MICROSTRATEGY INC
Form 10-Q
May 07, 2009
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the Quarterly Period Ended March 31, 2009

OR

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

Commission File Number 000-24435

MICROSTRATEGY INCORPORATED

(Exact name of registrant as specified in its charter)

Delaware

(State of incorporation)

51-0323571

(I.R.S. Employer

Identification Number)

1861 International Drive, McLean, VA

(Address of Principal Executive Offices)

22102

(Zip Code)

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

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

Indicate by check mark whether the registrant 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 ¨

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

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

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

The number of shares of the registrant s class A common stock and class B common stock outstanding on April 30, 2009 was 9,120,602 and 2,770,244, respectively.

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

MICROSTRATEGY INCORPORATED

CONSOLIDATED BALANCE SHEETS

(in thousands, except per share data)

	March 31, 2009 (unaudited)	December 31, 2008 (audited)
Assets		
Current assets:		
Cash and cash equivalents	$ 162,193	$ 122,915
Restricted cash and investments	542	619
Accounts receivable, net	37,971	49,670
Prepaid expenses and other current assets	9,881	9,518
Deferred tax assets, net	14,442	26,743
Assets held-for-sale		4,964
	225,029	214,429
Property and equipment, net	8,611	8,978
Capitalized software development costs, net	18,619	14,823
Deposits and other assets	36,288	36,804
Deferred tax assets, net	15,368	17,105
Total assets	$ 303,915	$ 292,139
Liabilities and Stockholders Equity		
Current liabilities:		
Accounts payable and accrued expenses	$ 24,187	$ 27,697
Accrued compensation and employee benefits	27,761	42,634
Deferred revenue and advance payments	78,690	66,495
Liabilities held-for-sale		6,325
Total current liabilities	130,638	143,151
Deferred revenue and advance payments	3,467	1,679
Other long-term liabilities	9,246	9,268
Total liabilities	143,351	154,098
Commitments and Contingencies		
Stockholders Equity		
Preferred stock undesignated, $0.001 par value; 5,000 shares authorized; no shares issued or outstanding		
Class A common stock, $0.001 par value; 330,000 shares authorized; 14,168 shares issued and 9,121 shares outstanding, and 14,167 shares issued and 9,120 shares outstanding, respectively	14	14
Class B common stock, $0.001 par value; 165,000 shares authorized; 2,770 issued and outstanding	3	3
Additional paid-in capital	450,919	450,953

Treasury stock, at cost, 5,047 shares	(366,191)	(366,191)
Accumulated other comprehensive income	1,053	1,471
Retained earnings	74,766	51,791
Total stockholders equity	160,564	138,041
Total liabilities and stockholders equity	$ 303,915	$ 292,139

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

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MICROSTRATEGY INCORPORATED

CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share data)

	Three Months Ended March 31, 2009 (unaudited)	Three Months Ended March 31, 2008 (unaudited)
Revenues:		
Product licenses	$ 16,971	$ 22,127
Product support and other services	63,269	63,777
Total revenues	80,240	85,904
Cost of revenues:		
Product licenses	596	559
Product support and other services	14,065	13,947
Total cost of revenues	14,661	14,506
Gross profit	65,579	71,398
Operating expenses:		
Sales and marketing	30,530	29,688
Research and development	7,839	10,324
General and administrative	14,344	17,310
Total operating expenses	52,713	57,322
Income from continuing operations before financing and other income and income taxes	12,866	14,076
Financing and other income (expense):		
Interest income, net	145	800
Other income (expense), net	536	(861)
Total financing and other income (expense)	681	(61)
Income from continuing operations before taxes	13,547	14,015
Provision for income taxes	4,888	5,054
Income from continuing operations	8,659	8,961
Discontinued operations:		
Gain from sale of discontinued operations, net of tax provision of $11,121	14,423	
Loss from discontinued operations, net of tax benefit ($54 and $74, respectively)	(107)	(663)
Discontinued operations, net of tax	14,316	(663)

