MICROSTRATEGY INC
Form 10-Q
July 30, 2014
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the Quarterly Period Ended June 30, 2014

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 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 x No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See 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 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 July 22, 2014 was 9,073,710 and 2,227,327, respectively.

Table of Contents

MICROSTRATEGY INCORPORATED

FORM 10-Q

TABLE OF CONTENTS

Table of Contents

PART I FINANCIAL INFORMATION

Item 1. Financial Statements

MICROSTRATEGY INCORPORATED

CONSOLIDATED BALANCE SHEETS

(in thousands, except per share data)

	June 30, 2014 (unaudited)	December 31, 2013
Assets		
Current assets:		
Cash and cash equivalents	$ 111,859	$ 220,171
Restricted cash	705	583
Short-term investments	255,680	137,198
Accounts receivable, net	57,525	86,181
Prepaid expenses and other current assets	19,041	14,260
Deferred tax assets, net	21,676	21,555
Total current assets	466,486	479,948
Property and equipment, net	85,023	85,445
Capitalized software development costs, net	7,376	10,295
Deposits and other assets	5,282	6,622
Deferred tax assets, net	4,191	3,204
Total assets	$ 568,358	$ 585,514
Liabilities and Stockholders Equity		
Current liabilities:		
Accounts payable and accrued expenses	$ 40,336	$ 39,946
Accrued compensation and employee benefits	57,604	79,495
Deferred revenue and advance payments	132,323	113,656
Deferred tax liabilities	594	422
Total current liabilities	230,857	233,519
Deferred revenue and advance payments	13,021	8,970
Other long-term liabilities	26,299	25,511
Deferred tax liabilities	56	7,188
Total liabilities	270,233	275,188
Commitments and Contingencies		
Stockholders Equity		

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 15,478 shares issued and 9,073 shares outstanding, respectively	15	15
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	498,768	494,086
Treasury stock, at cost; 6,405 shares	(475,184)	(475,184)
Accumulated other comprehensive loss	(895)	(831)
Retained earnings	275,419	292,238
Total stockholders equity	298,125	310,326
Total liabilities and stockholders equity	$ 568,358	$ 585,514

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

1

Table of Contents

MICROSTRATEGY INCORPORATED

CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share data)

	Three Months Ended June 30, 2014 (unaudited)	Three Months Ended June 30, 2013 (unaudited)
Revenues:		
Product licenses and subscription services	$ 35,266	$ 33,373
Product support	74,569	68,439
Other services	32,018	36,093
Total revenues	141,853	137,905
Cost of revenues:		
Product licenses and subscription services	7,006	5,558
Product support	3,475	4,254
Other services	25,132	26,634
Total cost of revenues	35,613	36,446
Gross profit	106,240	101,459
Operating expenses:		
Sales and marketing	60,956	52,686
Research and development	32,748	24,227
General and administrative	25,262	26,594
Total operating expenses	118,966	103,507
Loss from continuing operations	(12,726)	(2,048)
Interest income, net	32	322
Other expense, net	(474)	(419)
Loss from continuing operations before income taxes	(13,168)	(2,145)
Benefit from income taxes	(2,831)	(592)
Loss from continuing operations, net of tax	(10,337)	(1,553)
Discontinued operations:		
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 $0, respectively)	0	0

Discontinued operations, net of tax	0	0
Net loss	$ (10,337)	$ (1,553)
Basic loss per share (1)		
From continuing operations	$ (0.91)	$ (0.14)
From discontinued operations	0	0
Basic loss per share	$ (0.91)	$ (0.14)
Weighted average shares outstanding used in computing basic loss per share	11,301	11,301
Diluted loss per share (1)		
From continuing operations	$ (0.91)	$ (0.14)
From discontinued operations	0	0
Diluted loss per share	$ (0.91)	$ (0.14)
Weighted average shares outstanding used in computing diluted loss per share	11,301	11,301

(1) Basic and fully diluted 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 OPERATIONS

(in thousands, except per share data)

	Six Months Ended June 30,	
	2014	**2013**
	(unaudited)	(unaudited)
Revenues:		
Product licenses and subscription services	$ 67,563	$ 64,196
Product support	146,050	133,789
Other services	66,144	70,103
Total revenues	279,757	268,088
Cost of revenues:		
Product licenses and subscription services	13,241	10,918
Product support	7,018	8,455
Other services	48,363	52,974
Total cost of revenues	68,622	72,347
Gross profit	211,135	195,741
Operating expenses:		
Sales and marketing	119,833	103,400
Research and development	60,810	50,044
General and administrative	51,565	53,006
Total operating expenses	232,208	206,450
Loss from continuing operations	(21,073)	(10,709)
Interest income, net	80	383
Other (expense) income, net	(1,592)	1,289
Loss from continuing operations before income taxes	(22,585)	(9,037)
Benefit from income taxes	(5,766)	(2,293)
Loss from continuing operations, net of tax	(16,819)	(6,744)
Discontinued operations:		
Gain from sale of discontinued operations, net of tax provision ($0 and $37,548, respectively)	0	57,377
Loss from discontinued operations, net of tax benefit ($0 and $391, respectively)	0	(595)

Discontinued operations, net of tax		0		56,782
Net (loss) income	$	(16,819)	$	50,038
Basic (loss) earnings per share (1)				
From continuing operations	$	(1.49)	$	(0.60)
From discontinued operations		0		5.03
Basic (loss) earnings per share	$	(1.49)	$	4.43
Weighted average shares outstanding used in computing basic (loss) earnings per share		11,301		11,298
Diluted (loss) earnings per share (1)				
From continuing operations	$	(1.49)	$	(0.60)
From discontinued operations		0		5.03
Diluted (loss) earnings per share	$	(1.49)	$	4.43
Weighted average shares outstanding used in computing diluted (loss) earnings per share		11,301		11,298

