services	15,908	11,277			15,908	11,277
Angel.com telephony services			396	507	396	507
Total cost of revenues	**16,330**	**11,990**	**396**	**507**	**16,726**	**12,497**
Gross profit	**71,610**	**77,417**	**2,292**	**1,318**	**73,902**	**78,735**
Operating expenses						
Sales and marketing	33,767	26,932	2,121	1,612	35,888	28,544
Research and development	5,234	8,615	688	664	5,922	9,279
General and administrative	14,679	12,163	65 (a)	7 (a)	14,744	12,170
Total operating expenses	**53,680**	**47,710**	**2,874**	**2,283**	**56,554**	**49,993**
Income (loss) from operations	**$ 17,930**	**$ 29,707**	**$ (582)**	**$ (965)**	**$ 17,348**	**$ 28,742**

(a) An insignificant amount of general and administrative services is provided to the Angel.com business unit by MicroStrategy s core business operations.

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	Core BI Business Nine Months Ended September 30, 2008	2007	Angel.com Nine Months Ended September 30, 2008	2007	Consolidated Nine Months Ended September 30, 2008	2007
Revenues						
Product licenses	$ 67,966	$ 68,608	$	$	$ 67,966	$ 68,608
Product support and other services	189,629	166,622			189,629	166,622
Angel.com telephony services			7,793	4,917	7,793	4,917
Total revenues	**257,595**	**235,230**	**7,793**	**4,917**	**265,388**	**240,147**
Cost of revenues						
Product licenses	1,442	2,156			1,442	2,156
Product support and other services	44,602	33,482			44,602	33,482
Angel.com telephony services			1,296	1,443	1,296	1,443
Total cost of revenues	**46,044**	**35,638**	**1,296**	**1,443**	**47,340**	**37,081**
Gross profit	**211,551**	**199,592**	**6,497**	**3,474**	**218,048**	**203,066**
Operating expenses						
Sales and marketing	93,962	74,684	6,098	4,539	100,060	79,223
Research and development	22,229	23,048	2,220	2,078	24,449	25,126
General and administrative	46,840	37,169	215 (a)	7 (a)	47,055	37,176
Total operating expenses	**163,031**	**134,901**	**8,533**	**6,624**	**171,564**	**141,525**
Income (loss) from operations	**$ 48,520**	**$ 64,691**	**$ (2,036)**	**$ (3,150)**	**$ 46,484**	**$ 61,541**

(a) An insignificant amount of general and administrative services is provided to the Angel.com business unit by MicroStrategy s core business operations.

The business intelligence market is highly competitive and our results of operations depend on our ability to market and sell product offerings that provide customers with greater value than those offered by our competitors. Organizations recently have sought, and we expect may continue to seek, to standardize their various business intelligence applications around a single software platform. This trend presents both opportunities and risks for our business. It offers us the opportunity to increase the size of transactions with new customers and to expand the size of our business intelligence installations with existing customers. On the other hand, it presents the risk that we may not be able to penetrate accounts where a competitor currently is or may become the incumbent business intelligence application provider. In addition, companies with industry leading positions in certain software markets, such as Microsoft, Oracle, IBM and SAP AG, have incorporated business intelligence capabilities into their product suites. As a result, our products need to be sufficiently differentiated from these bundled software offerings to create customer demand for our platform and products.

To address these opportunities and challenges, we are implementing a number of initiatives, including:

concentrating our research and development efforts on maintaining our position as a technology leader by continuing to innovate and lead in enterprise business intelligence, improving the capability of our products to efficiently handle the ever increasing volume of data and user scalability needs of our current and future customers, and adding analytical and end user features to support the increasing levels of sophistication in our customers business intelligence needs and applications, such as the incorporation of dynamic enterprise dashboards to our interfaces; and enhancing our global sales and services organizations, which we have grown substantially over the last three years, by focusing on integrating and leveraging the additional sales and services capacity we now have in place.

We base our operating expense budgets on expected revenue trends. Many of our expenses, such as office leases and certain personnel costs, are relatively fixed. We may be unable to adjust spending quickly enough in any particular period to offset any unexpected revenue shortfall in that period. Accordingly, any shortfall in revenue may cause significant variation in our operating results. We therefore believe that quarter-to-quarter comparisons of our operating results may not be a good indication of our future performance.