Net Income	$ 22,975	$ 8,298
Basic earnings (loss) per share (1):		
From continuing operations	$ 0.73	$ 0.75
From discontinued operations	$ 1.20	$ (0.05)
Basic earnings per share	$ 1.93	$ 0.70
Weighted average shares outstanding used in computing basic earnings per share	11,890	11,927
Diluted earnings (loss) per share (1):		
From continuing operations	$ 0.71	$ 0.72
From discontinued operations	$ 1.17	$ (0.05)
Diluted earnings per share	$ 1.88	$ 0.67
Weighted average shares outstanding used in computing diluted earnings per share	12,219	12,381

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

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

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MICROSTRATEGY INCORPORATED

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(unaudited)

	Three Months Ended March 31, 2009	Three Months Ended March 31, 2008
Operating activities:		
Net income	$ 22,975	$ 8,298
Plus: (Income) loss from discontinued operations, net	(14,316)	663
Income from continuing operations	8,659	8,961
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	1,770	1,642
Bad debt expense	222	632
Deferred taxes	2,823	2,753
Stock-based compensation		44
Excess tax benefits from stock-based payment arrangements		(56)
Other, net		10
Changes in operating assets and liabilities:		
Accounts receivable	9,281	4,485
Prepaid expenses and other current assets	(609)	(1,301)
Deposits and other assets	354	191
Accounts payable and accrued expenses, compensation and employee benefits, accrued interest	(16,328)	(13,239)
Deferred revenue and advance payments	16,960	13,283
Other long-term liabilities	(23)	890
Net cash provided by operating activities from continuing operations	23,109	18,295
Net cash used in operating activities from discontinued operations	(472)	(206)
Net cash provided by operating activities	22,637	18,089
Investing activities:		
Purchases of property and equipment	(1,131)	(699)
Capitalized software development costs	(4,218)	
Decrease in restricted cash and investments	23	56
Net cash used in investing activities from continuing operations	(5,326)	(643)
Net cash provided by (used in) investing activities from discontinued operations	24,546	(24)
Net cash provided by (used in) investing activities	19,220	(667)
Financing activities:		
Distribution to Alarm.com minority shareholders	(60)	
Proceeds from sale of class A common stock under exercise of employee stock options	19	124
Excess tax benefits from stock-based payment arrangements		56
Purchases of treasury stock		(5,366)

Net cash used in financing activities from continuing activities	(41)	(5,186)
Net cash used in financing activities from discontinued activities		
Net cash used in financing activities	(41)	(5,186)
Effect of foreign exchange rate changes on cash and cash equivalents	(2,538)	2,447
Net increase in cash and cash equivalents	39,278	14,683
Cash and cash equivalents, beginning of period	122,915	85,194
Cash and cash equivalents, end of period	$ 162,193	$ 99,877

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

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MICROSTRATEGY INCORPORATED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

(1) Basis of Presentation

Except for the consolidated balance sheet of MicroStrategy Incorporated (MicroStrategy or the Company) as of December 31, 2008, which is derived from audited financial statements, the accompanying consolidated financial statements are unaudited. In the opinion of management, all adjustments necessary for a fair statement of such financial position and results of operations have been included. All such adjustments are of a normal recurring nature unless otherwise disclosed. Interim results are not necessarily indicative of results for a full year.

The consolidated financial statements and notes are presented as required by Form 10-Q and do not contain certain information included in the Company s annual financial statements and notes. These financial statements should be read in conjunction with the Company s audited financial statements and the notes thereto filed with the Securities and Exchange Commission (SEC) in the Company s Annual Report on Form 10-K for the year ended December 31, 2008.