(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 COMPREHENSIVE (LOSS) INCOME

(in thousands)

	Three Months Ended June 30,	
	2014	**2013**
	(unaudited)	(unaudited)
Net loss	$ (10,337)	$ (1,553)
Other comprehensive (loss) income, net of applicable taxes:		
Foreign currency translation adjustment	(286)	173
Unrealized gain (loss) on short-term investments	10	(1)
Total other comprehensive (loss) income	(276)	172
Comprehensive loss	$ (10,613)	$ (1,381)

	Six Months Ended June 30,	
	2014	**2013**
	(unaudited)	(unaudited)
Net (loss) income	$ (16,819)	$ 50,038
Other comprehensive loss, net of applicable taxes:		
Foreign currency translation adjustment	(83)	(811)
Unrealized gain (loss) on short-term investments	19	(4)
Total other comprehensive loss	(64)	(815)
Comprehensive (loss) income	$ (16,883)	$ 49,223

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,	
	2014	**2013**
	(unaudited)	(unaudited)
Operating activities:		
Net (loss) income	$ (16,819)	$ 50,038
Plus: (Income) from discontinued operations, net of tax	0	(56,782)
Loss from continuing operations, net of tax	(16,819)	(6,744)
Adjustments to reconcile net (loss) income to net cash provided by (used in) operating activities:		
Depreciation and amortization	13,260	13,102
Bad debt expense	2,033	1,395
Deferred taxes	(8,924)	(6,141)
Release of liabilities for unrecognized tax benefits	0	(1,446)
Share-based compensation expense	4,682	0
Excess tax benefits from share-based compensation arrangements	0	(23,580)
Changes in operating assets and liabilities:		
Accounts receivable	26,443	12,706
Prepaid expenses and other current assets	(3,988)	1,714
Deposits and other assets	406	134
Accounts payable and accrued expenses	(5,107)	(2,122)
Accrued compensation and employee benefits	(21,897)	(12,515)
Deferred revenue and advance payments	22,226	9,701
Other long-term liabilities	2,055	(2,154)
Net cash provided by (used in) operating activities from continuing operations	14,370	(15,950)
Net cash used in operating activities from discontinued operations	0	(664)
Net cash provided by (used in) operating activities	14,370	(16,614)
Investing activities:		
Proceeds from redemption of short-term investments	93,200	0
Purchases of property and equipment	(4,184)	(8,921)
Purchases of short-term investments	(211,603)	(129,043)
Capitalized software development costs	0	(1,736)
Increase in restricted cash	(90)	(84)
Net cash used in investing activities from continuing operations	(122,677)	(139,784)
Net cash provided by investing activities from discontinued operations	0	99,136

Net cash used in investing activities	(122,677)	(40,648)
Financing activities:		
Proceeds from sale of class A common stock under exercise of employee stock options	0	341
Excess tax benefits from share-based compensation arrangements	0	23,580
Payments on capital lease obligations and other financing arrangements	(341)	(324)
Net cash (used in) provided by financing activities from continuing operations	(341)	23,597
Net cash provided by financing activities from discontinued operations	0	0
Net cash (used in) provided by financing activities	(341)	23,597
Effect of foreign exchange rate changes on cash and cash equivalents	336	(2,040)
Net decrease in cash and cash equivalents	(108,312)	(35,705)
Cash and cash equivalents (including held-for-sale of $0 and $1,350, respectively), beginning of period	220,171	224,393
Cash and cash equivalents (including held-for-sale of $0 and $0, respectively), end of period	$ 111,859	$ 188,688
Supplemental disclosure of noncash investing and financing activities:		
Assets acquired under capital lease obligations and other financing arrangements	$ 0	$ 3,793

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

5

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, 2013, 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 and Notes to Consolidated Financial Statements have been reclassified to conform to current year presentation. Revenues and cost of revenues have been reclassified in the Consolidated Statements of Operations to reflect the new presentation of the Company s three different types of revenue. In addition, bad debt expense, changes in accounts receivable, release of liabilities for unrecognized tax benefits, and changes in other long-term liabilities have been reclassified within operating activities in the Consolidated Statements of Cash Flows.

The Consolidated Financial Statements and Notes to Consolidated Financial Statements 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, 2013. There have been no significant changes in the Company s accounting policies since December 31, 2013.

On March 15, 2013, the Company completed the sale of its wholly-owned subsidiary, Angel.com Incorporated (Angel.com), and subsequently classified this business line as discontinued operations. 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.

(2) Recent Accounting Standards

In July 2013, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update No. 2013-11, *Income Taxes (Topic 740)* (ASU 2013-11), which requires the financial statement presentation of an unrecognized tax benefit in a particular jurisdiction, or a portion thereof, as a reduction to a deferred tax asset for a net operating loss (NOL) carryforward, a similar tax loss, or a tax credit carryforward, unless the uncertain tax position is not available to reduce, or would not be used to reduce, the NOL or carryforward under the tax law in the same jurisdiction; otherwise, the unrecognized tax benefit should be presented as a gross liability and should not be combined with a deferred tax asset. The Company adopted ASU 2013-11 on January 1, 2014. As a result, liabilities for unrecognized tax benefits of $0.9 million were netted against deferred tax assets, as of June 30, 2014. The adoption of this guidance did not have a material effect on the Company s consolidated results of operations or cash flows.

