

MICROSTRATEGY INC  
Form 10-Q  
August 01, 2013  
Table of Contents

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

(Mark One)

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the Quarterly Period Ended June 30, 2013

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 or other jurisdiction of  
incorporation or organization)**

**51-0323571**

**(I.R.S. Employer**

**Identification Number)**

**1850 Towers Crescent Plaza, Tysons Corner, VA**

**(Address of Principal Executive Offices)**

**22182**

**(Zip Code)**

**(703) 848-8600**

**(Registrant's telephone number, including area code)**

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

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

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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 the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  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

The number of shares of the registrant's class A common stock and class B common stock outstanding on July 23, 2013 was 9,073,710 and 2,227,327, respectively.

**Table of Contents**

**MICROSTRATEGY INCORPORATED**

**FORM 10-Q**

**TABLE OF CONTENTS**

	Page
<b>PART I. <u>FINANCIAL INFORMATION</u></b>	
Item 1. <u>Financial Statements (unaudited except for the Consolidated Balance Sheet as of December 31, 2012, which was derived from audited financial statements)</u>	1
<u>Consolidated Balance Sheets as of June 30, 2013 and December 31, 2012</u>	1
<u>Consolidated Statements of Operations for the Three Months Ended June 30, 2013 and 2012</u>	2
<u>Consolidated Statements of Operations for the Six Months Ended June 30, 2013 and 2012</u>	3
<u>Consolidated Statements of Comprehensive Income for the Three and Six Months Ended June 30, 2013 and 2012</u>	4
<u>Consolidated Statements of Cash Flows for the Six Months Ended June 30, 2013 and 2012</u>	5
<u>Notes to Consolidated Financial Statements</u>	6
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	17
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	33
Item 4. <u>Controls and Procedures</u>	34
<b>PART II. <u>OTHER INFORMATION</u></b>	
Item 1. <u>Legal Proceedings</u>	35
Item 1A. <u>Risk Factors</u>	36
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	50
Item 6. <u>Exhibits</u>	50

**Table of Contents****PART I - FINANCIAL INFORMATION****Item 1. Financial Statements****MICROSTRATEGY INCORPORATED****CONSOLIDATED BALANCE SHEETS****(in thousands, except per share data)**

	<b>June 30, 2013</b> (unaudited)	<b>December 31, 2012</b>
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 188,688	\$ 223,043
Restricted cash	122	50
Short-term investments	129,087	36
Accounts receivable, net	73,397	89,038
Prepaid expenses and other current assets	11,836	12,689
Deferred tax assets, net	19,113	26,616
Assets held-for-sale	0	10,571
<b>Total current assets</b>	<b>422,243</b>	<b>362,043</b>
Property and equipment, net	93,153	96,751
Capitalized software development costs, net	9,389	10,360
Deposits and other assets	7,136	5,120
Deferred tax assets, net	4,196	3,664
<b>Total assets</b>	<b>\$ 536,117</b>	<b>\$ 477,938</b>
<b>Liabilities and Stockholders Equity</b>		
Current liabilities:		
Accounts payable and accrued expenses	\$ 42,386	\$ 40,905
Accrued compensation and employee benefits	58,310	71,789
Deferred revenue and advance payments	108,155	101,249
Deferred tax liabilities	376	523
Liabilities held-for-sale	0	4,689
<b>Total current liabilities</b>	<b>209,227</b>	<b>219,155</b>
Deferred revenue and advance payments	9,454	8,823
Other long-term liabilities	42,022	43,418
Deferred tax liabilities	1,958	6,231
<b>Total liabilities</b>	<b>262,661</b>	<b>277,627</b>
<b>Commitments and Contingencies</b>		
<b>Stockholders Equity</b>		
Preferred stock undesignated, \$0.001 par value; 5,000 shares authorized; no shares issued or outstanding	0	0
Class A common stock, \$0.001 par value; 330,000 shares authorized; 15,478 shares issued and 9,073 shares outstanding, and 15,462 shares issued and 9,057 shares outstanding, respectively	15	15

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Class B convertible common stock, \$0.001 par value; 165,000 shares authorized; 2,227 shares issued and outstanding, and 2,227 shares issued and outstanding, respectively	2	2
Additional paid-in capital	492,009	468,087
Treasury stock, at cost; 6,405 shares	(475,184)	(475,184)
Accumulated other comprehensive loss	(2,330)	(1,515)
Retained earnings	258,944	208,906
<b>Total Stockholders Equity</b>	<b>273,456</b>	<b>200,311</b>
<b>Total Liabilities and Stockholders Equity</b>	<b>\$ 536,117</b>	<b>\$ 477,938</b>

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

Table of Contents

**MICROSTRATEGY INCORPORATED**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**

(in thousands, except per share data)

	Three Months Ended June 30,	
	2013 (unaudited)	2012 (unaudited)
<b>Revenues:</b>		
Product licenses	\$ 30,605	\$ 31,890
Product support and other services	107,300	103,434
<b>Total revenues</b>	137,905	135,324
<b>Cost of revenues:</b>		
Product licenses	1,621	982
Product support and other services	34,825	33,078
<b>Total cost of revenues</b>	36,446	34,060
<b>Gross profit</b>	101,459	101,264
<b>Operating expenses:</b>		
Sales and marketing	52,686	48,693
Research and development	24,227	19,017
General and administrative	26,594	23,067
<b>Total operating expenses</b>	103,507	90,777
<b>(Loss) income from continuing operations before financing and other (expense) income and income taxes</b>	(2,048)	10,487
<b>Financing and other (expense) income:</b>		
Interest income, net	322	37
Other (expense) income, net	(419)	1,000
<b>Total financing and other (expense) income</b>	(97)	1,037
<b>(Loss) income from continuing operations before income taxes</b>	(2,145)	11,524
(Benefit) provision for income taxes	(592)	3,596
<b>(Loss) income from continuing operations</b>	(1,553)	7,928
<b>Discontinued operations:</b>		
Gain from sale of discontinued operations, net of tax provision (\$0 and \$0, respectively)	0	0
Loss from discontinued operations, net of tax benefit (\$0 and \$332, respectively)	0	(657)

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<b>Discontinued operations, net of tax</b>	0	(657)
<b>Net (loss) income</b>	\$ (1,553)	\$ 7,271
<b>Basic (loss) earnings per share (1)</b>		
From continuing operations	\$ (0.14)	\$ 0.73
From discontinued operations	0.00	(0.06)
<b>Basic (loss) earnings per share</b>	\$ (0.14)	\$ 0.67
Weighted average shares outstanding used in computing basic (loss) earnings per share	11,301	10,875
<b>Diluted (loss) earnings per share (1)</b>		
From continuing operations	\$ (0.14)	\$ 0.71
From discontinued operations	0.00	(0.06)
<b>Diluted (loss) earnings per share</b>	\$ (0.14)	\$ 0.65
Weighted average shares outstanding used in computing diluted (loss) earnings per share	11,301	11,121

- (1) Basic and fully diluted (loss) 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.



Table of Contents

**MICROSTRATEGY INCORPORATED**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**

(in thousands, except per share data)

	Six Months Ended June 30,	
	2013 (unaudited)	2012 (unaudited)
<b>Revenues:</b>		
Product licenses	\$ 58,973	\$ 69,343
Product support and other services	209,115	204,315
<b>Total revenues</b>	268,088	273,658
<b>Cost of revenues:</b>		
Product licenses	3,214	3,128
Product support and other services	69,133	66,662
<b>Total cost of revenues</b>	72,347	69,790
<b>Gross profit</b>	195,741	203,868
<b>Operating expenses:</b>		
Sales and marketing	103,400	103,834
Research and development	50,044	41,191
General and administrative	53,006	46,732
<b>Total operating expenses</b>	206,450	191,757
<b>(Loss) income from continuing operations before financing and other income and income taxes</b>	(10,709)	12,111
<b>Financing and other income:</b>		
Interest income, net	383	52
Other income, net	1,289	876
<b>Total financing and other income</b>	1,672	928
<b>(Loss) income from continuing operations before income taxes</b>	(9,037)	13,039
(Benefit) provision for income taxes	(2,293)	4,050
<b>(Loss) income from continuing operations</b>	(6,744)	8,989
<b>Discontinued operations:</b>		
Gain from sale of discontinued operations, net of tax provision (\$37,548 and \$0, respectively)	57,377	0
Loss from discontinued operations, net of tax benefit (\$391 and \$745, respectively)	(595)	(1,446)

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<b>Discontinued operations, net of tax</b>	56,782	(1,446)
<b>Net income</b>	\$ 50,038	\$ 7,543
<b>Basic earnings (loss) per share (1)</b>		
From continuing operations	\$ (0.60)	\$ 0.83
From discontinued operations	5.03	(0.13)
<b>Basic earnings per share</b>	\$ 4.43	\$ 0.70
Weighted average shares outstanding used in computing basic earnings (loss) per share	11,298	10,841
<b>Diluted earnings (loss) per share (1)</b>		
From continuing operations	\$ (0.60)	\$ 0.81
From discontinued operations	5.03	(0.13)
<b>Diluted earnings per share</b>	\$ 4.43	\$ 0.68
Weighted average shares outstanding used in computing diluted earnings (loss) per share	11,298	11,107

- (1) Basic and fully diluted earnings (loss) 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.

**Table of Contents**

**MICROSTRATEGY INCORPORATED**  
**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

(in thousands)

	<b>Three Months Ended</b>	
	<b>June 30,</b>	
	<b>2013</b>	<b>2012</b>
	(unaudited)	(unaudited)
<b>Net (loss) income</b>	\$ (1,553)	\$ 7,271
Other comprehensive income (loss), net of applicable taxes:		
Foreign currency translation adjustment	173	(512)
Unrealized loss on short-term investments	(1)	(24)
<b>Total other comprehensive income (loss)</b>	<b>172</b>	<b>(536)</b>
<b>Comprehensive (loss) income</b>	<b>\$ (1,381)</b>	<b>\$ 6,735</b>
	<b>Six Months Ended</b>	
	<b>June 30,</b>	
	<b>2013</b>	<b>2012</b>
	(unaudited)	(unaudited)
<b>Net income</b>	\$ 50,038	\$ 7,543
Other comprehensive loss, net of applicable taxes:		
Foreign currency translation adjustment	(811)	(224)
Unrealized loss on short-term investments	(4)	(5)
<b>Total other comprehensive loss</b>	<b>(815)</b>	<b>(229)</b>
<b>Comprehensive income</b>	<b>\$ 49,223</b>	<b>\$ 7,314</b>

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

**Table of Contents**

**MICROSTRATEGY INCORPORATED**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

(in thousands)

	Six Months Ended June 30,	
	2013 (unaudited)	2012 (unaudited)
<b>Operating activities:</b>		
Net income	\$ 50,038	\$ 7,543
Plus: (Income) loss from discontinued operations, net of tax	(56,782)	1,446
(Loss) income from continuing operations	(6,744)	8,989
Adjustments to reconcile net income to net cash (used in) provided by operating activities:		
Depreciation and amortization	13,111	10,809
Bad debt expense	3,409	3,040
Deferred taxes	(6,141)	6,356
Excess tax benefits from share-based compensation arrangements	(23,580)	0
Other, net	(9)	0
Changes in operating assets and liabilities:		
Accounts receivable	10,692	12,131
Prepaid expenses and other current assets	1,714	(4,043)
Deposits and other assets	134	214
Accounts payable and accrued expenses	(2,122)	(5,701)
Accrued compensation and employee benefits	(12,515)	(11,721)
Deferred revenue and advance payments	9,701	3,172
Other long-term liabilities	(3,600)	(811)
Net cash (used in) provided by operating activities from continuing operations	(15,950)	22,435
Net cash used in operating activities from discontinued operations	(664)	(2,586)
Net cash (used in) provided by operating activities	(16,614)	19,849
<b>Investing activities:</b>		
Purchases of property and equipment	(8,921)	(23,266)
Purchases of short-term investments	(129,043)	0
Capitalized software development costs	(1,736)	(5,050)
Insurance proceeds	0	3,206
(Increase) decrease in restricted cash	(84)	42
Net cash used in investing activities from continuing operations	(139,784)	(25,068)
Net cash provided by (used in) investing activities from discontinued operations	99,136	(676)
Net cash used in investing activities	(40,648)	(25,744)
<b>Financing activities:</b>		
Proceeds from sale of class A common stock under exercise of employee stock options	341	2,947
Excess tax benefits from share-based compensation arrangements	23,580	0
Payments on capital lease obligations and other financing arrangements	(324)	0
Net cash provided by financing activities from continuing operations	23,597	2,947
Net cash provided by financing activities from discontinued operations	0	0

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Net cash provided by financing activities	23,597	2,947
Effect of foreign exchange rate changes on cash and cash equivalents	(2,040)	(1,146)
<b>Net decrease in cash and cash equivalents</b>	<b>(35,705)</b>	<b>(4,094)</b>
<b>Cash and cash equivalents (including held-for-sale of \$1,350 and \$5,300, respectively), beginning of period</b>	<b>224,393</b>	<b>199,634</b>
<b>Cash and cash equivalents (including held-for-sale of \$0 and \$2,150, respectively), end of period</b>	<b>\$ 188,688</b>	<b>\$ 195,540</b>
<b>Supplemental disclosure of noncash investing and financing activities:</b>		
Assets acquired under capital lease obligations and other financing arrangements	\$ 3,793	\$ 0

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

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**Table of Contents**

**MICROSTRATEGY INCORPORATED**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

**(1) Summary of Significant Accounting Policies**

**(a) Basis of Presentation**

Except for the Consolidated Balance Sheet of MicroStrategy Incorporated ( MicroStrategy or the Company ) as of December 31, 2012, which was 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. Certain amounts in the prior year's Consolidated Financial Statements have been reclassified to conform to the current year presentation.

The Consolidated Financial Statements and notes are presented as required by the United States Securities and Exchange Commission ( SEC ) 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 SEC in the Company's Annual Report on Form 10-K for the year ended December 31, 2012. There have been no significant changes in the Company's accounting policies since December 31, 2012, other than the addition of accounting policies related to Fair Value Measurements, Derivative Financial Instruments, and Short-term Investments as disclosed below.

The Company must classify a business line as discontinued operations once the Company has committed to a plan to sell the business. On February 25, 2013, the Company committed to a plan to sell its wholly-owned subsidiary, Angel.com Incorporated ( Angel.com ), which focused outside of the Company's business intelligence software and services offerings. On March 15, 2013, the Company completed the sale of this business. Historical financial information presented in the Consolidated Financial Statements and Notes to Consolidated Financial Statements have been reclassified to conform to current year presentation. Refer to Note 12, Discontinued Operations, to the Consolidated Financial Statements for further information.

The accompanying Consolidated Financial Statements include the accounts of the Company and its subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation. The Company is not aware of any subsequent event which would require recognition or disclosure.

**(b) Fair Value Measurements**

The Company measures certain assets and liabilities at fair value on a recurring basis. Fair value is defined as the price that is expected to be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The Company uses a three-level hierarchy that prioritizes fair value measurements based on the types of inputs used for the various valuation techniques. The three levels of the fair value hierarchy are described below:

- Level 1: Quoted (unadjusted) prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities.
- Level 2: Inputs other than quoted prices that are either directly or indirectly observable, such as quoted prices in active markets for similar assets or liabilities, quoted prices for identical or similar assets or liabilities in inactive markets, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.
- Level 3: Inputs that are generally unobservable, supported by little or no market activity, and typically reflect management's estimates of assumptions that market participants would use in pricing the asset or liability.



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**Table of Contents**

**MICROSTRATEGY INCORPORATED**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

The categorization of an asset or liability within the fair value hierarchy is based upon the lowest level of input that is significant to the fair value measurement. The valuation techniques used by the Company when measuring fair value maximize the use of observable inputs and minimize the use of unobservable inputs.

**(c) *Derivative Financial Instruments***

The Company is exposed to certain risks related to its ongoing business operations, including the effect of changes in foreign exchange rates on the Company's monetary assets and liabilities denominated in foreign currency. The Company uses foreign currency forward contracts as part of its strategy to manage these risks but does not hold or issue derivative instruments for trading purposes or speculation. These foreign currency forward contracts do not meet the requirements for hedge accounting.

Derivative instruments are recorded on the balance sheet as either an asset or liability measured at their fair value as of the reporting date. Changes in the fair value of derivative instruments are recognized in Other income (expense), net in the Company's Consolidated Statements of Operations.

**(d) *Short-term Investments***

The Company periodically invests a portion of its excess cash in short-term investment instruments. All highly liquid investments with stated maturity dates between three months and one year from the purchase date are classified as short-term investments. We determine the appropriate classification of our short-term investments at the time of purchase.