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

(2) Recent Accounting Standards

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

In December 2007, the FASB issued SFAS No. 160, Noncontrolling Interests in Consolidated Financial Statements An Amendment of ARB No. 51 (SFAS 160). SFAS 160 establishes new accounting and reporting standards for the non-controlling interest in a subsidiary and for the deconsolidation of a subsidiary. SFAS 160 is effective for fiscal years beginning on or after December 15, 2008. The Company s adoption of SFAS 160 did not have a material impact on its consolidated results of operations and financial position.

In March 2008, the FASB issued SFAS No. 161, Disclosures About Derivative Instruments and Hedging Activities an amendment of FASB Statement No. 133 (SFAS 161). SFAS 161 expands quarterly disclosure requirements in SFAS No. 133 about an entity s derivative instruments and hedging activities. SFAS 161 is effective for fiscal years beginning after November 15, 2008. The Company s adoption of SFAS 161 did not have a material impact on its consolidated results of operations and financial position.

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MICROSTRATEGY INCORPORATED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

(3) Restricted Cash and Investments

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

On March 15, 2005, the Company entered into a security agreement with a bank under which the Company posted cash to secure existing letters of credit. These letters of credit are used as security deposits for office leases, including the office lease for the Company s corporate headquarters, as well as collateral for performance bonds. The Company may invest the cash collateral under the security agreement in certain permitted investments. As of both March 31, 2009 and December 31, 2008, the Company had $1.0 million in cash collateral posted under the security agreement, all invested in money market funds that are included in restricted cash and investments or deposits and other assets in the accompanying balance sheets depending on whether the contractual obligation for which the collateral is posted is short term or long term, respectively.

(4) Accounts Receivable

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

	March 31, 2009	December 31, 2008
Billed and billable	$ 87,528	$ 115,316
Less: billed and unpaid deferred revenue	(46,511)	(62,648)
	41,017	52,668
Less: allowance for doubtful accounts	(3,046)	(2,998)
	$ 37,971	$ 49,670

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

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MICROSTRATEGY INCORPORATED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

(5) Deferred Revenue and Advance Payments

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

	March 31, 2009	December 31, 2008
Current:		
Deferred product licenses revenue	$ 5,014	$ 6,024
Deferred product support revenue	105,003	105,123
Deferred other services revenue	11,916	13,249
	121,933	124,396
Less: billed and unpaid deferred revenue	(43,243)	(57,901)
	$ 78,690	$ 66,495
Non-current:		
Deferred product licenses revenue	$ 322	$ 696
Deferred product support revenue	6,300	5,690
Deferred other services revenue	113	40
	6,735	6,426
Less: billed and unpaid deferred revenue	(3,268)	(4,747)
	$ 3,467	$ 1,679

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

(6) Litigation

On November 8, 2007 Diagnostic Systems Corp. (DSC), a subsidiary of Acacia Technology Group, filed a complaint for patent infringement against MicroStrategy and a number of other unrelated defendants in the United States District Court for the Central District of California, Southern Division. The case has been consolidated with Case No. SA CV 07-896 AG (MLGx) pending against other unrelated defendants. The consolidated complaint accuses MicroStrategy of infringing U.S. Patent No. 5,537,590 directly, contributorily and by inducement by making, using, selling and offering for sale in the United States MicroStrategy 8 Business Intelligence Platform, when used with an appropriate database. The consolidated complaint accuses MicroStrategy of willful infringement and seeks damages, a finding that the case is exceptional and an award of attorneys fees, and preliminary and permanent injunctive relief. In its initial disclosures on December 28, 2007, DSC declined to disclose the amount of its alleged damages, but disclosed that its alleged damages are based on a reasonable royalty theory. MicroStrategy answered the consolidated complaint on December 28, 2007, denied infringement, asserted affirmative defenses of non-infringement, invalidity and unenforceability, among others, and counter-claimed for declaratory judgment that the 590 patent is not infringed, is invalid, and is unenforceable. At a scheduling conference held on April 13, 2009, the Court set a trial date of February 23, 2010. On April 27, 2009, MicroStrategy filed an amended answer and amended counterclaims, adding Acacia Research Corporation, Acacia Patent Acquisition Corporation, and Acacia Technology Services Corporation as counterclaim defendants. The outcome of this litigation is not presently determinable. Accordingly, no provision for this matter has been made in the accompanying consolidated financial statements.