In May 2014, the FASB issued Accounting Standards Update No. 2014-09, *Revenue from Contracts with Customers (Topic 606)* (ASU 2014-09), which supersedes nearly all existing revenue recognition guidance. The standard s core principle is that an entity should recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The standard creates a five-step model to achieve its core principle: (1) identify the contract(s) with a customer, (2) identify the performance obligations in the contract, (3) determine the transaction price, (4) allocate the transaction price to the separate performance obligations in the contract, and (5) recognize revenue when (or as) the entity satisfies a performance obligation. In addition, entities must disclose sufficient information to enable users of financial statements to understand the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. Qualitative and quantitative disclosures are required about: (1) the entity s contracts with customers, (2) the significant

MICROSTRATEGY INCORPORATED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

judgments, and changes in judgments, made in applying the guidance to those contracts, and (3) any assets recognized from the costs to obtain or fulfill a contract with a customer. ASU 2014-09 is effective for interim and annual periods beginning January 1, 2017. Early adoption is not permitted. The standard allows entities to apply the standard retrospectively to each prior reporting period presented (full retrospective adoption) or retrospectively with the cumulative effect of initially applying the standard recognized at the date of initial application (modified retrospective adoption). The Company is currently evaluating the impact of this guidance on its consolidated financial position, results of operations, and cash flows.

(3) 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.

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.

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. The Company executes these instruments with financial institutions that hold an investment grade credit rating. These foreign currency forward contracts do not meet the requirements for hedge accounting and 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, as measured using the three-level hierarchy described above, are recognized in Other (expense) income, net in the Company s Consolidated Statements of Operations.

Table of Contents

MICROSTRATEGY INCORPORATED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

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:

		June 30, 2014 Fair Value Measurements Using Input Types			
	Line Item	**Level 1**	**Level 2**	**Level 3**	**Total**
Non-hedging derivative assets:					
Foreign currency forward contracts	Prepaid expenses and other current assets	$ 0	$ 3	$ 0	$ 3
Non-hedging derivative liabilities:					
Foreign currency forward contracts	Accounts payable and accrued expenses	$ 0	$ 131	$ 0	$ 131

		December 31, 2013 Fair Value Measurements Using Input Types			
	Line Item	**Level 1**	**Level 2**	**Level 3**	**Total**
Non-hedging derivative assets:					
Foreign currency forward contracts	Prepaid expenses and other current assets	$ 0	$ 5	$ 0	$ 5
Non-hedging derivative liabilities:					
Foreign currency forward contracts	Accounts payable and accrued expenses	$ 0	$ 46	$ 0	$ 46

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, 2014 were for durations of twelve months or less and consisted of the following sale contracts (in thousands):

	Notional Value Local Currency		**Notional Value U.S. Dollar**	**Fair Value Gain (Loss) U.S. Dollar**
Forward contracts to sell:				
Australian Dollar	AUD	985	$ 900	$ (6)

Brazilian Real	BRL	3,184		1,300		(11)
British Pound	GBP	950		1,600		(16)
Canadian Dollar	CAD	757		700		(3)
Chinese Renminbi	CNY	10,664		1,700		(13)
Euro	EUR	3,534		4,800		(49)
Indian Rupee	INR	19,347		300		(2)
Japanese Yen	JPY	131,508		1,300		(3)
Korean Won	KRW	881,552		850		(9)
Mexican Peso	MXN	4,001		300		(1)
Polish Zloty	PLN	4,980		1,600		(9)
Russian Rouble	RUB	7,323		200		0
Singapore Dollar	SGD	500		400		(1)
South African Rand	ZAR	6,769		600		3
Swedish Krona	SEK	1,698		250		(3)
Swiss Franc	CHF	268		300		(3)
Turkish New Lira	TRY	230		100		(1)
United Arab Emirates Dirham	AED	738		200		(1)
			$	17,400	$	(128)

Table of Contents

MICROSTRATEGY INCORPORATED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

Changes in the fair value of our foreign currency forward contracts (in thousands) for each of the three and six months ended June 30, 2014 and 2013 were as follows:

		(Loss) Gain on Derivative Instruments Recognized in Income			
		Three Months Ended June 30,		Six Months Ended June 30,	
	Location	2014	2013	2014	2013
Non-hedging derivative instruments:					
Unrealized (loss) gain on foreign currency forward contracts	Other (expense) income, net	$ (5)	$ 5	$ (86)	$ 5
Realized loss on foreign currency forward contracts	Other (expense) income, net	$ (307)	$ 0	$ (562)	$ 0

There were no transfers among the levels within the fair value hierarchy during each of the three and six months ended June 30, 2014 and 2013. As of June 30, 2014 and December 31, 2013, 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. Substantially all 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 accompanying Consolidated Balance Sheets. 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, 2014 were $255.6 million, $255.6 million, and $255.6 million, respectively. The amortized cost, carrying value, and fair value of held-to-maturity investments at December 31, 2013 were $137.2 million, $137.2 million, and $137.2 million, respectively. The gross unrecognized holding gains and losses were not material for each of the three and six months ended June 30, 2014 and 2013. No other-than-temporary impairments related to these investments have been recognized in accumulated other comprehensive loss as of June 30, 2014 and December 31, 2013. As of June 30, 2014 and December 31, 2013, 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, 2014	December 31, 2013
Billed and billable	$ 128,836	$ 190,446
Less: unpaid deferred revenue	(67,168)	(100,276)
Accounts receivable, gross	61,668	90,170
Less: allowance for doubtful accounts	(4,143)	(3,989)
Accounts receivable, net	$ 57,525	$ 86,181

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

9

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, 2014	December 31, 2013
Current:		
Deferred product licenses revenue	$ 14,487	$ 14,538
Deferred subscription services revenue	11,174	10,923
Deferred product support revenue	156,018	167,771
Deferred other services revenue	14,696	17,056
Gross current deferred revenue and advance payments	196,375	210,288
Less: unpaid deferred revenue	(64,052)	(96,632)
Net current deferred revenue and advance payments	$ 132,323	$ 113,656
Non-current:		
Deferred product licenses revenue	$ 7,431	$ 4,401
Deferred subscription services revenue	949	1,161
Deferred product support revenue	6,696	5,877
Deferred other services revenue	1,061	1,175
Gross non-current deferred revenue and advance payments	16,137	12,614
Less: unpaid deferred revenue	(3,116)	(3,644)
Net non-current deferred revenue and advance payments	$ 13,021	$ 8,970

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. Thus, 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 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, 2014 or December 31, 2013.