The majority of the Company's short-term investments are in U.S. Treasury securities and the Company has the ability and intent to hold these investments to maturity. Therefore, these short-term investments are classified and accounted for as held-to-maturity and are reported at amortized cost. Each reporting period, the Company determines whether a decline in fair value below the amortized cost for each individual security is other-than-temporary and if it would be required to sell the security before recovery of its amortized cost basis. If an other-than-temporary impairment has occurred, the amount representing the credit loss is recorded in Other income (expense), net, and the amount related to all other factors is recognized in Accumulated other comprehensive loss. Upon recognition of an other-than-temporary impairment, the previous amortized cost basis less the other-than-temporary impairment recognized in earnings becomes the new amortized cost basis of the investment.

**(2) Recent Accounting Standards**

In February 2013, the Financial Accounting Standards Board ( FASB ) issued Accounting Standards Update No. 2013-02, *Comprehensive Income (Topic 220)* ( ASU 2013-02 ), which established the effective date for the requirement to present components of reclassifications out of accumulated other comprehensive income either in a single note or parenthetically on the face of the financial statements. ASU 2013-02 is effective for interim and annual periods beginning after December 15, 2012. The adoption of this guidance did not have a material effect on the Company's consolidated financial position, results of operations, or cash flows.



**Table of Contents****MICROSTRATEGY INCORPORATED**

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

**(3) Fair Value Measurements**

Financial assets and liabilities measured at fair value on a recurring basis, by level within the fair value hierarchy, consisted of the following (in thousands), as of:

	Location	June 30, 2013 Fair Value Measurements Using Input Types			Total
		Level 1	Level 2	Level 3	
<b>Non-hedging derivative assets:</b>					
Foreign currency forward contracts	Prepaid expenses and other current assets	\$ 0	\$ 54	\$ 0	\$ 54

**Non-hedging derivative liabilities:**

Foreign currency forward contracts	Accounts payable and accrued expenses	\$ 0	\$ 49	\$ 0	\$ 49
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The fair value of our foreign currency forward contracts is determined using Level 2 observable market inputs to extrapolate forward points to be added to or subtracted from the closing market spot rate on the reporting date, and then discounted to present value. All foreign currency forward contracts outstanding as of June 30, 2013 were for durations of three months or less and consisted of the following sale contracts (amounts in thousands):

	Notional Value		Notional Value		Fair Value Gain (Loss)
	Local Currency	U.S. Dollar	U.S. Dollar		U.S. Dollar
<b>Forward contracts to sell:</b>					
Australian Dollar	AUD 995	\$ 900	\$ 900		\$ (5)
Brazilian Real	BRL 2,740	1,200	1,200		(8)
British Pound	GBP 858	1,300	1,300		(4)
Canadian Dollar	CAD 264	250	250		(1)
Chinese Renminbi	CNY 6,234	1,000	1,000		(3)
Euro	EUR 2,770	3,657	3,657		51
Indian Rupee	INR 18,278	300	300		(2)
Japanese Yen	JPY 119,434	1,200	1,200		(4)
Korean Won	KRW 575,655	500	500		(2)
Mexican Peso	MXN 2,625	200	200		(1)
Polish Zloty	PLN 6,718	2,000	2,000		(10)
Singapore Dollar	SGD 381	300	300		(1)
South African Rand	ZAR 3,020	300	300		(1)
Swedish Krona	SEK 1,683	250	250		(1)
Swiss Franc	CHF 379	400	400		(1)
Turkish New Lira	TRY 491	250	250		(1)
United Arab Emirates Dirham	AED 1,105	300	300		(1)
			\$ 14,307		\$ 5

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As of December 31, 2012, the Company held no foreign currency forward contracts.

**Table of Contents****MICROSTRATEGY INCORPORATED**

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

Changes in the fair value of our foreign currency forward contracts for each of the three and six months ended June 30, 2013 and 2012 were as follows (in thousands):

Location	Gains (Losses) on Derivative Instruments Recognized in Income				
	Three months		Six months		
	ended June 30, 2013	ended June 30, 2012	ended June 30, 2013	ended June 30, 2012	
<b>Non-hedging derivative instruments:</b>					
Foreign currency forward contracts	Other income (expense), net	\$ 5	\$ 0	\$ 5	\$ 0

There were no transfers among the levels within the fair value hierarchy during each of the three and six months ended June 30, 2013 and 2012. As of June 30, 2013 and December 31, 2012, the Company had no assets or liabilities that were required to be measured at fair value on a non-recurring basis.

The Company also estimates the fair value of cash and cash equivalents, restricted cash, accounts receivable, accounts payable and accrued expenses, and accrued compensation and employee benefits. The Company considers the carrying value of these instruments in the financial statements to approximate fair value due to their short maturities.

**(4) Short-term Investments**

The Company periodically invests a portion of its excess cash in short-term investment instruments. The majority of the Company's short-term investments are in U.S. Treasury securities, and the Company has the ability and intent to hold these investments to maturity. The stated maturity dates of these investments are between three months and one year from the purchase date. These held-to-maturity investments are recorded at amortized cost and included within Short-term investments on the Consolidated Balance Sheet. The fair value of held-to-maturity investments in U.S. Treasury securities is determined based on quoted market prices in active markets for identical securities (Level 1 inputs).

The amortized cost, carrying value, and fair value of held-to-maturity investments at June 30, 2013 were \$129.1 million, \$129.1 million, and \$129.1 million, respectively. The gross unrecognized holding gains and losses were not material for each of the three and six months ended June 30, 2013 and 2012. No other-than-temporary impairments related to these investments have been recognized in accumulated other comprehensive loss as of June 30, 2013. As of December 31, 2012, the Company held no held-to-maturity investments. As of June 30, 2013 and December 31, 2012, the Company's available-for-sale investments were not material.

**(5) Accounts Receivable**

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

	June 30, 2013	December 31, 2012
Billed and billable	\$ 155,451	\$ 176,511
Less: unpaid deferred revenue	(77,932)	(83,107)
Accounts receivable, gross	77,519	93,404

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Less: allowance for doubtful accounts	(4,122)	(4,366)
Accounts receivable, net	\$ 73,397	\$ 89,038

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

**Table of Contents****MICROSTRATEGY INCORPORATED**

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

The Company maintains an allowance for doubtful accounts which represents its best estimate of probable losses inherent in the accounts receivable balances. The Company evaluates specific accounts when it becomes aware that a customer may not be able to meet its financial obligations due to deterioration of its liquidity or financial viability, credit ratings, or bankruptcy. In addition, the Company periodically adjusts this allowance based upon its review and assessment of the aging of receivables.

**(6) Deferred Revenue and Advance Payments**

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

	June 30, 2013	December 31, 2012
<b>Current:</b>		
Deferred product licenses revenue	\$ 11,125	\$ 12,252
Deferred product support revenue	149,280	145,343
Deferred subscription services revenue	7,968	6,569
Deferred other services revenue	14,612	15,650
Gross current deferred revenue and advance payments	182,985	179,814
Less: unpaid deferred revenue	(74,830)	(78,565)
Net current deferred revenue and advance payments	\$ 108,155	\$ 101,249
<b>Non-current:</b>		
Deferred product licenses revenue	\$ 3,306	\$ 3,280
Deferred product support revenue	6,709	8,205
Deferred subscription services revenue	792	696
Deferred other services revenue	1,749	1,184
Gross non-current deferred revenue and advance payments	12,556	13,365
Less: unpaid deferred revenue	(3,102)	(4,542)
Net non-current deferred revenue and advance payments	\$ 9,454	\$ 8,823

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

**(7) Commitments and Contingencies****(a) Commitments**

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 third party 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

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payments for these obligations and does not currently expect to incur any material obligations in the future. Accordingly, the Company has not recorded an indemnification liability on its balance sheets as of June 30, 2013 or December 31, 2012.

On March 15, 2013, the Company completed the sale of its wholly-owned subsidiary, Angel.com, pursuant to a stock purchase and sale agreement, which contains certain customary seller representations, warranties, and indemnification provisions.

**Table of Contents****MICROSTRATEGY INCORPORATED**

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

The Company leases office space and computer and other equipment under operating lease agreements. It also leases certain computer and other equipment under capital lease agreements and licenses certain software under other financing arrangements. Under the lease agreements, in addition to base rent, the Company is generally responsible for certain taxes, utilities and maintenance costs, and other fees; and several leases include options for renewal or purchase. The Company leases approximately 190,000 square feet of office space at a location in Northern Virginia that began serving as its corporate headquarters in October 2010. The term of the lease expires in December 2020. At June 30, 2013 and December 31, 2012, deferred rent of \$21.4 million and \$22.7 million, respectively, is included in other long-term liabilities and \$2.7 million and \$2.5 million, respectively, is included in current accrued expenses.

***(b) Contingencies***

In December 2011, DataTern, Inc. ( DataTern ) filed a complaint for patent infringement against the Company in the United States District Court for the District of Massachusetts. The complaint alleged that the Company infringes U.S. Patent No. 6,101,502 (the 502 Patent ), allegedly owned by DataTern, by making, selling, or offering for sale several of the Company's products and services including MicroStrategy™, MicroStrategy Intelligence Server™, MicroStrategy Business Intelligence Platform™, MicroStrategy Cloud Personal™, and other MicroStrategy applications for creating or using data mining, dashboards, business analytics, data storage and warehousing, and web hosting support. The complaint accused the Company of willful infringement and sought an unspecified amount of damages, an award of attorneys' fees, and preliminary and permanent injunctive relief. In October 2012, the case was stayed pending final judgment in a separate action involving the 502 Patent filed by DataTern in the Southern District of New York, in which MicroStrategy was not a party. Final judgment in that separate action was entered against DataTern in December 2012. In February 2013, MicroStrategy and DataTern filed motions for summary judgment of non-infringement in light of the New York judgment and the Court entered summary judgment against DataTern. In March 2013, DataTern filed a notice of appeal. The Company filed its brief in opposition on July 25, 2013. The Company received indemnification requests from certain of its resellers who were sued by DataTern in the United States District Court for the District of Massachusetts in lawsuits alleging infringement of the 502 Patent. The outcome of these matters is not presently determinable, and the Company cannot make a reasonable estimate of the possible loss or range of loss with respect to these matters at this time. Accordingly, no estimated liability for these matters has been accrued in the accompanying Consolidated Financial Statements.

In December 2011, Vasudevan Software, Inc. ( Vasudevan ) filed a complaint for patent infringement against the Company in the United States District Court for the Northern District of California. The complaint alleged that the Company's sale of MicroStrategy 9 and other MicroStrategy products infringes four patents allegedly owned by Vasudevan known as U.S. Patent Nos. 6,877,006, 7,167,864, 7,720,861, and 8,082,268, all entitled Multimedia Inspection Database System for Dynamic Runtime Evaluation. The complaint accused the Company of infringement, inducing others to infringe, and acts of contributory infringement with respect to the patents at issue and sought a permanent injunction, an unspecified amount of damages, and other relief as may be granted by the court. The Company filed its answer to the Vasudevan complaint and pled inequitable conduct counterclaims in March 2012. On June 5, 2013, each party filed motions for summary judgment. Trial is scheduled to begin on November 18, 2013. The outcome of this matter is not presently determinable, and the Company cannot make a reasonable estimate of the possible loss or range of loss with respect to this matter at this time. Accordingly, no estimated liability for this matter has been accrued in the accompanying Consolidated Financial Statements.

The Company is also 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.

The Company has contingent liabilities that, in management's judgment, are not probable of assertion. If such unasserted contingent liabilities were to be asserted, or become probable of assertion, the Company may be required to record significant expenses and liabilities in the period in which these liabilities are asserted or become probable of assertion.

**Table of Contents****MICROSTRATEGY INCORPORATED**

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

**(8) Treasury Stock**

The Board of Directors previously authorized the Company's repurchase of up to an aggregate of \$800.0 million of its class A common stock from time to time on the open market through April 29, 2013 (the 2005 Share Repurchase Program). On April 25, 2013, the Board of Directors extended the term of the 2005 Share Repurchase Program through April 29, 2018, 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 other funding arrangements which the Company may enter into in the future. During each of the three and six months ended June 30, 2013 and 2012, the Company did not repurchase any shares of its class A common stock pursuant to the 2005 Share Repurchase Program. As of June 30, 2013, pursuant to the 2005 Share Repurchase Program, the Company had repurchased an aggregate of 3,826,947 shares of its class A common stock at an average price per share of \$90.23 and an aggregate cost of \$345.3 million. The average price per share and aggregate cost amounts disclosed above 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 taxation 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 and 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 2001; however, due to its use of federal and state net operating loss (NOL) and tax credit carryovers in the U.S., U.S. tax authorities may attempt to reduce or fully offset the amount of NOL or tax credit carryovers from tax years ended in 2001 and forward that were used in later tax years. The Company is currently under tax examination in Spain. The Company settled a tax examination in Germany covering the years 2005-2008 in April 2013.

The Company released a liability for unrecognized tax benefits of \$1.4 million related to the German tax examination in the second quarter of 2013. As of June 30, 2013, the Company had recorded uncertain income tax positions of \$16.2 million, which are recorded in other long-term liabilities. If recognized, \$15.1 million of these unrecognized tax benefits would impact the effective tax rate. The Company recognizes estimated accrued interest related to unrecognized income tax benefits in the provision for income tax accounts. Penalties relating to income taxes, if incurred, would also be recognized as a component of the Company's provision for income taxes. Over the next 12 months, the amount of the Company's liability for unrecognized tax benefits is expected to decrease by approximately \$14.0 million primarily as a result of expiring statute of limitations periods. As of June 30, 2013, the amount of cumulative accrued interest expense on unrecognized income tax benefits was approximately \$1.4 million.

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

	<b>June 30, 2013</b>	<b>December 31, 2012</b>
Deferred tax assets, net of deferred tax liabilities	\$ 21,202	\$ 23,757
Valuation allowance	(227)	(231)
<b>Deferred tax assets, net of deferred tax liabilities and valuation allowance</b>	<b>\$ 20,975</b>	<b>\$ 23,526</b>



**Table of Contents**

**MICROSTRATEGY INCORPORATED**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

The valuation allowance as of June 30, 2013 and December 31, 2012 primarily relates to certain foreign net operating loss carryforward 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 FASB Accounting Standards Codification 740, *Income Taxes*, each interim period is considered integral to the annual period and tax expense is measured using an estimated annual effective tax rate. An entity is required to record income tax expense each quarter based on its best estimate of the annual effective tax rate for the full fiscal year and use that rate to provide for income taxes on a current year-to-date basis, as adjusted for discrete taxable events that occur during the interim period. If, however, the entity is unable to reliably estimate its annual effective tax rate, then the actual effective tax rate for the year-to-date may be the best annual effective tax rate estimate. For the six months ended June 30, 2013, the Company determined that it was unable to make a reliable estimate of the annual effective tax rate as relatively small changes in its projected income or loss produce significant variance in its annual effective tax rate. Therefore, the Company recorded a tax benefit for the six months ended June 30, 2013 based on the actual effective rate for the six months ended June 30, 2013 (i.e. the cut-off method). The effective tax rate for the six months ended June 30, 2012 was calculated based on an estimated annual effective tax rate plus discrete items, such as return to provision adjustments.

For the six months ended June 30, 2013, the Company recorded a benefit for income taxes from continuing operations of \$2.3 million that resulted in an effective tax rate of 25.4%, as compared to a provision for income taxes from continuing operations of \$4.1 million that resulted in an estimated annual effective tax rate of 31.1% for the six months ended June 30, 2012. The change in income taxes for the six months ended June 30, 2013 compared to the six months ended June 30, 2012 was primarily due to the change in overall income level, the change in the proportion of U.S. versus foreign income, a favorable settlement of a German tax examination in the second quarter of 2013, and the 2012 U.S. research and development tax credit, which was retroactively reinstated by the American Taxpayer Relief Act of 2012 signed into law on January 2, 2013 and recorded as a tax benefit as of June 30, 2013.

Except as discussed below, the Company intends to indefinitely reinvest its undistributed earnings of certain foreign subsidiaries. Therefore, the income tax benefit for the period ended June 30, 2013 does not include any provision for U.S. federal and state income taxes on the amount of the undistributed 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, the Company regularly repatriates Subpart F deemed dividends to the U.S. and no additional tax is incurred on the distribution. As of June 30, 2013 and December 31, 2012, the amount of cash and cash equivalents and short-term investments, excluding those held for sale, held by U.S. entities was \$106.3 million and \$39.2 million, respectively, and by non-U.S. entities was \$211.5 million and \$183.8 million, respectively. If the cash and cash equivalents and short-term investments held by non-U.S. entities were to be repatriated to the U.S., the Company would generate U.S. taxable income to the extent of the Company's undistributed foreign earnings, which amounted to \$184.0 million at December 31, 2012. Although the tax impact of repatriating these earnings is difficult to determine, the Company would not expect the maximum effective tax rate that would be applicable to such repatriation to exceed the U.S. statutory rate of 35.0%, after considering applicable foreign tax credits.