On December 10, 2003, MicroStrategy filed a complaint for patent infringement against Crystal Decisions, Inc. in the United States District Court for the District of Delaware. The lawsuit alleged that Crystal Decisions willfully infringed three patents issued to MicroStrategy relating to: (i) asynchronous control of report generation using a web browser (the 033 patent); (ii) management of an automatic OLAP report broadcast system (the 796 patent); and (iii) providing business intelligence web content with reduced client-side processing (the 432 patent). Following the filing of the complaint, Crystal Decisions was acquired by Business Objects Americas, Inc. Business Objects Americas, Inc. answered the complaint, denying infringement and seeking a declaration that the patents in suit are invalid and not infringed by Business Objects Americas, Inc. MicroStrategy filed a motion for summary judgment of infringement of

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

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

On March 9, 2006, Business Objects filed a motion seeking reimbursement from MicroStrategy of Business Objects attorneys fees and costs in the amount of $4.7 million. On March 25, 2008, the Court issued a memorandum opinion and an order. The Court awarded partial fees and expenses to Business Objects as the prevailing party. Business Objects was awarded reasonable fees and expenses for its defense after March 14, 2005 against the 796 patent, the 033 patent and claims 1, 2, 4, and 5 of the 432 patent. Business Objects motion for fees and expenses related to claims 6, 9, 10 and 13 of the 432 patent was denied. On November 20, 2008, the Court awarded Business Objects attorneys fees and costs of $2,245,263.87 for its defense of the 796 patent, the 033 patent and claims 1, 2, 4 and 5 of the 432 patent after March 14, 2005 and $138,399.02 for the preparation of the petition. On December 17, 2008, the Company filed a notice of appeal. On April 24, 2009, the Company filed its opening brief in the Federal Circuit. A mediation session with the Chief Federal Circuit Mediator was held on May 1, 2009. During the first quarter of 2008, the Company recorded a $2.3 million accrued liability related to this claim. The $2.3 million accrual is included in accounts payable and accrued expense in the Company s consolidated balance sheets, and was recorded as a general and administrative expense in the Company s consolidated statements of operations for the first quarter of 2008. The ultimate liability to the Company resulting from this proceeding may differ materially from the accrued amount.

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

(7) Commitments and Contingencies

On January 31, 2007, the Company entered into an agreement to purchase a corporate aircraft for delivery in mid-2009, which it expects to begin operating during the 2009 calendar year. The aggregate purchase price for the aircraft is $46.1 million, payable in installments on various dates related to the completion of manufacturing of the aircraft and the delivery of the aircraft. To date, the Company has made payments totaling $32.5 million toward the purchase price of the aircraft. The Company expects to pay the remaining $13.6 million of the purchase price upon delivery of the aircraft, which is expected to occur during the third quarter of 2009. The Company has the option to accelerate the delivery date under certain circumstances if the manufacturer is able to offer the aircraft prior to the scheduled delivery date. The Company expects to meet its payment obligations under this purchase commitment using funds from operations, but may consider using conventional aircraft financing or other borrowing arrangements.

The Company made payments of $5.0 million, $2.5 million and $25.0 million with regards to this aircraft in January 2007, September 2007 and October 2008, respectively, and recorded the amount of these payments in deposits and other assets.

In March 2009, the Company arranged the issuance of a standby letter of credit in the amount of $2.4 million, which was used to guarantee the potential liability related to the Business Objects attorneys fees and costs claim.