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. As of December 31, 2013, the Company was leasing approximately 190,000 square feet of office space at a location in Northern Virginia that began serving as its corporate headquarters in October 2010. In April 2014, the Company leased an additional 43,000 square feet of office space at its corporate headquarters location. The term of the amended lease expires in December 2020. At June 30, 2014 and December 31, 2013, deferred rent of $22.1 million and $20.1 million, respectively, is included in other long-term liabilities, and $1.9 million and $2.8 million, respectively, is included in current accrued expenses.

Table of Contents

MICROSTRATEGY INCORPORATED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

(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 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 (the New York Judgment). DataTern appealed the New York Judgment to the United States Court of Appeals for the Federal Circuit (the Federal Circuit). In February 2013, MicroStrategy and DataTern filed motions for summary judgment of non-infringement in light of the New York Judgment and the United States District Court for the District of Massachusetts entered summary judgment against DataTern. In March 2013, DataTern filed a notice of appeal with the Federal Circuit. In January 2014, the Federal Circuit stayed DataTern s appeal pending the disposition of DataTern s appeal of the New York Judgment. In May 2014, the Federal Circuit affirmed the New York Judgment in part and reversed it in part. The Company expects to file a letter with the Federal Circuit regarding the status of the stayed appeal in light of the Federal Circuit s May 2014 ruling. The Company has received indemnification requests from certain of its resellers and customers 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. In October 2013, following a series of motions by the parties, the court dismissed the case, entered judgment of non-infringement based on a stipulation of non-infringement filed by Vasudevan, and also granted MicroStrategy s motion for summary judgment of invalidity, finding the four patents in the suit invalid. In November 2013, Vasudevan filed its Notice of Appeal with the United States Court of Appeals for the Federal Circuit. Also in November 2013, Vasudevan filed a motion that was unopposed by the Company to consolidate the appeal with Vasudevan s appeal of a related matter against TIBCO Software, which had also been dismissed by the District Court on summary judgment. In February 2014, in response to Vasudevan s motion, the Court entered an order that the cases be treated as companion cases. The

Court has scheduled oral argument for September 12, 2014. The outcome of this matter on appeal 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.

MICROSTRATEGY INCORPORATED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

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.

(8) Treasury Stock

The Board of Directors has 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, 2018 (the 2005 Share Repurchase Program), 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 that the Company may enter into in the future. During each of the three and six months ended June 30, 2014 and 2013, the Company did not repurchase any shares of its class A common stock pursuant to the 2005 Share Repurchase Program. As of June 30, 2014, 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 2010. However, due to its use of state net operating loss (NOL) and federal tax credit carryovers in the U.S., U.S. tax authorities may attempt to reduce or fully offset the amount of state NOL or federal tax credit carryovers from tax years ended in 2005 and forward that were used in later tax years. The Company s major foreign tax jurisdictions and tax years that remain subject to examination are Germany for tax years 2009 forward, Poland for tax years 2010 forward, the United Kingdom and Spain for tax years 2011 forward, and China for tax years 2012 and forward. The Company is currently under tax examination in the United States for tax years 2011 and 2012 and in Germany for tax years 2009 to 2012.

As of June 30, 2014, the Company had recorded unrecognized tax benefits of $1.7 million, which are recorded in other long-term liabilities. If recognized, $1.2 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 not expected to change by a material amount. As of June 30, 2014, the amount of cumulative accrued interest expense on unrecognized income tax benefits was approximately $0.3 million.

MICROSTRATEGY INCORPORATED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

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

	June 30, 2014	December 31, 2013
Deferred tax assets, net of deferred tax liabilities	$ 25,496	$ 17,226
Valuation allowance	(279)	(77)
Deferred tax assets, net of deferred tax liabilities and valuation allowance	$ 25,217	$ 17,149

The valuation allowance as of June 30, 2014 and December 31, 2013 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.

The Company has estimated its annual effective tax rate for the full fiscal year 2014 and applied that rate to its loss from continuing operations before income taxes in determining its benefit for income taxes for the six months ended June 30, 2014. The Company also records discrete items in each respective period as appropriate. The estimated effective tax rate is subject to fluctuation based upon the level and mix of earnings and losses by tax jurisdiction, foreign tax rate differentials, and the relative impact of permanent book to tax differences (e.g., non-deductible expenses). Each quarter, a cumulative adjustment is recorded for any fluctuations in the estimated annual effective tax rate as compared to the prior quarter. As a result of these factors, and due to potential changes in the Company s period to period results, fluctuations in the Company s effective tax rate and respective tax provisions or benefits may occur. The effective tax rate for the six months ended June 30, 2013 was calculated based on the actual benefit for income taxes for the six months ended June 30, 2013 (i.e., the cut-off method) because 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 produced a significant variance in its annual effective tax rate.

For the six months ended June 30, 2014, the Company recorded a benefit for income taxes from continuing operations of $5.8 million that resulted in an effective tax rate of 25.5%, as compared to a benefit for income taxes from continuing operations of $2.3 million that resulted in an effective tax rate of 25.4% for the six months ended June 30, 2013. The change in the effective tax rate is mainly due to the change in the proportion of U.S. versus foreign income, offset by the release of liability for certain unrecognized tax benefits in the second quarter of 2013 and the 2012 U.S. research and development tax credit that was retrospectively reinstated and taken as a benefit in the first quarter of 2013.