In determining the Company's provision or benefit for income taxes, net deferred tax assets, liabilities, and valuation allowances, management is required to make judgments and estimates related to projections of domestic and foreign profitability, the timing and extent of the utilization of net operating loss carryforwards, applicable tax rates, transfer pricing methods, and prudent and feasible tax planning strategies. As a multinational company, the Company is required to calculate and provide for estimated income tax liabilities for 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

**Table of Contents**

**MICROSTRATEGY INCORPORATED**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

income, changes in tax laws, particularly changes 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 or benefit 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 research and development tax credit carryforward tax assets, alternative minimum tax credit carryforward tax assets, and foreign tax credit carryforward tax assets 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 more likely than not that such deferred tax assets are not realizable.

**(10) Share-Based Compensation**

The Company previously maintained share-based compensation arrangements under which directors, officers, employees, and other eligible participants received stock option awards to purchase the Company's class A common stock. The Company has not granted any new share-based awards to purchase the Company's class A common stock since the first quarter of 2004. As of June 30, 2013, there were no outstanding stock options granted under the Company's stock plans.

MicroStrategy's former subsidiary, Angel.com, previously maintained a stock incentive plan under which certain employees, officers, and directors of MicroStrategy and Angel.com were granted options to purchase shares of the class A common stock of Angel.com, subject to the satisfaction of both performance and continued service conditions. Share-based compensation expense would have been recognized over the requisite service period of the award based on the probability of the satisfaction of the performance condition, reduced by the number of awards that were not expected to vest due to the failure to satisfy the continued service condition. In connection with the sale of Angel.com in the first quarter of 2013, the Angel.com stock incentive plan was terminated and all outstanding options thereunder were terminated in exchange for cash payments totaling \$8.0 million. Prior to their termination, no share-based compensation expense was recognized for these awards for the three and six months ended June 30, 2013 and 2012 because the performance condition had not been satisfied.

**(11) 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 common stock and for 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. As of June 30, 2013 and December 31, 2012, there were no shares of preferred stock issued or outstanding.

Potential shares of common stock are included in the diluted earnings per share calculation when dilutive. For the three and six months ended June 30, 2013, 27 and 2,037 potential shares of common stock, respectively, were excluded from the diluted earnings per share calculation because their impact would have been anti-dilutive. Potential shares of common stock issuable upon exercise of outstanding stock options are calculated using the treasury stock method. As of June 30, 2013, there were no outstanding stock options granted under the Company's stock plans.

**Table of Contents****MICROSTRATEGY INCORPORATED**

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

**(12) Discontinued Operations**

On February 25, 2013, the Company committed to a plan to sell its Angel.com business. The Company made the decision to sell Angel.com in order to focus on its business intelligence software and services offerings.

On March 15, 2013, the Company completed the sale of its equity interest in Angel.com for consideration to the Company of approximately \$111.2 million, resulting in a net cash inflow of \$100.7 million after \$10.5 million in transaction costs. The sale resulted in a gain of \$57.4 million, net of tax. As of December 31, 2012, the associated assets and liabilities of the Angel.com business are classified as held-for-sale and are presented in the following table (in thousands):

	<b>December 31, 2012</b>	
<b>Assets:</b>		
Cash and cash equivalents	\$	1,350
Accounts receivable, net of unpaid deferred revenue of \$554 and allowance for doubtful accounts of \$347, respectively		4,720
Prepaid expenses and other assets		738
Property and equipment, net		3,763
 Total assets	 \$	 10,571
<b>Liabilities:</b>		
Accounts payable and accrued expenses	\$	1,587
Accrued compensation and employee benefits		2,364
Gross deferred revenue and advance payments, net of unpaid deferred revenue of \$554		639
Other liabilities		99
 Total liabilities	 \$	 4,689
 Net assets and liabilities of disposal group	 \$	 5,882

The following table summarizes the revenues and pre-tax loss generated by the Angel.com business during the three and six months ended June 30, 2013 and 2012, respectively, in addition to the pre-tax gain on the sale of Angel.com recorded by the Company during the three and six months ended June 30, 2013 and 2012, respectively (in thousands):

	<b>Three months</b>		<b>Six months ended</b>	
	<b>ended</b>		<b>June 30,</b>	
	<b>2013</b>	<b>2012</b>	<b>2013</b>	<b>2012</b>
Angel.com revenues	\$ 0	\$ 6,514	\$ 6,320	\$ 13,265
Angel.com pre-tax loss	\$ 0	\$ 989	\$ 986	\$ 2,191

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MicroStrategy pre-tax (loss) gain on sale	\$ 0	\$ 0	\$ 94,925	\$ 0
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**(13) Segment Information**

The Company manages its business in one operating segment Business Intelligence (BI) Software and Services. As discussed in Note 12, the Angel.com business was sold on March 15, 2013. Prior to its

**Table of Contents****MICROSTRATEGY INCORPORATED**

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

divestiture, the Angel.com business was the sole component of the former operating segment Other. The BI Software and Services operating segment is engaged in the design, development, marketing, and sales of business intelligence software through licensing arrangements and cloud-based subscriptions, and related services. It includes the MicroStrategy Analytics Platform™, the MicroStrategy Mobile App Platform™, MicroStrategy Cloud™, and MicroStrategy Express™. The Company has also included the MicroStrategy Loyalty Platform™, branded as MicroStrategy Alert, and the MicroStrategy Identity Platform™, branded as MicroStrategy Usher™, as part of the BI Software and Services operating segment for each of the three and six months ended June 30, 2013 and 2012 since these platforms generated no significant revenues during these periods. The following table presents total revenues from continuing operations, gross profit from continuing operations, and long-lived assets, excluding long-term deferred tax assets and assets held-for-sale, (in thousands) according to geographic region:

Geographic regions:	BI Software and Services			Consolidated
	Domestic	EMEA	Other Regions	
<b>Three months ended June 30, 2013</b>				
Total revenues	\$ 83,287	\$ 38,608	\$ 16,010	\$ 137,905
Gross profit	61,154	27,083	13,222	101,459
<b>Three months ended June 30, 2012</b>				
Total revenues	\$ 81,111	\$ 39,107	\$ 15,106	\$ 135,324
Gross profit	61,052	28,259	11,953	101,264
<b>Six months ended June 30, 2013</b>				
Total revenues	\$ 160,595	\$ 76,544	\$ 30,949	\$ 268,088
Gross profit	117,280	53,012	25,449	195,741
<b>Six months ended June 30, 2012</b>				
Total revenues	\$ 160,107	\$ 83,896	\$ 29,655	\$ 273,658
Gross profit	118,226	62,392	23,250	203,868
<b>As of June 30, 2013</b>				
Long-lived assets	\$ 95,206	\$ 7,983	\$ 6,489	\$ 109,678
<b>As of June 30, 2012</b>				
Long-lived assets	\$ 96,979	\$ 9,525	\$ 6,121	\$ 112,625

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 six months ended June 30, 2013, no individual foreign country accounted for 10% or more of total consolidated revenues from continuing operations. For the three and six months ended June 30, 2012, no individual foreign country accounted for 10% or more of total consolidated revenues from continuing operations.

For the three and six months ended June 30, 2013 and 2012, no individual customer accounted for 10% or more of total consolidated revenues from continuing operations.

As of June 30, 2013 and December 31, 2012, no individual foreign country accounted for 10% or more of total consolidated assets, excluding assets held-for-sale.

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**Table of Contents**

**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 (the Exchange Act). 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 under Part II, Item 1A, Risk Factors, among others, could cause actual results to differ materially from those indicated by forward-looking statements made herein and presented elsewhere by management from time to time. 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**

MicroStrategy® is a leading worldwide provider of enterprise software platforms. The Company's mission is to provide the most flexible, powerful, scalable, and user-friendly platforms for analytics, mobile, identity, and loyalty, offered either on premises or in the cloud.

The MicroStrategy Analytics Platform enables organizations to analyze vast amounts of data and distribute actionable business insight throughout the enterprise. Our analytics platform delivers reports and dashboards, and enables users to conduct ad hoc analysis and share insights anywhere, anytime. The MicroStrategy Mobile App Platform lets organizations rapidly build information-rich applications that combine multimedia, transactions, analytics, and custom workflows. MicroStrategy Cloud is a cloud-based Platform-as-a-Service (PaaS) offering. It allows enterprises to deploy MicroStrategy analytics and mobile apps using MicroStrategy's Analytics Platform and the MicroStrategy Mobile App Platform more quickly and with lower upfront costs than equivalent on-premises solutions. MicroStrategy Express is designed to be the fastest way for companies, departments, and small businesses to build and deploy MicroStrategy-caliber analytics and mobile apps with little or no assistance of internal IT professionals. MicroStrategy Express guides business people through a streamlined flow from data-to-discovery-to-dashboard-to-distribution and is available as a cloud-based service to allow rapid startup.

The MicroStrategy Loyalty Platform, branded as MicroStrategy Alert, is a next-generation, mobile customer loyalty and engagement solution. It is designed to help companies compete effectively in the new mobile world by providing a powerful, new channel for targeted marketing, commerce, and consumer engagement. The MicroStrategy Identity Platform, branded as MicroStrategy Usher, provides organizations the ability to develop a secure mobile application for identity validation and credentials. It provides businesses with a mobile identity network alternative to traditional employee IDs, keys, and proximity cards, and helps companies to reduce fraud and cyber crime.

The MicroStrategy Analytics Platform and MicroStrategy Mobile App Platform, together with related product and support services, continue to generate the vast majority of our revenue. During each of the three and six months ended June 30, 2013 and 2012, we did not generate significant revenues from MicroStrategy Express, the MicroStrategy Loyalty Platform, or the MicroStrategy Identity Platform.

We previously operated Angel.com, a provider of cloud-based Customer Experience Management (CEM) solutions for Interactive Voice Response (IVR) and contact centers. On February 25, 2013, in connection with our consideration of strategic alternatives relating to our Angel.com business, we committed to a plan to sell the business. We made the decision to sell the business in order to focus on our business intelligence software and services offerings. On March 15, 2013, we completed the sale of our equity interest in Angel.com to Genesys Telecommunications Laboratories, Inc. As a result of the transaction, we received consideration of approximately \$111.2 million, resulting in a net cash inflow of \$100.7 million after \$10.5 million in transaction costs. The sale of our ownership interest in Angel.com resulted in us recognizing an

**Table of Contents**

after-tax gain of approximately \$57.4 million in the first half of 2013, which included the cost of terminating all outstanding Angel.com employee stock options prior to the closing of the transaction and other costs associated with the sale. Accordingly, on our Consolidated Balance Sheets, we have classified the associated assets and liabilities of the Angel.com business as held-for-sale as of December 31, 2012. In our Consolidated Statement of Operations, we classified operations of the Angel.com business as Loss from Discontinued Operations, net of tax, because we have no continuing involvement with or cash flows from this business following its divestiture. All assets and liabilities that are reported in these financial statements as held-for-sale as of December 31, 2012 are reported at the lower of the carrying cost or fair value less cost to sell.

The following table sets forth certain operating highlights (in thousands) for the three and six months ended June 30, 2013 and 2012:

	BI Software and Services			
	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
<b>Revenues</b>				
Product licenses	\$ 30,605	\$ 31,890	\$ 58,973	\$ 69,343
Product support and other services	107,300	103,434	209,115	204,315
<b>Total revenues</b>	<b>137,905</b>	<b>135,324</b>	<b>268,088</b>	<b>273,658</b>
<b>Cost of revenues</b>				
Product licenses	1,621	982	3,214	3,128
Product support and other services	34,825	33,078	69,133	66,662
<b>Total cost of revenues</b>	<b>36,446</b>	<b>34,060</b>	<b>72,347</b>	<b>69,790</b>
<b>Gross profit</b>	<b>101,459</b>	<b>101,264</b>	<b>195,741</b>	<b>203,868</b>
<b>Operating expenses</b>				
Sales and marketing	52,686	48,693	103,400	103,834
Research and development	24,227	19,017	50,044	41,191
General and administrative	26,594	23,067	53,006	46,732
<b>Total operating expenses</b>	<b>103,507</b>	<b>90,777</b>	<b>206,450</b>	<b>191,757</b>
<b>(Loss) income from continuing operations before financing and other income and income taxes</b>	<b>\$ (2,048)</b>	<b>\$ 10,487</b>	<b>\$ (10,709)</b>	<b>\$ 12,111</b>

The business intelligence market is highly competitive and our results of operations depend on our ability to market and sell 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 challenges 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 challenge that we may not be able to penetrate accounts that a competitor has penetrated or in which a competitor is the incumbent business intelligence application provider. In addition, companies with industry leading positions in certain software markets, such as Microsoft, Oracle, IBM, and SAP, have incorporated business intelligence capabilities into their product suites. As a result, our offerings need to be sufficiently differentiated from these bundled software offerings to create customer demand for our platform, products, and services.

## **Table of Contents**

We have undertaken a number of initiatives to address these opportunities and challenges, including:

enhancement of our ability to support new enterprise-scale requirements for BI, where we are currently a technology leader, with a focus on supporting more varied database platforms, providing higher performance, and providing greater ability to manage and administer large-scale BI operations;

extension of the analytic breadth of our technology with greater statistical and predictive capabilities through integration with the R open source project, a widely-used statistical programming language;

extension of our technology to provide greater support for the latest trend in self-service BI, which is often referred to as visual data discovery or agile analytics, by adding new user interface flows, new visualizations, new exploration features, and new capabilities for the importation of end-user data;

the introduction of new channels to enable customers to access our BI capabilities in the form of MicroStrategy Cloud and MicroStrategy Express;

enhancement of our mobile application platforms for creating and deploying BI applications to the expanding community of users of mobile devices;

expansion of our offerings to include new platforms derived from our software technology base, such as the MicroStrategy Loyalty Platform and the MicroStrategy Identity Platform;

sales and marketing activities to enhance corporate branding, obtain new customers, and expand and strengthen our existing customer base; and

maintaining a dedicated performance engineering team and conducting research and development focused on providing our customers with the highest levels of performance for BI applications of all sizes.

As part of these initiatives, we continue to make additional investments in research and development capabilities. We expect the level of investments and related expenses in 2013 to be higher than in 2012. We generated a loss from continuing operations for each of the three and six months ended June 30, 2013. If our revenues are not sufficient to offset our operating expenses or we are unable to timely adjust our operating expenses in response to any shortfall in anticipated revenue, we may continue to incur operating losses.

We believe that effective recruiting, education, and nurturing of human resources are critical to our success and we have traditionally made investments in these areas in order to differentiate ourselves from our competition, increase employee loyalty, and create a culture conducive to creativity, cooperation, and continuous improvement.

As of June 30, 2013, we had a total of 3,186 employees, of whom 1,428 were based in the United States and 1,758 were based internationally. Of our 3,186 employees, 802 were engaged in sales and marketing, 909 in research and development, 1,001 in technical support and other services, and 474 in finance, administration, and corporate operations.

We lease approximately 190,000 square feet of office space at a location in Northern Virginia that began serving as our corporate headquarters in October 2010. The term of the lease expires in December 2020. We recognize lease expense ratably over the term of the lease.

In July 2011, we entered into a lease for a 37.5% fractional interest in a corporate aircraft owned and managed by a fractional interest program operator. During the three and six months ended June 30, 2012, we incurred approximately \$0.5 million and \$1.5 million, respectively, in



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general and administrative expenses for the fractional interest lease. We terminated the fractional interest lease in September 2012 following the return to service of our owned corporate aircraft in the second quarter of 2012. No such expenses were incurred for the three and six months ended June 30, 2013.

**Table of Contents**

We base our internal operating expense forecasts on expected revenue trends and strategic objectives. 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.

## **Table of Contents**

### **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 property and equipment, litigation and contingencies, and valuation of net deferred tax assets, have a material impact on our financial statements and are discussed in detail throughout our analysis of the results of operations discussed below. In some cases, changes in accounting estimates are reasonably likely to occur from period to period.

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, 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 and/or consolidated into our Consolidated Financial Statements. Additionally, MicroStrategy does not have any material related party transactions.

The section **Critical Accounting Policies** included in Item 7 and the section **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, 2012 provide a more detailed explanation of the judgments made in these areas and a discussion of our accounting estimates and policies. There have been no significant changes in such estimates and policies since December 31, 2012, other than the addition of our accounting policies related to **Fair Value Measurements**, **Derivative Financial Instruments**, and **Short-term Investments** as disclosed in Note 1 **Summary of Significant Accounting Policies**.

**Table of Contents****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. As currency rates change from quarter to quarter and year over year, our results of operations 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 (decrease) in revenues or expenses, as applicable, from the same period in the prior year. The term "international" refers to operations outside of the United States and Canada.