MICROSTRATEGY INCORPORATED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

From time to time, the Company enters into certain types of contracts that require it to indemnify parties against third party claims. These contracts primarily relate to agreements under which the Company has agreed to indemnify customers and partners for claims arising from intellectual property infringement. The conditions of these obligations vary and generally a maximum obligation is explicitly stated. Because the conditions of these obligations vary and the maximum is not always explicitly stated, the overall maximum amount of the Company s indemnification obligations cannot be reasonably estimated. Historically, the Company has not been obligated to make significant payments for these obligations, and as such has not recorded an indemnification liability on its balance sheets as of March 31, 2009 or December 31, 2008. The Company carries coverage under certain insurance policies for certain of these liabilities; however, this coverage may not be sufficient.

(8) Treasury Stock

On July 28, 2005, the Company announced that its Board of Directors had authorized the Company s repurchase of up to an aggregate of $300.0 million of its class A common stock from time-to-time on the open market (the 2005 Share Repurchase Program). On April 29, 2008, the Company s Board of Directors amended the 2005 Share Repurchase Program to increase the amount of class A common stock that the Company is authorized to repurchase from $300 million to $800 million in the aggregate. The term of the 2005 Share Repurchase Program was also extended to April 29, 2013, although the program may be suspended or discontinued by the Company at any time. The timing and amount of any shares repurchased will be determined by the Company s management based on its evaluation of market conditions and other factors. The 2005 Share Repurchase Program may be funded using the Company s working capital, as well as proceeds from any credit facilities and other borrowing arrangements which the Company may enter into in the future. During the three months ended March 31, 2009, the Company did not repurchase any shares of its class A common stock pursuant to the 2005 Share Repurchase Program. As of March 31, 2009, the Company had repurchased an aggregate of 2,469,473 shares of its class A common stock at an average price per share of $95.69 and an aggregate cost of $236.3 million pursuant to the 2005 Share Repurchase Program.

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

(9) Income Taxes

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

As of March 31, 2009, the Company has recorded a liability for uncertain income tax positions in the amount of $8.8 million. If recognized, the entire balance of these unrecognized tax benefits would impact the effective tax rate. Over the next 12 months, the amount of the net liability for unrecognized tax benefits could increase between $1.0 and $2.0 million related to our international operations. The Company recognizes estimated accrued interest related to unrecognized income tax benefits in the provision for income taxes accounts. Penalties relating to income taxes, if incurred, would also be recognized as a component of the Company s provision for income taxes. As of March 31, 2009, the amount of accrued interest expense on unrecognized income tax benefits was not material.

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MICROSTRATEGY INCORPORATED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

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

	March 31, 2009	December 31, 2008
Deferred tax assets, net of deferred tax liabilities	$ 35,482	$ 49,518
Valuation allowance	(5,672)	(5,670)
Deferred tax assets, net of valuation allowance	$ 29,810	$ 43,848
Short-term deferred tax assets, net	$ 14,442	$ 26,743
Long-term deferred tax assets, net	15,368	17,105
Total deferred tax assets, net	$ 29,810	$ 43,848

The valuation allowance as of March 31, 2009 and December 31, 2008 relates to foreign net operating loss carryforwards and other foreign deferred tax assets. The Company has determined that there is insufficient positive evidence that it is more likely than not that such deferred tax assets will be realized in accordance with the rules under SFAS No. 109, Accounting for Income Taxes .

The Company has estimated its annual effective tax rate for the full fiscal year 2009 and applied that rate to its income before income taxes in determining its provision for income taxes for the three months ended March 31, 2009. The Company also records discrete items in each respective period as appropriate. For the three months ended March 31, 2009 and 2008, the Company s consolidated annualized effective tax rate from continuing operations was 36.1% and 36.1%, respectively. The Company s effective tax rate from continuing operations during the three months ended March 31, 2009 remained unchanged as compared to the three months ended March 31, 2008.

The Company intends to indefinitely reinvest its undistributed earnings of certain foreign subsidiaries, in accordance with APB 23, Accounting for Income Taxes, Special Areas. Therefore, the annualized effective tax rate applied to the Company s pre-tax income 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 to the U.S. Subpart F deemed dividends and no additional tax is incurred on the distribution.