Except as discussed below, the Company intends to indefinitely reinvest its undistributed earnings of all of its foreign subsidiaries. Therefore, the annualized effective tax rate applied to the Company s pre-tax income from continuing operations 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, 2014 and December 31, 2013, the amount of cash and cash equivalents and short-term investments held by U.S. entities was $134.1 million and $160.5 million, respectively, and by non-U.S. entities was $233.4 million and $196.9 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 $192.7 million at December 31, 2013. 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.

Table of Contents

MICROSTRATEGY INCORPORATED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

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 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 net operating loss carryforward tax assets, 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. Over the course of 2013 and the first half of 2014, we increased our headcount as part of our initiatives to focus on specific research and development as well as increased sales and marketing efforts. As a result of these initiatives, our operating expenses have increased. If our revenues in the future are not sufficient to offset these operating expenses, or we are unable to adjust our operating expenses in a timely manner in response to any shortfall in anticipated revenue, we may incur additional operating losses. 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. If the Company is unable to achieve profitability in the near future, it may be required to increase the valuation allowance against the 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.

(10) Share-based Compensation

In September 2013, the Board of Directors approved the Company s 2013 Stock Incentive Plan (the 2013 Plan), under which the Company s employees, officers, directors, and other eligible participants may be awarded various types of share-based compensation. In April 2014, the Company s stockholders approved the 2013 Plan at the Company s annual meeting.

In September 2013, the Board of Directors also authorized 600,000 shares of the Company s class A common stock for issuance under the 2013 Plan. In April 2014, the Board of Directors authorized, subject to stockholder approval, an amendment to the 2013 Plan to increase the total number of shares of the Company s class A common stock authorized for issuance under the 2013 Plan from 600,000 to 1,500,000 shares. Also in April 2014, the Compensation Committee of the Board of Directors (the Compensation Committee) authorized, subject to stockholder approval, an additional amendment to the 2013 Plan to provide for automatic annual stock option grants to each of the Company s non-employee directors with respect to 5,000 shares of the Company s class A common stock, beginning in 2015. The Company considers stockholder approval of both amendments to the 2013 Plan to be perfunctory since the Company s Chairman and Chief Executive Officer holds a majority of the total voting power of all the Company s outstanding voting stock.

In April and May 2014, the Compensation Committee approved, in each case subject to stockholder approval of the amendment to the 2013 Plan to increase the total number of shares authorized for issuance, the grant of stock options to purchase an aggregate of 660,000 shares of class A common stock to certain Company executives and directors pursuant to the 2013 Plan. These awards, and any additional awards granted prior to stockholder approval, will be terminated or forfeited if stockholder approval is not obtained within 12 months of the date of grant of the awards, and no award may be exercised or settled prior to such stockholder approval. However, the Company expects to obtain stockholder approval of both amendments to the 2013 Plan at or before the Company s annual meeting of stockholders in 2015. In the event stockholder approval is not obtained within 12 months of the grant date of any option awards, the cumulative share-based compensation expense associated with those stock option awards would be reversed. As of June 30, 2014, there were options to purchase 1,260,000 shares of class A common stock outstanding under the 2013 Plan (including the options to purchase 660,000 shares of class A common stock that are subject to stockholder approval of the amendment to the 2013 Plan to increase the total number of shares authorized for issuance) and 240,000 remaining shares of class A common stock authorized for issuance under the 2013 Plan.

MICROSTRATEGY INCORPORATED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

Shares issued under the 2013 Plan may consist in whole or in part of authorized but unissued shares or treasury shares. Stock options that are granted under the 2013 Plan must have an exercise price equal to at least the fair market value of the Company s class A common stock on the date of grant, become exercisable as established by the Board of Directors or the Compensation Committee, and expire no later than ten years following the date of grant. The Company recognizes share-based compensation expense associated with such stock option awards on a straight-line basis over the award s requisite service period (generally, the vesting period). The stock option awards granted to date vest in equal annual installments over an approximately four-year vesting period (unless accelerated upon a change in control event (as defined in the stock option agreement for the applicable award) or otherwise in accordance with provisions of the 2013 Plan or applicable option agreement).

Share-based compensation expense is based on the fair value of the stock option awards on the date of grant, as estimated using the Black-Scholes option pricing model. The Black-Scholes option pricing model requires the input of certain management assumptions, including the expected term, expected stock price volatility, risk-free interest rate, and expected dividend yield. The Company estimates the term over which optionholders are expected to hold their stock options by using the simplified method for plain-vanilla stock option awards because the Company s stock option exercise history does not provide a reasonable basis to compute the expected term for stock options granted under the 2013 Plan. The Company relies exclusively on its historical stock price volatility to estimate the expected stock price volatility over the expected term because the Company believes future volatility is unlikely to differ from the past. In estimating the expected stock price volatility, the Company uses a simple average calculation method. The risk-free interest rate is based on U.S. Treasury securities with terms that approximate the expected term of the stock options. The expected dividend yield is based on the Company s past cash dividend history and anticipated future cash dividend payments. The expected dividend yield is zero, as the Company has not previously declared cash dividends and does not currently intend to declare cash dividends in the foreseeable future. These assumptions are based on management s best judgment, and changes to these assumptions could materially affect the fair value estimates and amount of share-based compensation expense recognized.

Prior to the adoption of the 2013 Plan, the Company had maintained other share-based compensation plans with respect to the Company s class A common stock (the Other Stock Incentive Plans), but had not granted any share-based awards under the Other Stock Incentive Plans since the first quarter of 2004 and is no longer authorized to grant any awards under such plans. As of June 30, 2014, there were no outstanding share-based awards granted under the Other Stock Incentive Plans.