	<b>Three Months</b>		<b>Six Months Ended</b>	
	<b>Ended</b>		<b>June 30,</b>	
	<b>2013</b>	<b>2012</b>	<b>2013</b>	<b>2012</b>
International product licenses revenues	\$ (515)	\$ (1,115)	\$ (886)	\$ (1,552)
International product support revenues	(260)	(2,941)	(725)	(3,804)
International other services revenues	(245)	(1,602)	(584)	(2,130)
Cost of product support revenues	(41)	(85)	(81)	(113)
Cost of other services revenues	(21)	(1,657)	(120)	(2,345)
Sales and marketing expenses	(210)	(1,918)	(619)	(2,500)
Research and development expenses	123	41	161	177
General and administrative expenses	(35)	(492)	(126)	(694)

For example, if there had been no change to foreign currency exchange rates from 2012 to 2013, international product licenses revenues would have been \$12.9 million rather than \$12.4 million and \$25.1 million rather than \$24.2 million for the three and six months ended June 30, 2013, respectively. If there had been no change to foreign currency exchange rates from 2012 to 2013, sales and marketing expenses would have been \$52.9 million rather than \$52.7 million and \$104.0 million rather than \$103.4 million for the three and six months ended June 30, 2013, respectively.

**Table of Contents****Results of Operations****Comparison of the three and six months ended June 30, 2013 and 2012****Revenues**

Except as otherwise indicated herein, the term *domestic* refers to operations in the United States and Canada, and the term *international* refers to operations outside of the United States and Canada.

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

	Three Months Ended June 30,			Six Months Ended June 30,		
	2013	2012	% Change	2013	2012	% Change
<b>Product Licenses Revenues:</b>						
Domestic	\$ 18,250	\$ 19,731	-7.5%	\$ 34,806	\$ 40,774	-14.6%
International	12,355	12,159	1.6%	24,167	28,569	-15.4%
Total product licenses revenues	\$ 30,605	\$ 31,890	-4.0%	\$ 58,973	\$ 69,343	-15.0%

The following table sets forth a summary, grouped by size, of the number of recognized product licenses transactions for the periods indicated:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
<b>Product Licenses Transactions with Recognized Licenses Revenue in the Applicable Period:</b>				
More than \$1.0 million in licenses revenue recognized	3	6	6	10
Between \$0.5 million and \$1.0 million in licenses revenue recognized	11	7	19	14
Total	14	13	25	24
<b>Domestic:</b>				
More than \$1.0 million in licenses revenue recognized	3	5	5	8
Between \$0.5 million and \$1.0 million in licenses revenue recognized	7	4	13	9
Total	10	9	18	17
<b>International:</b>				
More than \$1.0 million in licenses revenue recognized	0	1	1	2
Between \$0.5 million and \$1.0 million in licenses revenue recognized	4	3	6	5
Total	4	4	7	7

**Table of Contents**

The following table sets forth the recognized revenue (in thousands) attributable to product licenses transactions, grouped by size, and related percentage changes for the periods indicated:

	Three Months Ended June 30,			Six Months Ended June 30,		
	2013	2012	% Change	2013	2012	% Change
<b>Product Licenses Revenue Recognized in the Applicable Period:</b>						
More than \$1.0 million in licenses revenue recognized	\$ 3,224	\$ 8,031	-59.9%	\$ 7,058	\$ 18,241	-61.3%
Between \$0.5 million and \$1.0 million in licenses revenue recognized	6,737	4,647	45.0%	12,685	9,923	27.8%
Less than \$0.5 million in licenses revenue recognized	20,644	19,212	7.5%	39,230	41,179	-4.7%
<b>Total</b>	<b>30,605</b>	<b>31,890</b>	<b>-4.0%</b>	<b>58,973</b>	<b>69,343</b>	<b>-15.0%</b>
<b>Domestic:</b>						
More than \$1.0 million in licenses revenue recognized	3,224	6,882	-53.2%	5,981	13,239	-54.8%
Between \$0.5 million and \$1.0 million in licenses revenue recognized	4,390	2,757	59.2%	8,614	6,699	28.6%
Less than \$0.5 million in licenses revenue recognized	10,636	10,092	5.4%	20,211	20,836	-3.0%
<b>Total</b>	<b>18,250</b>	<b>19,731</b>	<b>-7.5%</b>	<b>34,806</b>	<b>40,774</b>	<b>-14.6%</b>
<b>International:</b>						
More than \$1.0 million in licenses revenue recognized	0	1,149	-100.0%	1,077	5,002	-78.5%
Between \$0.5 million and \$1.0 million in licenses revenue recognized	2,347	1,890	24.2%	4,071	3,224	26.3%
Less than \$0.5 million in licenses revenue recognized	10,008	9,120	9.7%	19,019	20,343	-6.5%
<b>Total</b>	<b>\$ 12,355</b>	<b>\$ 12,159</b>	<b>1.6%</b>	<b>\$ 24,167</b>	<b>\$ 28,569</b>	<b>-15.4%</b>

Product licenses revenues decreased \$1.3 million and \$10.4 million for the three and six months ended June 30, 2013, respectively, as compared to the same periods in the prior year. For the three months ended June 30, 2013 and 2012, product licenses transactions with more than \$0.5 million in recognized revenue represented 32.5% and 39.8%, respectively, of our product licenses revenues. For the six months ended June 30, 2013, our top three product licenses transactions totaled \$3.9 million in recognized revenue, or 6.6% of total product licenses revenues, compared to \$9.1 million, or 13.1% of total product licenses revenues, for the six months ended June 30, 2012.

**Domestic product licenses revenues.** Domestic product licenses revenues decreased \$1.5 million for the three months ended June 30, 2013, as compared to the same period in the prior year, primarily due to a decrease in the number and average deal size of transactions with more than \$1.0 million in recognized revenue, partially offset by an increase in the number of transactions with between \$0.5 million and \$1.0 million in recognized revenue and an increase in the average deal size of transactions with less than \$0.5 million in recognized revenue.

Domestic product licenses revenues decreased \$6.0 million for the six months ended June 30, 2013, as compared to the same period in the prior year, primarily due to a decrease in the number and average deal size of transactions with more than \$1.0 million in recognized revenue and a decrease in the number of transactions with less than \$0.5 million in recognized revenue, partially offset by an increase in the number of transactions with between \$0.5 million and \$1.0 million in recognized revenue.

**International product licenses revenues.** International product licenses revenues increased \$0.2 million for the three months ended June 30, 2013, as compared to the same period in the prior year, primarily due to an increase in the number of both transactions with between \$0.5 million and \$1.0 million in recognized revenue and transactions with less than \$0.5 million in recognized revenue, partially offset by a decrease in the number of transactions with more than \$1.0 million in recognized revenue.

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International product licenses revenues decreased \$4.4 million for the six months ended June 30, 2013, as compared to the same period in the prior year, primarily due to a decrease in the number and average deal size of both transactions with more than \$1.0 million in recognized revenue and transactions with less than \$0.5 million in recognized revenue, partially offset by an increase in the number and average deal size of transactions with between \$0.5 million and \$1.0 million in recognized revenue.

**Table of Contents**

**Product support and other services revenues.** The following table sets forth product support and other services revenues (in thousands) and related percentage changes for the periods indicated:

	Three Months Ended June 30,			Six Months Ended June 30,		
	2013	2012	% Change	2013	2012	% Change
<b>Product Support and Other Services Revenues:</b>						
<b>Product Support</b>						
Domestic	\$ 39,632	\$ 37,228	6.5%	\$ 77,358	\$ 73,382	5.4%
International	28,807	27,320	5.4%	56,431	54,076	4.4%
<b>Total product support revenues</b>	<b>68,439</b>	<b>64,548</b>	<b>6.0%</b>	<b>133,789</b>	<b>127,458</b>	<b>5.0%</b>
<b>Consulting</b>						
Domestic	20,400	21,077	-3.2%	38,877	39,781	-2.3%
International	11,646	12,726	-8.5%	23,155	26,977	-14.2%
<b>Total consulting revenues</b>	<b>32,046</b>	<b>33,803</b>	<b>-5.2%</b>	<b>62,032</b>	<b>66,758</b>	<b>-7.1%</b>
Education	4,047	4,645	-12.9%	8,071	9,292	-13.1%
Subscription services	2,768	438	532.0%	5,223	807	547.2%
<b>Total product support and other services revenues</b>	<b>\$ 107,300</b>	<b>\$ 103,434</b>	<b>3.7%</b>	<b>\$ 209,115</b>	<b>\$ 204,315</b>	<b>2.3%</b>

**Product support revenues.** Product support revenues are derived from providing technical software support and software updates and upgrades to customers. Product support revenues are recognized ratably over the term of the contract, which in most cases is one year. Product support revenues increased \$3.9 million and \$6.3 million for the three and six months ended June 30, 2013, respectively, as compared to the same periods in the prior year, primarily due to an increase in the number of new product support contracts and an increase in domestic renewal rates.

**Consulting revenues.** Consulting revenues are derived from helping customers plan and execute the deployment of our software. Consulting revenues decreased for the three and six months ended June 30, 2013, as compared to the same periods in the prior year, primarily due to a decrease in billable hours internationally.

**Education revenues.** Education revenues are derived from the education and training that we provide to our customers to enhance their ability to fully utilize the features and functionality of our software. These offerings include self-tutorials, custom course development, joint training with customers' internal staff, and standard course offerings, with pricing dependent on the specific offering delivered. Education revenues decreased for the three and six months ended June 30, 2013, as compared to the same periods in the prior year, primarily due to a decrease in private and custom courses delivered and shifting demand from traditional classroom training to virtual training within our perennial education pass program.

**Subscription services revenues.** Subscription services revenues are derived primarily from our Cloud services offerings that are recognized on a subscription basis over the service period of the contract. Subscription services revenues increased for the three and six months ended June 30, 2013, as compared to the same periods in the prior year, primarily due to an increase in new customers as our Cloud business continued to grow.



**Table of Contents****Costs and Expenses**

**Cost of revenues.** The following table sets forth cost of revenues (in thousands) and related percentage changes for the periods indicated:

	Three Months Ended			Six Months Ended		
	June 30,		%	June 30,		%
	2013	2012	Change	2013	2012	Change
Cost of Revenues:						
Product licenses	\$ 1,621	\$ 982	65.1%	\$ 3,214	\$ 3,128	2.7%
Product support	4,254	3,635	17.0%	8,455	7,203	17.4%
Consulting	25,024	26,179	-4.4%	49,660	52,862	-6.1%
Education	1,610	1,924	-16.3%	3,314	3,929	-15.7%
Subscription services	3,937	1,340	193.8%	7,704	2,668	188.8%
Total cost of revenues	\$ 36,446	\$ 34,060	7.0%	\$ 72,347	\$ 69,790	3.7%

**Cost of product licenses revenues.** Cost of product licenses revenues consists of amortization of capitalized software development costs and the costs of product manuals, media, and royalties paid to third-party software vendors. Capitalized software development costs are generally amortized over a useful life of three years.

Cost of product licenses revenues increased \$0.6 million for the three months ended June 30, 2013, as compared to the same period in the prior year, primarily due to a \$0.7 million increase in amortization of capitalized software development costs related to the release of MicroStrategy 9.3 in September 2012. Cost of product licenses revenues increased \$0.1 million for the six months ended June 30, 2013, as compared to the same period in the prior year, due to a \$1.4 million increase in amortization of capitalized software development costs related to the release of MicroStrategy 9.3 in September 2012, partially offset by a \$1.3 million decrease in amortization of capitalized software development costs related to MicroStrategy 9, which became fully amortized in March 2012. We expect to amortize the remaining balance of our products capitalized software development costs as of June 30, 2013 ratably over the applicable remaining amortization periods as follows:

	Capitalized Software Balance as of June 30, 2013 (in thousands)	Remaining Amortization Period (in months)
MicroStrategy 9.2	\$ 944	9
MicroStrategy 9.2.1	734	12
MicroStrategy 9.3	5,975	27
New product development	1,736	n/a
Total capitalized software development costs	\$ 9,389	

During the three months ended June 30, 2013, we also recorded \$1.7 million in capitalized software development costs associated with development efforts related to new products. Upon these products becoming generally available, these costs will begin to be amortized over the estimated product life of 36 months.

**Cost of product support revenues.** Cost of product support revenues consists of product support personnel and related overhead costs. Cost of product support revenues increased \$0.6 million for the three months ended June 30, 2013, as compared to the same period in the prior year, due to a \$0.5 million increase in compensation and related costs associated with an increase in staffing levels to support an increased customer base, and a \$0.1 million increase in facility and other related support costs. Product support headcount increased 12.4% to 172 at June 30, 2013 from 153 at June 30, 2012.

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Cost of product support revenues increased \$1.3 million for the six months ended June 30, 2013, as compared to the same period in the prior year, primarily due to a \$0.9 million increase in compensation and related costs associated with an increase in staffing levels to support an increased customer base and a \$0.2 million increase in facility and other related support costs.

***Cost of consulting revenues.*** Cost of consulting revenues consists of personnel and related overhead costs. Cost of consulting revenues decreased \$1.2 million for the three months ended June 30, 2013, as compared to the same period in the prior year, due to a

**Table of Contents**

\$2.2 million decrease in compensation and related costs due to a decrease in staffing levels, partially offset by a \$0.4 million increase in travel and entertainment expenditures, a \$0.3 million increase in subcontractor costs, and a \$0.3 million increase in facility and other related support costs. Consulting headcount decreased 9.1% to 757 at June 30, 2013 from 833 at June 30, 2012.

Cost of consulting revenues decreased \$3.2 million for the six months ended June 30, 2013, as compared to the same period in the prior year, primarily due to a \$5.1 million decrease in compensation and related costs due to a decrease in staffing levels, partially offset by a \$0.9 million increase in subcontractor costs, a \$0.6 million increase in facility and other related support costs, and a \$0.5 million increase in travel and entertainment expenditures.

**Cost of education revenues.** Cost of education revenues consists of personnel and related overhead costs. Cost of education revenues decreased \$0.3 million for the three months ended June 30, 2013, as compared to the same period in the prior year, due to a \$0.3 million decrease in compensation and related costs due to a decrease in staffing levels. Education headcount decreased 8.7% to 42 at June 30, 2013 from 46 at June 30, 2012.

Cost of education revenues decreased \$0.6 million for the six months ended June 30, 2013, as compared to the same period in the prior year, primarily due to a \$0.5 million decrease in compensation and related costs due to a decrease in staffing levels.

**Cost of subscription services revenues.** Cost of subscription services revenues consists of equipment, facility and other related support costs, and personnel and related overhead costs. Cost of subscription services revenues increased \$2.6 million for the three months ended June 30, 2013, as compared to the same period in the prior year, primarily due to a \$1.7 million increase in equipment depreciation and facility and other related support costs, a \$0.5 million increase in consulting and advisory costs, and a \$0.3 million increase in compensation and related costs due to an increase in staffing levels. Subscription services headcount increased 150.0% to 30 at June 30, 2013 from 12 at June 30, 2012.

Cost of subscription services revenues increased \$5.0 million for the six months ended June 30, 2013, as compared to the same period in the prior year, due to a \$3.4 million increase in equipment depreciation and facility and other related support costs, a \$1.0 million increase in consulting and advisory costs, and a \$0.6 million increase in compensation and related costs due to an increase in staffing levels.

**Sales and marketing expenses.** Sales and marketing expenses consists of personnel and related overhead costs, commissions, office facilities, travel, advertising, public relations programs, and promotional events, such as trade shows, seminars, and technical conferences. The following table sets forth sales and marketing expenses (in thousands) and related percentage changes for the periods indicated:

	Three Months Ended			Six Months Ended		
	June 30, 2013	2012	% Change	June 30, 2013	2012	% Change
BI Software and Services	\$ 52,686	\$ 48,693	8.2%	\$ 103,400	\$ 103,834	-0.4%

Sales and marketing expenses increased \$4.0 million for the three months ended June 30, 2013, as compared to the same period in the prior year, primarily due to a \$3.3 million increase in compensation, variable compensation and related costs, a \$0.5 million increase in travel and entertainment expenditures, a \$0.3 million increase in recruiting expenditures, a \$0.3 million increase in facilities and other related support costs, and a \$0.1 million increase in subcontractor costs, partially offset by a \$0.6 million decrease in marketing and advertising costs. Sales and marketing headcount increased 10.0% to 802 at June 30, 2013 from 729 at June 30, 2012. We do not expect to increase sales and marketing headcount significantly in the near term.

**Table of Contents**

Sales and marketing expenses decreased \$0.4 million for the six months ended June 30, 2013, as compared to the same period in the prior year, primarily due to a \$1.5 million decrease in marketing and advertising costs and a \$1.0 million decrease in travel and entertainment expenditures, partially offset by a \$1.1 million increase in compensation, variable compensation and related costs, a \$0.6 million increase in recruiting expenditures, and a \$0.3 million increase in facilities and other related support costs.