In determining the Company s provision 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 both net operating loss carryforwards and capital 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 income, changes in tax laws particularly related to the utilization of net operating losses in various jurisdictions, and changes resulting from tax audits can all affect the overall effective income tax rate which, in turn, impacts the overall level of income tax expense and net income.

Judgments and estimates related to the Company s projections and assumptions are inherently uncertain; therefore, actual results could differ materially from projections. The timing and manner in which the Company will use the net operating loss carryforwards, research and development tax credit 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

MICROSTRATEGY INCORPORATED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

Revenue Code limitations, within the carryforward periods. Valuation allowances have been established where the Company has concluded that it is not more likely than not that such deferred tax assets are realizable.

(10) Share-Based Compensation

The Company has share-based compensation plans under which directors, officers, employees and other eligible participants have previously received stock option awards. All stock options granted under the Company s stock plans have terms of five to ten years and generally vest ratably over five years. Upon exercise, the Company generally issues new shares in the amount of the award exercised. The Company had 2.4 million shares of class A common stock available for issuance under its share-based compensation plans as of March 31, 2009. The Company has not issued any material stock option or other share-based compensation awards since the first quarter of 2004.

Share-based compensation expense during the three months ended March 31, 2009 and 2008 was not significant.

(11) Comprehensive Income

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

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

	Three Months Ended March 31,	
	2009	2008
Net income	$ 22,975	$ 8,298
Foreign currency translation adjustment	(418)	1,057
Unrealized loss on short-term investments, net of applicable taxes		(2)
Comprehensive income	$ 22,557	$ 9,353

(12) Common Equity and Earnings per Share

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

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

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MICROSTRATEGY INCORPORATED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

(13) Discontinued Operations

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

On February 13, 2009, the Company completed the sale of its equity interest in Alarm.com for consideration to the Company of $24.5 million in cash net of post-closing purchase price adjustments and transaction costs totaling $3.3 million in the aggregate, resulting in a gain of $14.4 million, net of tax. As of December 31, 2008, the associated assets and liabilities of the Alarm.com business were classified as held-for-sale in accordance with SFAS 144, and are presented in the following table.

(in thousands)		**December 31, 2008**
Assets:		
Accounts Receivable	$	4,522
Prepaid Expenses & Other Current Assets		222
Property and equipment, net		220
Total assets	$	4,964
Liabilities:		
Accounts payable and accrued expenses	$	1,868
Accrued compensation and employee benefits		1,008
Deferred revenue and advance payments		3,449
Total liabilities	$	6,325
Net assets and liabilities of disposal group	$	(1,361)

The following table summarizes the revenues, pre-tax gain on sale and pre-tax loss generated by the Alarm.com business during the three months ended March 31, 2009 and 2008, respectively, (amounts in thousands):

	Three Months Ended March 31,	
(in thousands)	**2009**	**2008**
Revenues	$ 2,217	$ 2,581
Pre-tax gain on sale	$ 25,544	$
Pre-tax loss	$ (161)	$ (737)

(14) Segment Information

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

	Business Intelligence Software and Services			Other	
	Domestic	**EMEA**	**Other Regions**	**Domestic**	**Consolidated**
Geographic regions:					
Three months ended March 31, 2009					
Total revenues	$ 45,016	$ 25,584	$ 6,981	$ 2,659	$ 80,240
Long-lived assets	57,066	2,917	1,981	1,554	$ 63,518
Three months ended March 31, 2008					
Total revenues	$ 49,855	$ 26,389	$ 7,295	$ 2,365	$ 85,904
Long-lived assets	16,211	4,540	1,790	642	$ 23,183

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 months ended March 31, 2009 and 2008, no individual country outside the United States accounted for 10% or more of total consolidated revenues.