Table of Contents

MICROSTRATEGY INCORPORATED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

The following table summarizes the Company s stock option activity (in thousands, except per share data and years) for the three months ended June 30, 2014:

	Stock Options Outstanding			
	Shares	Weighted Average Exercise Price Per Share	Aggregate Intrinsic Value	Weighted Average Remaining Contractual Term (Years)
Balance as of April 1, 2014	600	$ 92.84		
Granted	660	120.90		
Exercised	0	0		
Forfeited/Expired	0	0		
Balance as of June 30, 2014	1,260	$ 107.54		
Exercisable as of June 30, 2014	0	$ 0	$ 0	0.0
Expected to vest as of June 30, 2014	1,260	$ 107.54	$ 41,683	9.5
Total	1,260	$ 107.54	$ 41,683	9.5

No stock options vested during the three months ended June 30, 2014. The Company expects all unvested options at June 30, 2014 to fully vest in future years in accordance with their vesting schedules and therefore share-based compensation expense has not been adjusted for any expected forfeitures. The weighted average grant date fair value of stock option awards using the Black-Scholes option pricing model was $54.01 for each share subject to a stock option granted during the three months ended June 30, 2014, based on the following assumptions:

	Three months ended June 30,	
	2014	2013
Expected term of options in years	6.3	0.0
Expected volatility	42.4-42.5%	0.0%
Risk-free interest rate	2.2-2.3%	0.0%
Expected dividend yield	0.0%	0.0%

For the three and six months ended June 30, 2014, the Company recognized approximately $3.1 million and $4.7 million, respectively, in share-based compensation expense from stock options granted under the 2013 Plan. For the three and six months ended June 30, 2013, the Company did not recognize any share-based compensation expense from stock options granted under the 2013 Plan as no options had been granted under such plan. For each of the three and six months ended June 30, 2014 and 2013, the Company did not recognize any share-based compensation expense from stock options granted under the Other Stock Incentive Plans as all such options fully vested in prior years. As of June 30, 2014, there was approximately $54.1 million of total unrecognized share-based compensation expense related to unvested stock options. The Company expects to recognize this remaining share-based compensation expense over a weighted average vesting period of approximately 3.6 years.

During the three and six months ended June 30, 2014, no windfall tax benefits were realized from the exercise of stock options. During the three and six months ended June 30, 2013, the Company was able to recognize and utilize net operating loss carryforwards arising directly from tax deductions related to equity compensation in excess of compensation recognized for financial reporting that was generated primarily in prior years under the Other Stock Incentive Plans. Accordingly, stockholders equity increased by $23.6 million during the six months ended June 30, 2013.

MICROSTRATEGY INCORPORATED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

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 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, 2014 and December 31, 2013, 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. Potential shares of common stock, consisting of common stock issuable upon exercise of outstanding stock options, are calculated using the treasury stock method. For the three and six months ended June 30, 2014, 14,340 and 4,297 potential shares of common stock, respectively, under the 2013 Plan were excluded from the diluted earnings per share calculation because their impact would have been anti-dilutive. For the three and six months ended June 30, 2013, 27 and 2,037 potential shares of common stock, respectively, under the Other Stock Incentive Plans were excluded from the diluted earnings per share calculation because their impact would have been anti-dilutive.

(12) Discontinued Operations

On March 15, 2013, the Company completed the sale of its equity interest in its Angel.com business 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. On 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. 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, 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 (in thousands):

	Three Months Ended June 30, 2013		Six Months Ended June 30, 2013	
Angel.com revenues	$	0	$	6,320
Angel.com pre-tax loss	$	0	$	986
MicroStrategy pre-tax gain on sale	$	0	$	94,925

Table of Contents

MICROSTRATEGY INCORPORATED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

(13) Segment Information

The Company manages its business in one operating segment. As discussed in Note 12, the Angel.com business was sold on March 15, 2013. Prior to its divestiture, the Angel.com business was the sole component of the former operating segment Other. The Company s one operating segment is engaged in the design, development, marketing, and sales of analytics software through licensing arrangements and cloud-based subscriptions and related services. It includes the MicroStrategy Analytics Platform™, MicroStrategy Mobile™, and MicroStrategy Cloud™. 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 one operating segment for the three and six months ended June 30, 2014 and 2013 because these platforms did not generate 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, (in thousands) according to geographic region:

Geographic regions:	**Domestic**	**EMEA**	**Other Regions**	**Consolidated**
Three months ended June 30, 2014				
Total revenues	$ 82,542	$ 43,933	$ 15,378	$ 141,853
Gross profit	$ 61,694	$ 31,905	$ 12,641	$ 106,240
Three months ended June 30, 2013				
Total revenues	$ 83,287	$ 38,608	$ 16,010	$ 137,905
Gross profit	$ 61,154	$ 27,083	$ 13,222	$ 101,459
Six months ended June 30, 2014				
Total revenues	$ 163,147	$ 87,070	$ 29,540	$ 279,757
Gross profit	$ 123,004	$ 63,845	$ 24,286	$ 211,135
Six months ended June 30, 2013				
Total revenues	$ 160,595	$ 76,544	$ 30,949	$ 268,088
Gross profit	$ 117,280	$ 53,012	$ 25,449	$ 195,741
As of June 30, 2014				
Long-lived assets	$ 85,706	$ 6,022	$ 5,953	$ 97,681
As of June 30, 2013				
Long-lived assets	$ 95,206	$ 7,983	$ 6,489	$ 109,678

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, 2014 and 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, 2014 and 2013, no individual customer accounted for 10% or more of total consolidated revenues from continuing operations.

As of June 30, 2014 and December 31, 2013, no individual foreign country accounted for 10% or more of total consolidated assets.