**General and administrative expenses.** General and administrative expenses consists of personnel and related overhead costs, and other costs of our executive, finance, human resources, information systems, and administrative departments, as well as third-party consulting, legal, and other professional fees. The following table sets forth general and administrative expenses (in thousands) and related percentage changes for the periods indicated:

	Three Months Ended			Six Months Ended		
	June 30, 2013	2012	% Change	June 30, 2013	2012	% Change
BI Software and Services	\$ 26,594	\$ 23,067	15.3%	\$ 53,006	\$ 46,732	13.4%

General and administrative expenses increased \$3.5 million for the three months ended June 30, 2013, as compared to the same period in the prior year, due to a \$3.1 million increase in compensation and related costs due to an increase in staffing levels, a \$1.1 million increase in facility and other related support costs, and a \$0.3 million increase in travel and entertainment expenditures, partially offset by a \$0.5 million decrease in third-party legal, consulting, and other advisory costs and a \$0.5 million decrease in other aircraft-related operating costs. General and administrative headcount increased 20.3% to 474 at June 30, 2013 from 394 at June 30, 2012. We do not expect to increase general and administrative headcount significantly in the near term.

General and administrative expenses increased \$6.3 million for the six months ended June 30, 2013, as compared to the same period in the prior year, primarily due to a \$5.9 million increase in compensation and related costs due to an increase in staffing levels and an increase in variable compensation resulting from the sale of Angel.com, a \$1.8 million increase in facility and other related support costs, a \$0.3 million increase in travel and entertainment expenditures, and a \$0.2 million increase in recruiting costs, partially offset by a \$0.9 million decrease in third-party legal, consulting, and other advisory costs and a \$0.9 million decrease in other aircraft-related operating costs.

**Research and development expenses.** Research and development expenses consists of the personnel costs for our software engineering personnel, depreciation of equipment, and other related costs. The following table summarizes research and development expenses and amortization of capitalized software development costs (in thousands) and related percentage changes for the periods indicated:

	Three Months Ended			Six Months Ended		
	June 30, 2013	2012	% Change	June 30, 2013	2012	% Change
Gross research and development expenses before capitalized software development costs	\$ 25,963	\$ 24,067	7.9%	\$ 51,780	46,241	12.0%
Capitalized software development costs	(1,736)	(5,050)	-65.6%	(1,736)	(5,050)	-65.6%
Total research and development expenses	\$ 24,227	\$ 19,017	27.4%	\$ 50,044	\$ 41,191	21.5%

Amortization of capitalized software development costs included in cost of product licenses revenues	\$ 1,353	\$ 674	100.7%	\$ 2,706	\$ 2,656	1.9%
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Research and development expenses, before capitalization of software development costs, increased \$1.9 million for the three months ended June 30, 2013, as compared to the same period in the prior year, due to a \$2.3 million increase in compensation and related costs due to an increase in staffing levels, partially offset by a \$0.4 million decrease in facilities and other related support costs. Research and development headcount increased 15.2% to 909 at June 30, 2013 from 789 at June 30, 2012.



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## **Table of Contents**

Research and development expenses, before capitalization of software development costs, increased \$5.5 million for the six months ended June 30, 2013, as compared to the same period in the prior year, primarily due to a \$5.2 million increase in compensation and related costs due to an increase in staffing levels, partially offset by a \$0.1 million decrease in facilities and other related support costs.

For the six months ended June 30, 2013, our research and development personnel were focused on the following: 63.9% on the MicroStrategy Analytics Platform, the MicroStrategy Mobile App Platform, MicroStrategy Cloud, and MicroStrategy Express, and 36.1% on other research and development, including the MicroStrategy Loyalty Platform, the MicroStrategy Identity Platform, and internal information technology initiatives.

### **Provision for Income Taxes**

In the second quarter of 2013, we determined that we were unable to make a reliable estimate of the 2013 annual effective tax rate as relatively small changes in projected income or loss produce a significant variance in our annual effective tax rate. Therefore, we recorded a tax benefit for the six months ended June 30, 2013 based on the actual effective rate for the six months ended June 30, 2013 (i.e. the cut-off method). For the six months ended June 30, 2013, we recorded a benefit for income taxes from continuing operations of \$2.3 million that resulted in an effective tax rate of 25.4%, as compared to a provision for income taxes from continuing operations of \$4.1 million that resulted in an estimated annual effective tax rate of 31.1% for the six months ended June 30, 2012. The effective tax rate for the six months ended June 30, 2012 was calculated based on an estimated annual effective tax rate plus discrete items, such as return to provision adjustments. The change in income taxes for the six months ended June 30, 2013 compared to the six months ended June 30, 2012 was primarily due to the change in overall income level, the change in the proportion of U.S. versus foreign income, a favorable settlement of a German tax examination in the second quarter of 2013, and the 2012 U.S. research and development tax credit, which was retroactively reinstated by the American Taxpayer Relief Act of 2012 signed into law on January 2, 2013 and recorded as a tax benefit as of June 30, 2013.

As of June 30, 2013, we estimated that the Company will have no U.S. net operating loss ( NOL ) carryforwards. All U.S. NOLs have been utilized due to the taxable gain arising from the sale of Angel.com. In addition, the Company was able to recognize and utilize the NOLs arising directly from tax deductions related to equity compensation in excess of compensation recognized for financial reporting that was generated primarily in the prior years. Accordingly, equity increased by \$23.6 million during the six months ended June 30, 2013. As of June 30, 2013, foreign NOL carryforwards, other temporary differences and carryforwards, and credits resulted in deferred tax assets, net of valuation allowances and deferred tax liabilities, of \$21.0 million. As of June 30, 2013, we had a valuation allowance of \$0.2 million primarily related to certain foreign NOL carryforwards.

Except as discussed below, we intend to indefinitely reinvest the accumulated undistributed earnings of certain foreign subsidiaries. Therefore, the income tax benefit for the period ended June 30, 2013 did not include any provision for U.S. federal and state taxes on the amount of the undistributed foreign earnings. U.S. federal tax laws, however, require us to include in our 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 our U.S. federal income tax return, we regularly repatriate Subpart F deemed dividends to the U.S. and no additional tax is incurred on the distribution. As of June 30, 2013 and December 31, 2012, the amount of cash and cash equivalents and short-term investments, excluding those held-for-sale, held by U.S. entities was \$106.3 million and \$39.2 million, respectively, and by non-U.S. entities was \$211.5 million and \$183.8 million, respectively. If the cash and cash equivalents and short-term investments held by non-U.S. entities were to be repatriated to the U.S., we would generate U.S. taxable income to the extent of our undistributed foreign earnings, which amounted to \$184.0 million at December 31, 2012. Although the tax impact of repatriating these earnings is difficult to determine, we would not expect the maximum effective tax rate that would be applicable to such repatriation to exceed the U.S. statutory rate of 35.0%, after considering applicable foreign tax credits.

**Table of Contents****Discontinued Operations**

On February 25, 2013, we committed to a plan to sell our Angel.com business. We have reported this business as discontinued on our Consolidated Statements of Operations because we have no continuing involvement with or cash flows from this business following its divestiture.

On March 15, 2013, we completed the sale of our equity interest in Angel.com and received consideration of approximately \$111.2 million, resulting in a net cash inflow of \$100.7 million after \$10.5 million in transaction costs. The sale resulted in a gain of \$57.4 million, net of tax. We reclassified revenues and expenses associated with the Angel.com business to discontinued operations for all periods presented. The following table summarizes the gain from the sale of discontinued operations, net of tax, and loss from discontinued operations, net of tax, (in thousands) and percentage changes for the periods indicated:

	Three Months			Six Months Ended		
	Ended		% Change	June 30,		% Change
	2013	2012		2013	2012	
Gain on sale of discontinued operations, net of tax	\$ 0	\$ 0	n/a	\$ 57,377	\$ 0	n/a
Loss from discontinued operations, net of tax	\$ 0	\$ 657	-100.0%	\$ 595	\$ 1,446	-58.9%

**Deferred Revenue and Advance Payments**

Deferred revenue and advance payments represent product support, subscription services, and other services fees that are collected in advance and recognized over the contract service period and product licenses revenues relating to multiple element software arrangements that include future deliverables.

The following table summarizes deferred revenue and advance payments (in thousands), as of:

	June 30, 2013	December 31, 2012	June 30, 2012
<b>Current:</b>			
Deferred product licenses revenue	\$ 11,125	\$ 12,252	\$ 9,044
Deferred product support revenue	149,280	145,343	136,815
Deferred subscription services revenue	7,968	6,569	1,644
Deferred other services revenue	14,612	15,650	14,049
Gross current deferred revenue and advance payments	182,985	179,814	161,552
Less: unpaid deferred revenue	(74,830)	(78,565)	(56,590)
Net current deferred revenue and advance payments	\$ 108,155	\$ 101,249	\$ 104,962
<b>Non-current:</b>			
Deferred product licenses revenue	\$ 3,306	\$ 3,280	\$ 3,033
Deferred product support revenue	6,709	8,205	8,379
Deferred subscription services revenue	792	696	802
Deferred other services revenue	1,749	1,184	815
Gross non-current deferred revenue and advance payments	12,556	13,365	13,029
Less: unpaid deferred revenue	(3,102)	(4,542)	(2,668)
Net non-current deferred revenue and advance payments	\$ 9,454	\$ 8,823	\$ 10,361

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We offset our accounts receivable and deferred revenue for any unpaid items included in deferred revenue and advance payments.

Total gross deferred revenue and advance payments increased \$2.4 million as of June 30, 2013, as compared to December 31, 2012, primarily due to an increase in the number of technical support and subscription services contracts in our installed customer base, partially offset by the recognition of previously deferred product licenses, and other services revenues. Total gross deferred



## **Table of Contents**

revenue and advance payments increased \$21.0 million as of June 30, 2013, as compared to June 30, 2012, primarily due to increases in the number of product licenses, product support, subscription services, and other services contracts in our installed customer base.

We expect to recognize approximately \$183.0 million of deferred revenue and advance payments over the next 12 months. However, the timing and ultimate recognition of our deferred revenue and advance payments depend on our performance of various service obligations, and the amount of deferred revenue and advance payments at any date should not be considered indicative of revenues for any succeeding period.

As of June 30, 2013, we had entered into certain additional agreements that include future minimum commitments by our customers to purchase products, product support, or other services through 2018, totaling approximately \$111.4 million. Revenue relating to such future commitments by our customers is not included in our deferred revenue balances.

Revenue relating to such agreements will be recognized during the period in which all revenue recognition criteria are met. The timing and ultimate recognition of any revenue from such customer purchase commitments depend on our customers meeting their future purchase commitments and our meeting our associated performance obligations related to those purchase commitments.

## **Liquidity and Capital Resources**

**Liquidity.** Our principal sources of liquidity are cash and cash equivalents and on-going collection of our accounts receivable. Cash and cash equivalents include holdings in bank demand deposits and U.S. Treasury bills. We also periodically invest a portion of our excess cash in short-term investments with stated maturity dates between three months and one year from the purchase date.

As of June 30, 2013 and December 31, 2012, the amount of cash and cash equivalents and short-term investments, excluding those held-for-sale, held by U.S. entities were \$106.3 million and \$39.2 million, respectively, and by non-U.S. entities were \$211.5 million and \$183.8 million, respectively. We earn a significant amount of our revenues outside the U.S. and, except for Subpart F deemed dividends, we intend to indefinitely reinvest undistributed earnings of certain non-U.S. entities. We do not anticipate needing to repatriate the cash or cash equivalents and short-term investments held by non-U.S. entities to the U.S. to finance our U.S. operations. However, if we were to elect to repatriate these amounts, we would generate U.S. taxable income to the extent of our undistributed foreign earnings, which amounted to \$184.0 million at December 31, 2012. Although the tax impact of repatriating these earnings is difficult to determine and our effective tax rate could increase as a result of any such repatriation, we would not expect the maximum effective tax rate that would be applicable to such repatriation to exceed the U.S. statutory rate of 35.0%, after considering applicable foreign tax credits.

On March 15, 2013, we completed the sale of our equity interest in Angel.com to Genesys Telecommunications Laboratories, Inc. for consideration of approximately \$111.2 million, resulting in a net cash inflow of \$100.7 million after \$10.5 million in transaction costs. The sale resulted in a gain of \$57.4 million, net of tax. The net proceeds from the sale of Angel.com helped strengthen our balance sheet and will be used for general corporate purposes.

We believe that existing cash and cash equivalents and short-term investments held by us and cash and cash equivalents anticipated to be generated by us are sufficient to meet working capital requirements, anticipated capital expenditures, and contractual obligations for at least the next 12 months.

**Table of Contents**

The following table sets forth a summary of our cash flows from continuing operations (in thousands) and related percentage changes for the periods indicated:

	Six Months Ended		
	June 30,		%
	2013	2012	Change
Net cash (used in) provided by operating activities from continuing operations	\$ (15,950)	\$ 22,435	-171.1%
Net cash used in investing activities from continuing operations	\$ (139,784)	\$ (25,068)	457.6%
Net cash provided by financing activities from continuing operations	\$ 23,597	\$ 2,947	700.7%

**Net Cash Used in Operating Activities from Continuing Operations.** The primary source of our cash provided by operating activities from continuing operations is cash collections of our accounts receivable from customers following the sales and renewals of our software licenses, technical software support, software updates and upgrades, as well as consulting, education, subscription services, and other services. Our primary uses of cash from operating activities are for personnel related expenditures for software development, personnel related expenditures for providing consulting, education, and other services, and for sales and marketing costs, general and administrative costs, and income taxes.

Net cash used in operating activities from continuing operations was \$16.0 million for the six months ended June 30, 2013. Net cash provided by operating activities from continuing operations was \$22.4 million for the six months ended June 30, 2012. The decrease in net cash provided by operating activities from continuing operations during the six months ended June 30, 2013, as compared to the same period in the prior year, was primarily due to a \$33.4 million decrease from changes in non-cash items and a \$15.7 million decrease in income from continuing operations, partially offset by a \$10.8 million change in operating assets and liabilities. Non-cash items primarily consist of depreciation and amortization, bad debt expense, deferred taxes, and excess tax benefits from share-based compensation arrangements.

**Net Cash Used in Investing Activities from Continuing Operations.** The changes in net cash used in investing activities from continuing operations primarily relate to purchases of short-term investments, expenditures on property, plant and equipment, capitalized software development costs, and receipts of insurance proceeds related to our owned corporate aircraft. Net cash used in investing activities from continuing operations was \$139.8 million and \$25.1 million for the six months ended June 30, 2013 and 2012, respectively. The increase in net cash used in investing activities for the six months ended June 30, 2013, as compared to the same period in the prior year, was primarily due to \$129.0 million increase in purchases of short-term investments and a \$3.2 million decrease in the amount of insurance proceeds received related to our owned corporate aircraft, which was damaged in the first quarter of 2010 and subsequently repaired and returned to service in the second quarter of 2012, partially offset by a \$14.3 million decrease in purchases of property and equipment, comprised primarily of decreases in computer equipment purchases, expenditures associated with repairs to our owned corporate aircraft, and leasehold improvements and a \$3.3 million decrease in capitalized software development costs.

**Net Cash Provided by Financing Activities from Continuing Operations.** The changes in net cash provided by financing activities primarily relate to the exercise of employee stock options. Net cash provided by financing activities from continuing operations was \$23.6 million and \$2.9 million for the six months ended June 30, 2013 and 2012, respectively. The increase in net cash provided by financing activities from continuing operations for the six months ended June 30, 2013, as compared to the same period in the prior year, was primarily due to a \$23.6 million increase in excess tax benefits, generated primarily from stock option exercises in previous years, that were recognized in the current year due to the taxable gain arising from the sale of Angel.com.

**Contractual Obligations.** As disclosed in Note 7, Commitments and Contingencies, to the Consolidated Financial Statements, we lease office space and computer and other equipment under operating lease agreements. We also lease certain computer and other equipment under capital lease agreements and license certain software under other financing arrangements. Under the lease agreements, in addition to base rent, we are generally responsible for certain taxes, utilities and maintenance costs, and other fees; and several leases include options for renewal or purchase. The following table shows future minimum rent payments under noncancellable operating and capital leases and agreements with initial terms of greater than one year, net of total future minimum rent payments to be received under noncancellable sublease agreements (in thousands), based on the expected due dates of the various installments as of June 30, 2013:

	Total	Payments due by period ended June 30,			Thereafter
		2014	2015-2016	2017-2018	
<b>Contractual Obligations:</b>					
Operating leases	\$ 122,677	\$ 24,257	\$ 36,051	\$ 27,737	\$ 34,632

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Capital leases and other financing arrangements	5,774	2,375	3,371	28	0
Total	\$ 128,451	\$ 26,632	\$ 39,422	\$ 27,765	\$ 34,632

## **Table of Contents**

**Unrecognized Tax Benefits.** As of June 30, 2013, we had \$16.2 million of total gross unrecognized tax benefits, including interest accrued. The unrecognized tax benefits are recorded in other long-term liabilities. The timing of any payments which could result from these unrecognized tax benefits will depend on a number of factors, and accordingly the amount and period of any future payments cannot be estimated. We do not expect a significant tax payment related to these obligations within the next year.