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As of March 31, 2009, no more than 10% of consolidated assets were concentrated in any one country outside of the United States. As of March 31, 2008, total assets in Germany exceeded 10% of consolidated assets. For the three months ended March 31, 2009 and 2008, no individual customer accounted for 10% or more of the Company s total consolidated revenues.

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

FORWARD-LOOKING INFORMATION

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

Overview

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

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

Our core business intelligence (BI) business derives its revenues from product licenses and product support and other services. Product licenses revenues are derived from the sale of software licenses for our MicroStrategy 9 business intelligence platform and related products. We license our software to end users through our direct sales organization and through indirect sales channels, such as resellers, systems integrators and original equipment manufacturers, or OEMs. Our arrangements with customers typically include: (a) an end-user license fee paid for the use of our products in perpetuity or over a specified term; (b) an annual maintenance agreement that provides for software updates and upgrades and technical support for an annual fee; and (c) a services work order for implementation, consulting and training, generally for a fee determined on a time-and-materials basis or, in certain circumstances, a fixed-fee.

During the three months ended March 31, 2009, we operated two non-core businesses, Alarm.com and Angel.com, which focus outside of the BI software and services market. Alarm.com is a provider of web-enabled residential and commercial security and activity monitoring technology, and Angel.com is a provider of interactive voice response telephony systems. In March 2008, in connection with our consideration of strategic alternatives relating to our non-core Alarm.com and Angel.com businesses, we committed to a plan to sell these businesses. We made the decision to sell these businesses in order to focus our resources on our core competency of business intelligence software and services. Accordingly, the financial results for Alarm.com and Angel.com were reclassified as discontinued operations in the quarter ended March 31, 2008.

Although we explored strategic alternatives for the Angel.com business, based on changes in market conditions that occurred in the quarter ended June 30, 2008, we determined that Angel.com no longer met the criteria to permit discontinued operations treatment and held-for-sale classification. Accordingly, amounts related to Angel.com were reclassified to continuing operations in the second quarter of 2008 and since then have been reflected in continuing operations for all periods presented.

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On February 13, 2009, we completed the sale of our equity interest in Alarm.com for consideration of $24.5 million in cash net of post-closing purchase price adjustments and transaction costs totaling $3.3 million in the aggregate, resulting in a gain of $14.4 million, net of tax. Accordingly, on our Consolidated Balance Sheets, we classified the associated assets and liabilities of the Alarm.com business as held-for-sale in accordance with Statement of Financial Accounting Standard No. 144, Accounting for the Impairment of Long-Lived Assets , or SFAS 144. In our Consolidated Statement of Operations, we classified the operations of the Alarm.com business as Income (Loss) from Discontinued Operations, net of tax, because we do not expect to have significant continuing involvement or cash flows from this business after the divestiture. All assets and liabilities that are reported in these financial statements as held-for-sale are reported at the lower of the carrying cost or fair value less cost to sell.

The following table sets forth certain operating highlights for the three months ended March 31, 2009 and 2008 (in thousands):

	Core BI Business Three Months Ended March 31,		Angel.com Three Months Ended March 31,		Consolidated Three Months Ended March 31,	
	2009	2008	2009	2008	2009	2008
Revenues						
Product licenses	$ 16,971	$ 22,127	$	$	$ 16,971	$ 22,127
Product support and other services	60,610	61,412			60,610	61,412
Angel.com telephony services			2,659	2,365	2,659	2,365
Total revenues	**77,581**	**83,539**	**2,659**	**2,365**	**80,240**	**85,904**
Cost of revenues						
Product licenses	596	559			596	559
Product support and other services	13,027	13,487			13,027	13,487
Angel.com telephony services			1,038	460	1,038	460
Total cost of revenues	**13,623**	**14,046**	**1,038**	**460**	**14,661**	**14,506**
Gross profit	**63,958**	**69,493**	**1,621**	**1,905**	**65,579**	**71,398**
Operating expenses						
Sales and marketing	29,358	28,132	1,172	1,556	30,530	