(14) Subsequent Events

In July 2014, the Company announced that it is developing a restructuring plan to streamline its workforce and spending to better align its cost structure with its business strategy. The Company expects to finalize the restructuring plan and to implement a substantial portion of the plan in the third quarter of 2014, with the remaining portion to be implemented in the fourth quarter of 2014.

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 an enterprise. Our analytics platform delivers reports and dashboards, and enables users to conduct ad hoc analysis and share insights anywhere, anytime, via mobile devices or the Web. It also combines the agility and productivity of self-service visual data discovery with the security, scalability, and governance features of enterprise-grade business intelligence. The MicroStrategy Analytics Platform is compatible with MicroStrategy Analytics Desktop , a standalone desktop tool, available free of charge and designed to enable business users to analyze and understand their data. With MicroStrategy Analytics Desktop, business users can create stunning data visualizations and dashboards that provide new insight and new understanding in just minutes.

MicroStrategy Mobile is designed to allow organizations to rapidly build information-rich applications that combine multimedia, transactions, analytics, and custom workflows. The powerful code-free platform approach is designed to reduce the costs of development and enable organizations to get powerful mobile business apps quickly and cost-effectively. MicroStrategy Mobile is an easy, fast, and cost-effective way to mobilize an organization s information systems, including its data warehouses, business intelligence, ERP, CRM, and Web applications that are currently accessible only on the desktop. Using MicroStrategy Mobile, customers can transform their entire workforce into a connected and more productive mobile workforce with mobile apps that are significantly more robust than their Web-only counterparts. With mobile access to critical corporate data and systems that drive the business, employees can have a virtual office in their hands at all times.

MicroStrategy Cloud brings together enterprise analytics, analytical databases, and data integration capabilities in a high performance integrated environment. MicroStrategy Cloud offers on-demand access to the full breadth of the MicroStrategy Analytics Platform and MicroStrategy Mobile capabilities and is optimized for a variety of enterprise applications. Compared to traditional on-premises approaches, MicroStrategy Cloud is quicker to deploy, is more flexible, delivers consistent high-level performance and offers significant financial advantages. We offer MicroStrategy Cloud as a managed service to organizations that want the power of enterprise analytics and the ability to quickly build and deliver enterprise mobile apps that harness the potential of Big Data analytics.

The MicroStrategy Loyalty Platform, branded as MicroStrategy Alert, is a next-generation mobile customer loyalty and engagement solution. It is designed to help retailers harness the power of mobile technology by providing a mobile engagement channel to their customers for targeted marketing, commerce, and loyalty. MicroStrategy Alert is offered as a subscription-based service. It includes a consumer-facing branded mobile app; a campaign management system to create and launch targeted campaigns and publish content; an intelligence module to analyze app activity and campaign performance, as well as design target segments; and a library of content connectors to synchronize content from customers existing Websites and social pages with the MicroStrategy Alert-powered mobile app.

Table of Contents

The MicroStrategy Identity Platform, branded as MicroStrategy Usher, is a mobile identity solution that can deliver biometric-enhanced security to applications and business processes across an enterprise. MicroStrategy Usher can replace ID cards, key cards, employee badges, and passwords with a single mobile identity that is biometrically linked to its owner, cryptographically linked to its owner s phone, and dynamically linked to the enterprise s existing identity repositories. MicroStrategy Usher s architecture leverages three-factor authentication, out-of-band channels, time-limited codes, and bidirectional public key infrastructure encryption to offer enterprises increased protection against fraud and cybercrime. MicroStrategy Usher is designed to allow users to log in to applications, unlock doors, validate one another s identity, and authorize transactions more securely, using their MicroStrategy Usher mobile identities. Furthermore, MicroStrategy Usher uses the MicroStrategy Analytics Platform to support behavior monitoring and the detection of abnormal activity for even greater security. MicroStrategy Usher is offered as a subscription-based service.

The MicroStrategy Analytics Platform, MicroStrategy Mobile, and MicroStrategy Cloud 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, 2014 and 2013, we did not generate significant revenues from the MicroStrategy Loyalty Platform or the MicroStrategy Identity Platform.

The following table sets forth certain operating highlights (in thousands) for the three and six months ended June 30, 2014 and 2013:

	Three Months Ended June 30,		**Six Months Ended June 30,**	
	2014	**2013**	**2014**	**2013**
Revenues				
Product licenses and subscription services	$ 35,266	$ 33,373	$ 67,563	$ 64,196
Product support	74,569	68,439	146,050	133,789
Other services	32,018	36,093	66,144	70,103
Total revenues	**141,853**	**137,905**	**279,757**	**268,088**
Cost of revenues				
Product licenses and subscription services	7,006	5,558	13,241	10,918
Product support	3,475	4,254	7,018	8,455
Other services	25,132	26,634	48,363	52,974
Total cost of revenues	**35,613**	**36,446**	**68,622**	**72,347**
Gross profit	**106,240**	**101,459**	**211,135**	**195,741**
Operating expenses				
Sales and marketing	60,956	52,686	119,833	103,400
Research and development	32,748	24,227	60,810	50,044
General and administrative	25,262	26,594	51,565	53,006
Total operating expenses	**118,966**	**103,507**	**232,208**	**206,450**

Loss from continuing operations	**$ (12,726)**	**$ (2,048)**	**$ (21,073)**	**$ (10,709)**

The analytics 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. Within the analytics space we predominantly compete with two categories of vendors: 1) megavendors (IBM, SAP AG, and Oracle) that provide one or more analytics products as part of their enterprise product portfolio and typically compete for larger opportunities; and 2) independent data discovery vendors like Tableau Software, TIBCO Spotfire, and QlikTech that mainly compete for small to medium-size opportunities. Our success depends on the effectiveness with which we can differentiate our product from both the megavendors and the independent vendors across large, mid-sized, and small opportunities.