**Off-Balance Sheet Arrangements.** As of June 30, 2013, we did not have any off-balance sheet arrangements that had or were reasonably likely to have a current or future material impact on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures, or capital resources.

## **Recent Accounting Standards**

In February 2013, the Financial Accounting Standards Board ( FASB ) issued Accounting Standards Update No. 2013-02, *Comprehensive Income (Topic 220)* ( ASU 2013-02 ), which established the effective date for the requirement to present components of reclassifications out of accumulated other comprehensive income either in a single note or parenthetically on the face of the financial statements. ASU 2013-02 is effective for interim and annual periods beginning after December 15, 2012. The adoption of this guidance did not have a material effect on the Company's consolidated financial position, results of operations, or cash flows.

## **Item 3. Quantitative and Qualitative Disclosures About Market Risk**

The following discussion about our market risk exposures involves forward-looking statements. Actual results could differ materially from those projected in the forward-looking statements.

We are exposed to the impact of both interest rate changes and foreign currency fluctuations.

**Interest Rate Risk.** We face exposure to changes in interest rates primarily relating to our investments. We generally invest our excess cash in short-term, highly-rated, fixed-rate financial instruments. These fixed-rate instruments are subject to interest rate risk and may fall in value if interest rates increase. As of June 30, 2013, we held approximately \$129.1 million of investments in U.S. Treasury securities with stated maturity dates between three months and one year from the purchase date, and we intend to hold these investments until maturity.

**Foreign Currency Risk.** 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. International revenues accounted for 39.6% and 40.1% of our total revenues from continuing operations for the three months ended June 30, 2013 and 2012, respectively, and 40.1% and 41.5% of our total revenues from continuing operations for the six months ended June 30, 2013 and 2012, respectively. We anticipate that international revenues will continue to account for a significant portion of our total revenues. The functional currency of each of our foreign subsidiaries is the local currency.

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**Table of Contents**

Assets and liabilities of our foreign subsidiaries are translated into U.S. dollars at exchange rates in effect as of the applicable balance sheet date and any resulting translation adjustments are included as an adjustment to stockholders' equity. Revenues and expenses generated from these subsidiaries are translated at average monthly exchange rates during the quarter in which the transactions occur. Gains and losses from transactions in local currencies are included in net income.

As a result of transacting in multiple currencies and reporting our financial statements in U.S. dollars, our operating results may be adversely impacted by currency exchange rate fluctuations in the future. The impact of foreign currency exchange rate fluctuations on current and comparable periods is described in Item 2, Management's Discussion and Analysis of Financial Condition and Results of Operations.

We cannot predict the effect of exchange rate fluctuations upon our future results. We attempt to minimize our foreign currency risk by converting our excess foreign currency held in foreign jurisdictions to U.S. dollar denominated cash and investment accounts. In addition, beginning in the three months ended June 30, 2013, we have entered into foreign currency forward contracts to hedge certain risks associated with foreign currency exchange exposure. We manage the use of foreign exchange derivative instruments centrally, and we do not hold or enter into derivative financial instruments for speculative trading purposes. We cannot be sure that our hedging techniques will be successful or that our business, results of operations, financial condition, and cash flows will not be materially adversely affected by exchange rate fluctuations.

As of June 30, 2013 and December 31, 2012, a 10% adverse change in foreign currency exchange rates versus the U.S. dollar, before applying the impact of our foreign currency forward contracts, would have decreased our aggregate reported cash and cash equivalents and short-term investments by 0.3% and 0.7%, respectively. The decrease in exposure as of June 30, 2013 was primarily due to an increase in domestic cash resulting from the Angel.com sale and a decrease of cash balances in our non-U.S. dollar based bank accounts as compared to the prior year. Our foreign currency forward contracts have the effect of decreasing the exposure on our aggregate reported cash and cash equivalents and short-term investments to less than 0.1% as of June 30, 2013. If average exchange rates during the six months ended June 30, 2013 had changed unfavorably by 10%, our revenues for the six months ended June 30, 2013 would have decreased by 3.6%. During the six months ended June 30, 2013, our revenues decreased 0.8% as a result of a 1.5% unfavorable change in weighted average exchange rates, as compared to the same period in the prior year.

**Item 4. Controls and Procedures**

**Evaluation of disclosure controls and procedures.** Our management, with the participation of our chief executive officer and chief financial officer, evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of the end of the period covered by this quarterly report. Management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Our disclosure controls and procedures are designed to provide reasonable assurance of achieving their control objectives. Based on the evaluation of our disclosure controls and procedures as of the end of the period covered by this quarterly report, our chief executive officer and chief financial officer concluded that, as of such date, our disclosure controls and procedures were effective at the reasonable assurance level.

**Changes in internal controls.** No change in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) occurred during the fiscal quarter ended June 30, 2013 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

**Table of Contents**

**PART II - OTHER INFORMATION**

**Item 1. Legal Proceedings**

In December 2011, DataTern, Inc. ( DataTern ) filed a complaint for patent infringement against the Company in the United States District Court for the District of Massachusetts. The complaint alleged that the Company infringes U.S. Patent No. 6,101,502 (the 502 Patent ), allegedly owned by DataTern, by making, selling, or offering for sale several of the Company s products and services including MicroStrategy 9, MicroStrategy Intelligence Server, MicroStrategy Business Intelligence Platform, MicroStrategy Cloud Personal, and other MicroStrategy applications for creating or using data mining, dashboards, business analytics, data storage and warehousing, and web hosting support. The complaint accused the Company of willful infringement and sought an unspecified amount of damages, an award of attorneys fees, and preliminary and permanent injunctive relief. In October 2012, the case was stayed pending final judgment in a separate action involving the 502 Patent filed by DataTern in the Southern District of New York, in which MicroStrategy was not a party. Final judgment in that separate action was entered against DataTern in December 2012. In February 2013, MicroStrategy and DataTern filed motions for summary judgment of non-infringement in light of the New York judgment and the Court entered summary judgment against DataTern. In March 2013, DataTern filed a notice of appeal. The Company filed its brief in opposition on July 25, 2013. We have received indemnification requests from certain of our resellers who were sued by DataTern in the United States District Court for the District of Massachusetts in lawsuits alleging infringement of the 502 Patent. The outcome of these matters is not presently determinable.

In December 2011, Vasudevan Software, Inc. ( Vasudevan ) filed a complaint for patent infringement against the Company in the United States District Court for the Northern District of California. The complaint alleged that the Company s sale of MicroStrategy 9 and other MicroStrategy products infringes four patents allegedly owned by Vasudevan known as U.S. Patent Nos. 6,877,006, 7,167,864, 7,720,861, and 8,082,268, all entitled Multimedia Inspection Database System for Dynamic Runtime Evaluation. The complaint accused the Company of infringement, inducing others to infringe, and acts of contributory infringement with respect to the patents at issue and sought a permanent injunction, an unspecified amount of damages, and other relief as may be granted by the court. The Company filed its answer to the Vasudevan complaint and pled inequitable conduct counterclaims in March 2012. On June 5, 2013, each party filed motions for summary judgment. Trial is scheduled to begin on November 18, 2013. The outcome of this matter is not presently determinable.

We are also 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, we do not expect the resolution of these other legal proceedings to have a material adverse effect on our financial position, results of operations, or cash flows.

## **Table of Contents**

### **Item 1A. Risk Factors**

You should carefully consider the risks described below before making an investment decision. The risks and uncertainties described below are not the only ones facing MicroStrategy. Additional risks and uncertainties not presently known to us or that we currently deem immaterial may also impair our business operations.

If any of the following risks actually occur, our business, financial condition, or results of operations could be materially adversely affected. In such case, the market price of our class A common stock could decline and you may lose all or part of your investment.

#### **Our quarterly operating results, revenues, and expenses may fluctuate significantly, which could have an adverse effect on the market price of our stock**

For a number of reasons, including those described below, our operating results, revenues, and expenses have in the past varied and may in the future vary significantly from quarter to quarter. These fluctuations could have an adverse effect on the market price of our class A common stock.

*Fluctuations in Quarterly Operating Results.* Our quarterly operating results may fluctuate, in part, as a result of:

the size, timing, volume, and execution of significant orders and shipments;

the mix of products and services ordered by customers, including product licenses and subscription offerings, which can affect the extent to which revenue is recognized immediately or over future quarterly periods;

the timing of the release or delivery of new or enhanced offerings, which may affect the period in which we are able to recognize revenue;

the timing of announcements of new offerings by us or our competitors;

changes in our pricing policies or those of our competitors;

market acceptance of new and enhanced versions of our products and services;

the length of our sales cycles;

seasonal or other buying patterns of our customers;

changes in our operating expenses;

planned major maintenance activities related to our owned corporate aircraft;

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the timing of research and development projects and the capitalization of software development costs;

personnel changes;

our use of channel partners;

utilization of our consulting and education services, which can be affected by delays or deferrals of customer implementation of our software products;

changes in foreign currency exchange rates;



## **Table of Contents**

our profitability and expectations for future profitability and its effect on our deferred tax assets and net income for the period in which any adjustment to our net deferred tax asset valuation allowance may be made;

increases or decreases in our liability for unrecognized tax benefits; and

changes in customer budgets.

*Limited Ability to Adjust Expenses.* We base our operating expense budgets on expected revenue trends. Many of our expenses, such as office leases, corporate aircraft arrangements, and certain personnel costs, are relatively fixed. We may be unable to adjust spending quickly enough to offset any unexpected revenue shortfall. Accordingly, any shortfall in revenue may cause significant variation in operating results in any quarter.

Based on the above factors, we believe that quarter-to-quarter comparisons of our operating results are not a good indication of our future performance. It is possible that in one or more future quarters, our operating results may be below the expectations of public market analysts and investors. In that event, the market price of our class A common stock may fall.

### **The market price of our class A common stock has been and may continue to be volatile**

The market price of our class A common stock historically has been volatile and may continue to be volatile. The market price of our class A common stock may fluctuate widely in response to various factors, some of which are beyond our control. These factors include, but are not limited to:

quarterly variations in our results of operations or those of our competitors;

announcements about our earnings that are not in line with analyst expectations, the likelihood of which may be enhanced because it is our policy not to give guidance relating to our anticipated financial performance in future periods;

announcements by us or our competitors of acquisitions, dispositions, new offerings, significant contracts, commercial relationships, or capital commitments;

the emergence of new sales channels in which we are unable to compete effectively;

our ability to develop, market, and deliver new and enhanced offerings on a timely basis;

commencement of, or our involvement in, litigation;

any major change in our board or management;

changes in governmental regulations or in the status of our regulatory approvals;

recommendations by securities analysts or changes in earnings estimates;

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announcements by our competitors of their earnings that are not in line with analyst expectations;

the volume of shares of class A common stock available for public sale;

sales or purchases of stock by us or by our stockholders;

short sales, hedging, and other derivative transactions involving shares of our class A common stock; and

general economic conditions and slow or negative growth of related markets.

## **Table of Contents**

In addition, the stock market in general, and the market for technology companies in particular, have experienced extreme price and volume fluctuations that have often been unrelated or disproportionate to the operating performance of technology companies. These broad market and industry factors may seriously harm the market price of our class A common stock, regardless of our actual operating performance.

### **We incurred a loss from continuing operations in the first half of 2013 and we may not generate profits in the future**

We generated a loss from continuing operations for the six months ended June 30, 2013 and we may not generate profits on a quarterly or annual basis in the future.

Over the course of 2012 and the first half of 2013, we increased our headcount as part of our initiatives to focus specific research and development efforts on providing our customers with high levels of performance for BI applications of all sizes and introducing a number of innovative technologies designed to enable companies to capitalize on the big data, mobile applications, cloud-based services, and social networking trends in the marketplace. As a result, our cost of revenues and operating expenses have significantly increased. If our revenues do not increase sufficiently to offset these increased operating expenses, or we are unable to timely adjust our operating expenses, we may continue to incur operating losses. As a result, our business, results of operations, and financial condition may be materially adversely affected.

As of June 30, 2013, we had \$23.3 million of deferred tax assets, net of a \$0.2 million valuation allowance, and if we do not generate profits in the future, we may be required to increase the valuation allowance against these deferred tax assets, which could result in a charge that would materially adversely affect net income in the period in which the charge is incurred.

### **Economic uncertainty, particularly in the financial services and retail industries, could materially adversely affect our business and results of operations**

General worldwide economic conditions remain uncertain. Economic uncertainty, such as uncertainty in connection with the various European sovereign debt crises, issues related to the United States debt ceiling and tax rates, and associated macroeconomic conditions, makes it extremely difficult for our customers and us to accurately forecast and plan future business activities, and could cause our customers to slow spending on our products and services, which could delay and lengthen sales cycles. Furthermore, during uncertain economic times our customers may face issues gaining timely access to sufficient credit, which could result in an impairment of their ability to make timely payments to us. If that were to occur, we may be required to increase our allowance for doubtful accounts and our results would be negatively impacted.

Furthermore, we have a significant number of customers in the financial services and retail industries. A significant downturn in these industries may cause organizations to react by reducing their capital expenditures in general or by specifically reducing their spending on information technology. In addition, customers in these industries may delay or cancel information technology projects or seek to lower their costs by renegotiating vendor contracts. Customers with excess information technology resources may choose to develop in-house software solutions rather than obtain those solutions from us. Moreover, competitors may respond to challenging market conditions by lowering prices and attempting to lure away our customers. In addition, consolidation in the financial services industry may result in reduced overall spending on our products and services.

We cannot predict the timing, strength, or duration of any economic slowdown or any subsequent recovery generally, or in the financial services and retail industries in particular. If the conditions in the general economy and the markets in which we operate worsen from present levels, our business, financial condition, and results of operations could be materially adversely affected.

## **Table of Contents**

### **We may have exposure to greater than anticipated tax liabilities**

We are subject to income taxes and non-income taxes in a variety of domestic and foreign jurisdictions. Our future income taxes could be materially adversely affected by earnings that are lower than anticipated in jurisdictions where we have lower statutory rates and earnings that are higher than anticipated in jurisdictions where we have higher statutory rates, by changes in the valuation of our deferred tax assets and liabilities, changes in the amount of unrecognized tax benefits, or by changes in tax laws, regulations, accounting principles, or interpretations thereof.

Our determination of our tax liability is subject to review by applicable domestic and foreign tax authorities. For example, we are currently under tax examination in Spain. Any adverse outcome of such a review could have an adverse effect on our operating results and financial condition. The determination of our worldwide provision for income taxes and other tax liabilities requires significant judgment and, in the ordinary course of business, there are many transactions and calculations where the ultimate tax determination is uncertain. Moreover, as a multinational business, we have subsidiaries that engage in many intercompany transactions in a variety of tax jurisdictions where the ultimate tax determination is uncertain.

We also have contingent tax liabilities that, in management's judgment, are not probable of assertion. If such unasserted contingent liabilities were to be asserted, or become probable of assertion, we may be required to record significant expenses and liabilities in the period in which these liabilities are asserted or become probable of assertion.

As a result of these and other factors, the ultimate amount of tax obligations owed may differ from the amounts recorded in our financial statements and any such difference may materially affect our financial results in future periods in which we change our estimates of our tax obligations or in which the ultimate tax outcome is determined.

### **If the market for business intelligence offerings fails to grow as we expect, or if businesses fail to adopt our offerings, our business, operating results, and financial condition could be materially adversely affected**

Nearly all of our revenues to date have come from sales of business intelligence offerings and related technical support, consulting, and education services. We expect these sales to account for a large portion of our revenues for the foreseeable future. Although demand for business intelligence offerings has grown in recent years, the market for business intelligence offerings continues to evolve. Resistance from consumer and privacy groups to increased commercial collection and use of data on spending patterns and other personal behavior and governmental restrictions on the collection and use of personal data may impair the further growth of this market, as may other developments. We cannot be sure that this market will continue to grow or, even if it does grow, that businesses will adopt our solutions.

We have spent, and intend to keep spending, considerable resources to educate potential customers about business intelligence offerings in general and our offerings in particular. However, we cannot be sure that these expenditures will help any of our offerings achieve any additional market acceptance. If the market fails to grow or grows more slowly than we currently expect, our business, operating results, and financial condition could be materially adversely affected.