Critical Accounting Policies

Our discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States.

The preparation of our consolidated financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities and equity and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. These estimates, particularly estimates relating to revenue recognition, allowance for doubtful accounts, valuation of net deferred tax assets, and litigation and contingencies, have a material impact on our financial statements and are discussed in detail throughout our analysis of the results of operations discussed below.

In addition to evaluating estimates relating to the items discussed above, we also consider other estimates and judgments, including, but not limited to, those related to software development costs, intangible assets, provision for income taxes, and other contingent liabilities, including liabilities that we deem not probable of assertion. We base our estimates on historical experience and various other assumptions that we believe are reasonable under the circumstances, the results of which form the basis for making judgments about the carrying value of assets, liabilities and equity that are not readily apparent from other sources. Actual results and outcomes could differ from these estimates and assumptions.

MicroStrategy does not have any material ownership interest in any special purpose or other entities that are not wholly-owned or consolidated into our consolidated financial statements. Additionally, MicroStrategy does not have any material related party transactions as defined under Statement of Financial Accounting Standards (SFAS) No. 57, Related Party Disclosures.

For a more detailed explanation of the judgments made in these areas and a discussion of our accounting estimates and policies, refer to Critical Accounting Estimates included in Item 7 and Summary of Significant Accounting Policies (Note 2) included in Item 15 of our Annual Report on Form 10-K for the year ended December 31, 2007. Since December 31, 2007, there have been no significant changes to our critical accounting estimates and policies.

Impact of Foreign Currency Exchange Rate Fluctuations on Results of Operations

We conduct a significant portion of our business in currencies other than the U.S. dollar, the currency in which we report our consolidated financial statements. Historically, we have generated a significant portion of our revenues and incurred a significant portion of our expenses in Euro and British pound sterling. As currency rates change from quarter to quarter and year over year, our results of operation may be impacted. The table below summarizes the impact (in thousands) of fluctuations in foreign currency exchange rates on certain components of our consolidated statements of operations by showing the increase in revenues or expenses, as applicable, from the prior year.

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	Three Months Ended September 30, 2008	Three Months Ended September 30, 2007	Nine Months Ended September 30, 2008	Nine Months Ended September 30, 2007
International product licenses revenues	$ 463	$ 604	$ 2,218	$ 1,596
International product support revenues	1,265	1,176	5,632	3,351
International other services revenues	444	384	2,023	985
Cost of product support revenues	33	45	190	128
Cost of other services revenues	512	197	1,704	614
Sales and marketing expenses	747	740	3,777	2,057
General and administrative expenses	284	98	1,126	474

The term international refers to operations outside of the United States and Canada. For example, if there had been no change to foreign currency exchange rates from 2007 to 2008, international product licenses revenues would have been $12.1 million rather than $12.6 million and $26.0 million rather than $28.2 million for the three and nine months ended September 30, 2008, respectively. If there had been no change to foreign currency exchange rates from 2007 to 2008, sales and marketing expenses would have been $35.1 million rather than $35.9 million and $96.3 million rather than $100.1 million for the three and nine months ended September 30, 2008, respectively.

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Results of Operations

Comparison of the three and nine months ended September 30, 2008 and 2007

Revenues

Product licenses revenues. The following table sets forth product licenses revenues (in thousands) and percentage changes for the periods indicated:

	Three Months Ended September 30,		%	Nine Months Ended September 30,		%
	2008	2007	Change	2008	2007	Change
Product Licenses Revenues:						
Domestic	$ 12,220	$ 19,574	-37.6%	$ 39,748	$ 43,414	-8.4%
International	12,567	10,636	18.2%	28,218	25,194	12.0%
Total product licenses revenues	$ 24,787	$ 30,210	-18.0%	$ 67,966	$ 68,608	-0.9%

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
Product Licenses Transactions with Recognized Licenses Revenue in the Applicable Period:				
Above $1.0 million of licenses revenue recognized	2	6	6	10
From $500,000 to $1.0 million of licenses revenue recognized	8	7	17	18
Total	10	13	23	28
Domestic:				
Above $1.0 million of licenses revenue				