## **Table of Contents**

### **Our business intelligence offerings face intense competition, which may lead to lower prices for our products and services, reduced gross margins, loss of market share, and reduced revenue**

The BI platform market is intensely competitive and subject to rapidly changing technology paradigms. Within the BI space, we compete with many different vendors, including (1) large software vendors (megavendors), such as IBM, SAP, Microsoft, and Oracle, that provide one or more products that directly compete with our offerings; (2) open source BI vendors like JasperSoft and Pentaho; (3) various independent BI software providers, such as QlikTech, Tableau Software, TIBCO, Actuate, Information Builders, and the SAS Institute; (4) pure-play mobile BI vendors, such as MeLLmo (Roambi), that do not offer a BI platform but offer a mobile user interface that can be used as an extension to existing BI platforms; (5) pure BI and information-driven apps built by other mobile app development platform (MADP) vendors, including independent MADP vendors, such as Antenna, Kony, and Verivo, and mobile framework vendors, such as Sencha and jQuery Mobile; and (6) other analytics SaaS vendors, such as GoodData and Birst. Our future success depends on the effectiveness with which we can compete across all different sizes of implementations. Failure to maintain adequate technology differentiation from these competitors could materially adversely affect our recurring software maintenance revenue, as well as new license revenue, from existing and prospective customers.

Some of our competitors have longer operating histories and significantly greater financial, technical, and marketing resources than we do. As a result, they may be able to respond more quickly to new or emerging technologies and changes in customer requirements or devote greater resources to the development, promotion, sale, and marketing of their offerings than we can, such as offering certain BI products free of charge when bundled with other software offerings. In addition, many of our competitors have strong relationships with current and potential customers, extensive industry and specialized business knowledge, as well as corresponding proprietary technologies that they can leverage, such as multidimensional databases and ERP repositories. As a result, they may be able to prevent MicroStrategy from penetrating new accounts or expanding within existing accounts.

Increased competition may lead to price cuts, reduced gross margins, and loss of market share. We may not be able to compete successfully against current and future competitors and the failure to meet the competitive pressures we face may have a material adverse effect on our business, operating results, and financial condition.

Current and future competitors may also make strategic acquisitions or establish cooperative relationships among themselves or with others. By doing so, these competitors may increase their ability to meet the needs of our potential customers by virtue of their expanded offerings. Our current or prospective channel partners may establish cooperative relationships with our current or future competitors. These relationships may limit our ability to sell our BI offerings through specific distribution channels. Accordingly, new competitors or alliances among current and future competitors may emerge and rapidly gain significant market share. These developments could limit our ability to obtain revenues from new customers and to sustain software maintenance revenues from our installed customer base. In addition, basic office productivity software suites, such as Microsoft Office, could evolve to offer analysis and reporting capabilities that may reduce the demand for our BI offerings.

### **We depend on revenue from a single suite of products and related services**

Our MicroStrategy Analytics Platform and related products and services account for a substantial portion of our revenue. Because of this revenue concentration, our business could be harmed by a decline in demand for, or in the prices of, our MicroStrategy Analytics Platform software as a result of, among other factors, any change in our pricing model, increased competition, a maturation in the markets for these products, or other risks described in this document.

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## **Table of Contents**

### **If we are unable to develop and release product enhancements and new offerings to respond to rapid technological change in a timely and cost-effective manner, our business, operating results, and financial condition could be materially adversely affected**

The market for our offerings is characterized by rapid technological change, frequent new product introductions and enhancements, changing customer demands, and evolving industry standards. The introduction of offerings embodying new technologies can quickly make existing offerings obsolete and unmarketable. We believe that our future success depends largely on three factors:

our ability to continue to support a number of popular operating systems and databases;

our ability to maintain and improve our current offerings; and

our ability to rapidly develop new offerings and product enhancements that achieve market acceptance, maintain technological competitiveness, and meet an expanding range of customer requirements.

Business intelligence applications are inherently complex, and it can take a long time and require significant research and development expenditures to develop and test new offerings and product enhancements. In addition, customers may delay their purchasing decisions because they anticipate that new or enhanced versions of our offerings will soon become available. We cannot be sure that we will succeed in developing, marketing, and delivering on a timely and cost-effective basis new or enhanced offerings that respond to technological change or new customer requirements, nor can we be sure that any new or enhanced offerings will achieve market acceptance. Moreover, even if we introduce a new offering, we may experience a decline in revenues of our existing offerings that is not fully matched by the new offering's revenue. For example, customers may delay making purchases of a new offering to permit them to make a more thorough evaluation of the offering, or until industry and marketplace reviews become widely available. Some customers may hesitate migrating to a new offering due to concerns regarding the complexity of migration and product infancy issues on performance. In addition, we may lose existing customers who choose a competitor's offering rather than migrate to our new offering. This could result in a temporary or permanent revenue shortfall and materially adversely affect our business.

### **The introduction of our MicroStrategy Cloud offerings could affect the timing of revenue recognition and materially adversely affect our operating results**

While we have historically offered our BI platform principally in the form of a perpetual software license, we recently introduced MicroStrategy Cloud, a cloud-based BI PaaS that is available by subscription. The payment streams and revenue recognition timing for our perpetual software licenses are different from those for our subscription services. For perpetual software licenses, customers typically pay us a lump sum soon after entering into a software license agreement and revenue is typically recognized upon delivery of the software to the customer. For subscription services, customers typically make periodic payments over the subscription period and revenue is typically recognized ratably over the subscription period. As a result, if a substantial number of current or new customers shift to subscribing to MicroStrategy Cloud instead of purchasing perpetual software licenses for the MicroStrategy Analytics Platform, the resulting change in payment terms and revenue recognition may materially adversely affect our operating results for the reporting periods during which such a shift occurs.

### **Our investment in new business strategies and initiatives could disrupt the operations of our ongoing business and present risks that we have not adequately anticipated**

We have invested, and in the future may invest, in new business strategies and initiatives. For example, in recent years we have introduced a number of innovative technologies designed to enable companies to capitalize on the big data, mobile applications, cloud-based services, and social networking trends in the marketplace. These endeavors may involve significant risks and uncertainties, including distraction of management from other business operations, the dedication of significant research and development, sales and marketing, and other resources to these new initiatives at the expense of our other business operations,

## **Table of Contents**

generation of insufficient revenue to offset expenses associated with new initiatives, incompatibility of our new technologies with third party platforms, inadequate return of capital, and other risks that we may not have adequately anticipated. For example, we have expended significant resources in the development and marketing of MicroStrategy Express, the MicroStrategy Loyalty Platform, and the MicroStrategy Identity Platform, none of which have generated significant revenues to date. Because new strategies and initiatives are inherently risky, these strategies and initiatives may not be successful and could materially adversely affect our financial condition and operating results.

### **Business disruptions could materially adversely affect our operating results**

A significant portion of our research and development activities and certain other critical business operations are concentrated in facilities in Northern Virginia and two cities in China (Hangzhou and Beijing), and certain other critical business operations are concentrated in facilities in Northern Virginia and Warsaw, Poland. We are also a highly automated business and a disruption or failure of our systems could cause delays in completing sales and providing services. A major earthquake, fire, act of terrorism, or other catastrophic event that results in the destruction or disruption of any of our critical business operations or information technology systems could severely affect our ability to conduct normal business operations and as a result our future operating results could be materially adversely affected.

### **We use channel partners and if we are unable to maintain successful relationships with them, our business, operating results, and financial condition could be materially adversely affected**

In addition to our direct sales force, we use channel partners such as resellers, value-added resellers, system integrators and consulting firms, original equipment manufacturers, and technology partners to license and support our products. For the six months ended June 30, 2013, transactions by channel partners for which we recognized revenues accounted for 21.9% of our total product licenses revenues. Our channel partners generally offer customers the products and services of several different companies, including offerings that compete with ours. Because our channel partners generally do not have an exclusive relationship with us, we cannot be certain that they will prioritize or provide adequate resources to selling our products. Moreover, divergence in strategy or contract defaults by any of these channel partners may materially adversely affect our ability to develop, market, sell, or support our offerings.

Although we believe that direct sales will continue to account for a majority of product licenses revenues, we seek to maintain a significant level of sales activities through our channel partners. There can be no assurance that our channel partners will continue to cooperate with us. In addition, actions taken or omitted to be taken by such parties may materially adversely affect us. Our ability to achieve revenue growth in the future will depend in part on our ability to maintain successful relationships with our channel partners. If we are unable to maintain our relationships with these channel partners, our business, operating results, and financial condition could be materially adversely affected.

In addition, we rely on our channel partners to operate in accordance with the terms of their contractual agreements with us. For example, our agreements with our channel partners limit the terms and conditions pursuant to which they are authorized to resell or distribute our software and offer technical support and related services. We also typically require our channel partners to represent to us the dates and details of product licenses transactions sold through to end user customers. If our channel partners do not comply with their contractual obligations to us, our business, results of operations, and financial condition may be materially adversely affected.

### **Our recognition of deferred revenue and advance payments and future customer purchase commitments is subject to future performance obligations and may not be representative of revenues for succeeding periods**

Our gross current and non-current deferred revenue and advance payments totaled \$195.5 million as of June 30, 2013. We offset our accounts receivable and deferred revenue for any unpaid items, which totaled \$77.9 million, resulting in net current and non-current deferred revenue and advance payments of \$117.6 million as of June 30, 2013. The timing and ultimate recognition of our deferred revenue and advance payments depend on various factors, including our performance of various service obligations.

## **Table of Contents**

We have entered into certain additional agreements that include future minimum commitments by our customers to purchase products, product support, or other services through 2018 totaling \$111.4 million. These future commitments are not included in our deferred revenue balances. Because of the possibility of customer changes or delays in customer development or implementation schedules or budgets, and the need for us to satisfactorily perform product support and other services, deferred revenue and advance payments at any particular date may not be representative of actual revenue for any succeeding period.

### **Our international operations are complex and expose us to risks that could have a material adverse effect on our business, operating results, and financial condition**

We receive a significant portion of our total revenues from international sales, and are seeking to expand our business activities in various foreign countries, including some emerging markets where we have limited experience, where the challenges of conducting our business can be significantly different from those we have faced in more developed markets, and where business practices may create internal control risks. International revenues accounted for 39.6% and 40.1% of our total revenues from continuing operations for the three months ended June 30, 2013 and 2012, respectively, and 40.1% and 41.5% of our total revenues from continuing operations for the six months ended June 30, 2013 and 2012, respectively. Our international operations require significant management attention and financial resources.

There are certain risks inherent in our international business activities including:

fluctuations in foreign currency exchange rates;

new, or changes in, regulatory requirements;

tariffs, export restrictions, and other trade barriers;

costs of localizing offerings;

lack of acceptance of localized offerings;

difficulties in and costs of staffing, managing, and operating our international operations;

tax issues, including restrictions on repatriating earnings;

weaker intellectual property protection;

economic weakness or currency related crises;

the burden of complying with a wide variety of laws, including labor laws;

generally longer payment cycles and greater difficulty in collecting accounts receivable;



our ability to adapt to sales practices and customer requirements in different cultures; and

political instability in the countries where we are doing business.

As part of its 2014 budget proposal, the Obama Administration released a set of corporate tax reform proposals in April 2013; in addition, various corporate tax reform bills are currently under consideration by Congress. These proposals include unspecified corporate income tax rate cuts, the reduction or elimination of certain corporate tax incentives, modifications to the existing regime for taxing overseas earnings, and measures to prevent base erosion and profit shifting. It is not clear whether, or to what extent, these proposals may be enacted. Significant changes to the U.S. taxation of our international income could have a material adverse effect on our results of operations.

## **Table of Contents**

From time to time, we may undertake various potential intercompany transactions and legal entity restructurings that involve our international subsidiaries. We consider various factors in evaluating these potential transactions and restructurings, including the alignment of our corporate structure with our organizational objectives, the operational and tax efficiency of our corporate structure, and the long-term cash flows and cash needs of our business. Such transactions and restructurings could negatively impact our overall tax rate and result in additional tax liabilities.

In addition, compliance with foreign and U.S. laws and regulations that are applicable to our international operations is complex and may increase our cost of doing business in international jurisdictions, and our international operations could expose us to fines and penalties if we fail to comply with these regulations. These laws and regulations include import and export requirements and anti-bribery laws, such as the U.S. Foreign Corrupt Practices Act, the U.K. Bribery Act, and local laws prohibiting corrupt payments to governmental officials. Although we have implemented policies and procedures designed to help ensure compliance with these laws, there can be no assurance that our employees, partners, and other persons with whom we do business will not take actions in violation of our policies or these laws. Any violations of these laws could subject us to civil or criminal penalties, including substantial fines or prohibitions on our ability to offer our products and services to one or more countries, and could also materially damage our reputation, our brand, and our international expansion efforts.

These factors may have a material adverse effect on our future sales and, consequently, on our business, operating results, and financial condition.

### **We may lose sales, or sales may be delayed, due to the long sales and implementation cycles for our products, which could reduce our revenues**

To date, our customers have typically invested substantial time, money, and other resources and involved many people in the decision to license our software products and purchase our consulting and other services. As a result, we may wait nine months or more after the first contact with a customer for that customer to place an order while it seeks internal approval for the purchase of our products or services. During this long sales cycle, events may occur that affect the size and/or timing of the order or even cause it to be canceled. For example, our competitors may introduce new offerings, or the customer's own budget and purchasing priorities may change.

Even after an order is placed, the time it takes to deploy our products and complete consulting engagements can vary widely. Implementing our offerings can take several months, depending on the customer's needs, and may begin only with a pilot program. It may be difficult to deploy our products if the customer has complicated deployment requirements, which typically involve integrating databases, hardware, and software from different vendors. If a customer hires a third party to deploy our products, we cannot be sure that our products will be deployed successfully.

### **Our results in any particular period may depend upon the number and volume of large transactions in that period and these transactions may involve more lengthy, complex, and unpredictable sales cycles than other transactions**

As existing and potential customers seek to standardize on a single business intelligence vendor, our business may experience larger transactions at the enterprise level and larger transactions may account for a greater proportion of our business. The presence or absence of one or more large transactions in a particular period may have a material positive or negative effect on our revenue and operating results for that period. For the six months ended June 30, 2013 and 2012, our top three product licenses transactions with recognized revenue totaled \$3.9 million and \$9.1 million, respectively, or 6.6% and 13.1% of total product licenses revenues, respectively. These transactions represent significant business and financial decisions for our customers and require considerable effort on the part of customers to assess alternative products and require additional levels of management approval before being concluded. They are also often more complex than smaller transactions. These factors generally lengthen the typical sales cycle and increase

## **Table of Contents**

the risk that customers' purchasing decisions may be postponed or delayed from one period to another subsequent or later period or that customers will alter their purchasing requirements. The sales effort and service delivery scope for larger transactions also require additional resources to execute the transaction. These factors could result in lower than anticipated revenue and earnings for a particular period or in the reduction of estimated revenue and earnings in future periods.

### **We face a variety of risks in doing business with the U.S. and foreign governments, various state and local governments, and agencies, including risks related to the procurement process, budget constraints and cycles, termination of contracts, and compliance with government contracting requirements**

Our customers include the U.S. government and a number of state and local governments and agencies. There are a variety of risks in doing business with government entities, including:

*Procurement.* Contracting with public sector customers is highly competitive and can be time-consuming and expensive, requiring that we incur significant up-front time and expense without any assurance that we will win a contract.

*Budgetary Constraints and Cycles.* Demand and payment for our products and services are impacted by public sector budgetary cycles and funding availability, with funding reductions or delays adversely impacting public sector demand for our products and services.

*Termination of Contracts.* Public sector customers often have contractual or other legal rights to terminate current contracts for convenience or due to a default. If a contract is terminated for convenience, which can occur if the customer's needs change, we may only be able to collect fees for products or services delivered prior to termination and settlement expenses. If a contract is terminated because of default, we may not recover even those amounts, and we may be liable for excess costs incurred by the customer for procuring alternative products or services.

*Compliance with Government Contracting Requirements.* Government contractors are required to comply with a variety of complex laws, regulations, and contractual provisions relating to the formation, administration, or performance of government contracts that give public sector customers substantial rights and remedies, many of which are not typically found in commercial contracts. These may include rights with respect to price protection, the accuracy of information provided to the government, contractor compliance with socio-economic policies, and other terms that are particular to government contracts. U.S. government and state and local governments and agencies routinely investigate and audit contractors for compliance with these requirements. If, as a result of an audit or review, it is determined that we have failed to comply with these requirements, we may be subject to civil and criminal penalties and administrative sanctions, including termination of contracts, forfeiture of profits, cost associated with the triggering of price reduction clauses, fines, and suspensions or debarment from future government business, and we may suffer harm to our reputation.

Our customers also include a number of foreign governments and agencies. Similar procurement, budgetary, contract, and audit risks also apply to our doing business with these entities. In addition, compliance with complex regulations and contracting provisions in a variety of jurisdictions can be expensive and consume significant management resources. In certain jurisdictions our ability to win business may be constrained by political and other factors unrelated to our competitive position in the market. Each of these difficulties could materially adversely affect our business and results of operations.

### **We depend on technology licensed to us by third parties, and the loss of this technology could impair our software, delay implementation of our offerings, or force us to pay higher license fees**

We license third-party technologies that we incorporate into our existing offerings. There can be no assurance that the licenses for such third-party technologies will not be terminated or that we will be able to license third-party software for future offerings. In addition,

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**Table of Contents**

we may be unable to renegotiate acceptable third-party license terms. Changes in or the loss of third party licenses could lead to a material increase in the costs of licensing or to our software offerings becoming inoperable or their performance being materially reduced, with the result that we may need to incur additional development costs to ensure continued performance of our offerings, and we may experience a decreased demand for our offerings.

**If we are unable to recruit or retain skilled personnel, or if we lose the services of any of our key management personnel, our business, operating results, and financial condition could be materially adversely affected**

Our future success depends on our continuing ability to attract, train, assimilate, and retain highly skilled personnel. Competition for these employees is intense. We may not be able to retain our current key employees or attract, train, assimilate, or retain other highly skilled personnel in the future. Our future success also depends in large part on the continued service of key management personnel, particularly Michael J. Saylor, our Chairman and Chief Executive Officer. If we lose the services of Mr. Saylor or other key personnel, or if we are unable to attract, train, assimilate, and retain the highly skilled personnel we need, our business, operating results, and financial condition could be materially adversely affected.

**The emergence of new industry standards may materially adversely affect the demand for our existing offerings**

The emergence of new industry standards in related fields may materially adversely affect the demand for our existing offerings. This could happen, for example, if new web standards and technologies emerged that were incompatible with customer deployments of our software offerings. MicroStrategy currently supports SQL and MDX standards in database access technology. If we are unable to adapt our software offerings on a timely basis to new standards in database access technology, the ability of MicroStrategy's software offerings to access customer databases could be impaired. In addition, the emergence of new standards in the field of operating system support could materially adversely affect the demand for our existing software offerings. MicroStrategy technology is currently compatible with most major operating systems, including, among others, Windows Server, Sun Solaris, IBM AIX, HP's HP-UX, Red Hat Linux® AS, SuSE® Linux Enterprise Server, Apple's iOS and OSX®, RIM's BlackBerry® OS, and Google's Android®. If a different operating system were to gain widespread acceptance, we may not be able to achieve compatibility on a timely basis, resulting in an adverse effect on the demand for our software offerings.

**The nature of our software offerings makes them particularly vulnerable to undetected errors, or bugs, which could cause problems with how the offerings perform and which could in turn reduce demand for our offerings, reduce our revenue, and lead to product liability claims against us**

Software as complex as ours may contain errors and/or defects. Although we test our software offerings extensively, we have in the past discovered software errors in our offerings after their introduction. Despite testing by us and by our current and potential customers, errors may be found in new offerings or releases after commercial shipments begin. This could result in lost revenue, damage to our reputation, or delays in market acceptance, which could have a material adverse effect upon our business, operating results, and financial condition. We may also have to expend resources and capital to correct these defects.

Our license agreements with customers typically contain provisions designed to limit our exposure to product liability, warranty, and other claims. It is possible, however, that these provisions may not be effective under the laws of certain domestic or international jurisdictions and we may be exposed to product liability, warranty, and other claims. A successful product liability claim against us could have a material adverse effect on our business, operating results, and financial condition.

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**Table of Contents**

**Changes in laws or regulations relating to privacy or protection of personal data, or any failure by us to comply with such laws and regulations or our privacy policies, could materially adversely affect our business**

Aspects of our business, including MicroStrategy Cloud, MicroStrategy Express, the MicroStrategy Loyalty Platform, and the MicroStrategy Identity Platform, involve processing, storing, and transmitting personal data, which is subject to our privacy policies and certain federal, state, and foreign laws and regulations relating to privacy and data protection. The amount of data that we store for our customers in our cloud, networks, and other systems, including personal data, is increasing. Any systems failure or security breach that results in the release of, or unauthorized access to, personal data, or any failure or perceived failure by us to comply with our privacy policies or any applicable laws or regulations relating to privacy or data protection, could result in proceedings against us by governmental entities or others. Such proceedings could result in the imposition of fines, penalties, liabilities, and/or governmental orders requiring that we change our data practices, any of which could have a material adverse effect on our business, operating results, and financial condition.

The interpretation and application of laws and regulations relating to privacy and data protection are currently unsettled both in the U.S. and internationally. These laws and regulations may be interpreted and applied inconsistently from country to country, and these interpretations and applications may be inconsistent with our policies and practices. In addition, various federal, state, and foreign legislative or regulatory bodies may enact new or additional laws or regulations concerning privacy and data protection that could materially adversely impact our business. Complying with these varying requirements could cause us to incur substantial costs or require us to change our business practices, either of which could materially adversely affect our business and operating results. For example, legislation and regulation regarding mobile data collection continue to evolve and if laws or regulations restricting or limiting the collection or use of mobile data are enacted, they may reduce demand for certain of our services or require changes to our business practices, which could materially adversely affect our business and operating results.

**If we experience a security breach and unauthorized parties obtain access to our customers' data, our data, or our cloud, networks, or other systems, our offerings may be perceived as not being secure, our reputation may be harmed, demand for our offerings may be reduced, our operations may be disrupted, we may incur significant legal liabilities, and our business could be materially adversely affected**

As part of our business, we process, store, and transmit our customers' information and data as well as our own, including in our cloud, networks, and other systems. We have security measures in place to help protect our customers' data, our data, and our cloud, networks, and other systems against unauthorized access. However, there can be no assurance that these security measures will be effective against all security threats. Our security measures may be breached as a result of third-party action, including intentional misconduct by computer hackers, fraudulent inducement of employees or customers to disclose sensitive information such as user names or passwords, and employee error or malfeasance. Such breach could result in someone obtaining unauthorized access to our customers' data, our data, or our cloud, networks, or other systems. Because there are many different security breach techniques and such techniques continue to evolve, we may be unable to anticipate attempted security breaches and implement adequate preventative measures. Third parties may also conduct attacks designed to temporarily deny customers access to our services. Any security breach or successful denial of service attack could result in a loss of customer confidence in the security of our offerings and damage to our brand, reducing the demand for our offerings and our revenue, disrupt our normal business operations, require us to spend material resources to correct the breach, expose us to legal liabilities including litigation and indemnity obligations, and materially adversely affect our operating results. These risks will increase as we continue to grow the number and scale of our cloud-based offerings and process, store, and transmit increasingly large amounts of our customers' information and data, which may include proprietary or confidential data or personal or identifying information.

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## **Table of Contents**

### **Our intellectual property is valuable, and any inability to protect it could reduce the value of our products, services, and brand**

We rely on a combination of copyrights, patents, trademarks, trade secrets, confidentiality procedures, and contractual commitments to protect our intellectual property. Despite our efforts, these measures can only provide limited protection. Unauthorized third parties may try to copy or reverse engineer portions of our products or otherwise obtain and use our intellectual property. Any patents owned by us may be invalidated, circumvented, or challenged. Any of our pending or future patent applications, whether or not being currently challenged, may not be issued with the scope of the claims we seek, if at all. Moreover, recent amendments to U.S. patent law may affect our ability to protect our intellectual property and defend against claims of patent infringement. In addition, the laws of some countries do not provide the same level of protection of our intellectual property as do the laws of the United States. If we cannot protect our intellectual property against unauthorized copying or use, we may not remain competitive.

### **Third parties may claim we infringe their intellectual property rights**

We periodically receive notices from others claiming we are infringing their intellectual property rights, principally patent and trademark rights. We expect the number of such claims will increase as we continue to expand our offerings and branding, the number of offerings and level of competition in our industry segments grow, the functionality of offerings overlap, and the volume of issued patents, patent applications, and trademark registrations continues to increase. Responding to any infringement claim, regardless of its validity, could:

be time-consuming, costly, and/or result in litigation;

divert management's time and attention from developing our business;

require us to pay monetary damages or enter into royalty and licensing agreements that we would not normally find acceptable;

require us to stop selling certain of our offerings;

require us to redesign certain of our offerings using alternative non-infringing technology or practices, which could require significant effort and expense;

require us to rename certain of our offerings or entities; or

require us to satisfy indemnification obligations to our customers.

If a successful infringement claim is made against us and we fail to develop or license a substitute technology or brand name as applicable, our business, results of operations, financial condition, or cash flows could be materially adversely affected.

For example, we have recently been sued by two separate parties who alleged that certain of our BI products infringe their respective patents. These matters are described in further detail in this Quarterly Report on Form 10-Q under Part II, Item 1. Legal Proceedings.

### **Pending or future litigation could have a material adverse impact on our results of operation and financial condition**

In addition to intellectual property litigation, from time to time, we have been subject to other litigation. Regardless of the merits of any claims that may be brought against us, pending or future litigation could result in a diversion of management's attention and resources and we may be required to incur significant expenses defending against these claims. If we are unable to prevail in litigation we could incur substantial liabilities. Where we can make a reasonable estimate of the liability relating to pending litigation and determine that it is probable, we record a related liability. As additional information becomes available, we assess the potential liability and revise estimates as appropriate. However, because of uncertainties relating to litigation, the amount of our estimates could be wrong.



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**Table of Contents**

**Because of the rights of our two classes of common stock, and because we are controlled by our existing holders of class B common stock, these stockholders could transfer control of MicroStrategy to a third party without the approval of our Board of Directors or our other stockholders, prevent a third party from acquiring MicroStrategy, or limit your ability to influence corporate matters**

We have two classes of common stock: class A common stock and class B common stock. Holders of our class A common stock generally have the same rights as holders of our 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. As of July 23, 2013, holders of our class B common stock owned 2,227,327 shares of class B common stock, or 71.1% of the total voting power. Michael J. Saylor, our Chairman and Chief Executive Officer, beneficially owned 2,011,668 shares of class B common stock, or 64.2% of the total voting power, as of July 23, 2013. Accordingly, Mr. Saylor is able to control MicroStrategy through his ability to determine the outcome of elections of our directors, amend our certificate of incorporation and by-laws, and take other actions requiring the vote or consent of stockholders, including mergers, going-private transactions, and other extraordinary transactions and their terms.

Our certificate of incorporation allows holders of class B common stock, all of whom are current employees or directors of our company or related parties, to transfer shares of class B common stock, subject to the approval of stockholders possessing a majority of the outstanding class B common stock. Mr. Saylor or a group of stockholders possessing a majority of the outstanding class B common stock could, without the approval of our Board of Directors or our other stockholders, transfer voting control of MicroStrategy to a third party. Such a transfer of control could have a material adverse effect on our business, operating results, and financial condition. Mr. Saylor or a group of stockholders possessing a majority of the outstanding class B common stock will also be able to prevent a change of control of MicroStrategy, regardless of whether holders of class A common stock might otherwise receive a premium for their shares over the then current market price. In addition, this concentrated control limits stockholders' ability to influence corporate matters and, as a result, we may take actions that our non-controlling stockholders do not view as beneficial. As a result, the market price of our class A common stock could be materially adversely affected.

**We rely on the controlled company exemption from certain corporate governance requirements for Nasdaq-listed companies, which could make our class A common stock less attractive to some investors or otherwise materially adversely affect our stock price**

Because we qualify as a controlled company under the corporate governance rules for Nasdaq-listed companies, we are not required to have a majority of our board of directors be comprised of independent directors. Additionally, our board of directors is not required to have an independent compensation or nominating committee, or to have the independent directors exercise the nominating function. We also are not required to have the compensation of our executive officers be determined by a compensation committee of independent directors or a majority of the independent members of our board of directors. In addition, we are not required to empower our compensation committee with the authority to engage the services of any compensation consultants, legal counsel, or other advisors, or to have the compensation committee assess the independence of compensation consultants, legal counsel, and other advisors that it engages.

In light of our status as a controlled company, our board of directors has determined not to establish an independent nominating committee or have its independent directors exercise the nominating function, and has elected instead to have the board of directors be directly responsible for nominating members of the board. A majority of our board of directors is currently comprised of independent directors, and our board of directors has established a compensation committee comprised entirely of independent directors. The compensation committee determines the compensation of our chief executive officer. However, our board of directors has authorized our chief executive officer to determine the compensation of executive officers other than himself, rather than having such compensation determined by the compensation committee,



## **Table of Contents**

except that certain executive officer compensation that is intended to qualify as performance-based compensation for purposes of Section 162(m) of the Internal Revenue Code is determined by the compensation committee pursuant to the requirements of Section 162(m). Additionally, while our compensation committee is empowered with the authority to retain and terminate outside counsel, compensation consultants, and other experts or consultants, it is not required to assess their independence.

Although currently a majority of our board of directors is comprised of independent directors and the compensation committee is comprised entirely of independent directors, we may elect in the future not to have independent directors constitute a majority of the board of directors or the compensation committee, have our chief executive officer's compensation determined by a compensation committee of independent directors, or have a compensation committee of the board of directors at all.

Accordingly, should the interests of our controlling stockholder differ from those of other stockholders, the other stockholders may not have the same protections that are afforded to stockholders of companies that are required to follow all of the corporate governance rules for Nasdaq-listed companies. Our status as a controlled company could make our class A common stock less attractive to some investors or otherwise materially adversely affect our stock price.

### **Revenue recognition accounting pronouncements may materially adversely affect our reported results of operations**

We continuously review our compliance with all new and existing revenue recognition accounting pronouncements. Depending upon the outcome of these ongoing reviews and the potential issuance of further accounting pronouncements, implementation guidelines, and interpretations, we may be required to modify our reported results, revenue recognition policies, or business practices, which could have a material adverse effect on our results of operations.

### **Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

During the three months ended June 30, 2013, we did not repurchase any equity securities registered by us pursuant to Section 12 of the Exchange Act. See Note 8, Treasury Stock, to the Consolidated Financial Statements in Part I, Item 1. Financial Statements for further information regarding the Company's share repurchase plan.

### **Item 6. Exhibits**

We hereby file as part of this Quarterly Report on Form 10-Q the exhibits listed in the Index to Exhibits.

All other items not included in this Quarterly Report on Form 10-Q are omitted because they are not applicable or the answers thereto are none.

**Table of Contents**

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

**MICROSTRATEGY INCORPORATED**

By: /s/ Michael J. Saylor  
Michael J. Saylor  
Chairman of the Board of Directors and Chief  
Executive Officer

By: /s/ Douglas K. Thede  
Douglas K. Thede  
Senior Executive Vice President & Chief Financial  
Officer

Date: August 1, 2013

**Table of Contents****INDEX TO EXHIBITS**

<b>Exhibit Number</b>	<b>Description</b>
3.1	Second Restated Certificate of Incorporation of the registrant (filed as Exhibit 3.1 to the registrant's Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2003 (File No. 000-24435) and incorporated by reference herein).
3.2	Amended and Restated By-Laws of the registrant (filed as Exhibit 3.2 to the registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 2003 (File No. 000-24435) and incorporated by reference herein).
4.1	Form of Certificate of Class A Common Stock of the registrant (filed as Exhibit 4.1 to the registrant's Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2003 (File No. 000-24435) and incorporated by reference herein).
10.1	Summary of 2013 Cash Bonus Arrangements for Michael J. Saylor, Jonathan F. Klein, Douglas K. Thede, and Peng Xiao (set forth in Item 5.02 of the registrant's Current Report on Form 8-K (File No. 000-24435) filed on April 4, 2013 under the headings "2013 CEO Bonus Formula", "2013 President Bonus Formulas", and "2013 Cash Bonus Targets for Chief Financial Officer and Chief Technology Officer" and incorporated by reference herein).
10.2 *	Senior Executive Vice President & Chief Operating Officer 2013 Bonus Plan (filed as Exhibit 99.1 to the registrant's Current Report on Form 8-K (File No. 000-24435) filed on April 4, 2013 and incorporated by reference herein).
10.3	Summary of Perquisites and Associated Other Compensation Arrangements for Named Executive Officers.
31.1	Certification pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Chairman of the Board of Directors and Chief Executive Officer.
31.2	Certification pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Senior Executive Vice President & Chief Financial Officer.
32	Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS	XBRL Instance Document+
101.SCH	XBRL Taxonomy Extension Schema+
101.CAL	XBRL Taxonomy Extension Calculation Linkbase+
101.DEF	XBRL Taxonomy Extension Definition Linkbase+
101.LAB	XBRL Taxonomy Extension Label Linkbase+
101.PRE	XBRL Taxonomy Extension Presentation Linkbase+

**Table of Contents**

Management contracts and compensatory plans or arrangements

- \* Certain portions of this Exhibit were omitted by means of redacting a portion of the text. The Exhibit has been filed separately with the Secretary of the Commission with such text pursuant to an Application for Confidential Treatment under Rule 24b-2 under the Securities Exchange Act, as amended.
- + furnished, not filed, herewith