Table of Contents

Organizations have sought, and we expect may continue to seek, to standardize their various analytics 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 analytics 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 analytics provider.

The market for mobile business apps is rapidly changing, highly competitive, and complex with many competitors and different offerings ranging from fully custom-coded applications to plug-and-play solutions. While organizations vary greatly in their approach to, and pace of adoption of, mobile solutions, they are increasingly accelerating the transition of their businesses onto mobile devices, such as tablets and smartphones. Over the next few years, we expect that organizations will continue to construct their information and systems to take advantage of the efficiencies and cost savings of mobile computing. Ultimately, we expect that the majority of routine business tasks and workflows will become available as mobile-optimized touch-enabled apps.

In addition, there is increased market demand for analysis of a wider variety of data sources, including sensor data, social data, web log data, and other data types. These new data sources are driving massive increases in the volume of data that can potentially be analyzed (Big Data), which in turn is accelerating development of new storage technologies like Hadoop and NoSQL databases. The demand for analytics on Big Data represents an opportunity for MicroStrategy, as it opens up new potential applications and use cases for our technology. It also creates a challenge as we will need to continually enhance our technology to support emerging data sources; deliver faster performance necessary to support analysis against large scale data sets; and support analysis of a wider variety of data types, such as unstructured, semi-structured, and streaming data.

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

- a major simplification of our product packaging structure aimed at delivering the best end-to-end customer and partner experience, making it easier to acquire and deploy the MicroStrategy platform, and delivering free upgrades to premium capabilities for existing customers, empowering new and existing clients to realize the full potential of their analytical applications;

- enhancement of our ability to support new enterprise-scale requirements for analytics, 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 analytics operations, such as our introduction of MicroStrategy PRIME , a massively scalable, cloud-based, in-memory analytics service designed to deliver high performance for complex analytical applications that have the largest data sets and highest user concurrency;

- 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 analytics, 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;

introduction of new channels to enable customers to access our analytics capabilities in the form of MicroStrategy Analytics Desktop and MicroStrategy Analytics Express;

enhancement of our mobile application platform for creating and deploying analytics applications to the expanding community of mobile device users;

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

increased sales and marketing activities to enhance corporate branding, obtain new customers, expand and strengthen our existing customer base, and establish MicroStrategy as a solution for mobile apps that extends significantly beyond mobile analytics, while retaining all of the benefits of our analytics platform heritage;

maintenance of a dedicated performance engineering team and conduct of research and development focused on providing our customers with the highest levels of performance for analytics applications of all sizes;

investment in software engineering to further enhance the MicroStrategy Mobile product suite to empower our customers with a toolset to enable them to build consequential and durable mobile business apps; and

continued investment in the company s differentiated cloud offerings of business intelligence, data hosting, and data integration capabilities, enabling a robust selection of self-managed and fully-managed cloud offerings in five continents and over 10 global data centers allowing us to penetrate new markets and customer bases.

As part of these initiatives, we invested significantly in our research and development capabilities during 2013 and continued to make additional investments during the first half of 2014. In 2014, we expect the level of investments and related expenses to be higher than in 2013. We generated a loss from continuing operations, net of tax, for each of the three and six months ended June 30, 2014. If our revenues are not sufficient to offset increased operating expenses or we are unable to adjust our operating expenses in response to any shortfall in anticipated revenue in a timely manner, we may continue to incur operating losses on a quarterly or annual basis.

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, 2014, we had a total of 3,411 employees, of whom 1,534 were based in the United States and 1,877 were based internationally. Of our 3,411 employees, 920 were engaged in sales and marketing, 1,101 in research and development, 927 in subscription, product support, consulting, and education services, and 463 in finance, administration, and corporate operations.

As of December 31, 2013, we were leasing approximately 190,000 square feet of office space at a location in Northern Virginia that began serving as our corporate headquarters in October 2010. In April 2014, we leased an additional 43,000 square feet of office space at our corporate headquarters location. The term of the amended lease expires in December 2020. We recognize lease expense ratably over the term of the lease.

As discussed in Note 10, Share-based Compensation, to the Consolidated Financial Statements, we have outstanding stock options to purchase shares of our class A common stock under our amended 2013 Stock Incentive Plan (the

2013 Plan). Share-based compensation expense (in thousands) from these stock option awards was recognized in the following operating expense line items in our Consolidated Statements of Operations for the periods indicated:

Table of Contents

	Three Months Ended June 30, 2014	Three Months Ended June 30, 2013	Six Months Ended June 30, 2014	Six Months Ended June 30, 2013
Sales and marketing	$ 124	$ 0	$ 124	$ 0
Research and development	352	0	618	0
General and administrative	2,608	0	3,940	0
Total share-based compensation expense	$ 3,084	$ 0	$ 4,682	$ 0

We estimate that approximately $54.1 million of additional share-based compensation expense for options granted under the 2013 Plan will be recognized over a remaining weighted average period of 3.6 years.

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.

In July 2014, we announced that we are developing a restructuring plan to streamline our workforce and spending to better align our cost structure with our business strategy. We expect to finalize the restructuring plan and to implement a substantial portion of the plan in the third quarter of 2014, with the remaining portion to be implemented in the fourth quarter of 2014. The restructuring plan is expected to deliver annualized pre-tax savings of at least $40.0 million. The total charges resulting from this plan are expected to be approximately $3.0 million to $5.0 million.

Non-GAAP Financial Measures

We are providing a supplemental financial measure for loss from continuing operations that excludes the impact of our share-based compensation arrangements. This financial measure is not a measurement of financial performance under generally accepted accounting principles in the United States (GAAP) and, as a result, this financial measure may not be comparable to similarly titled measures of other companies. Management uses this non-GAAP financial measure internally to help understand, manage, and evaluate our business performance and to help make operating decisions. We believe that this non-GAAP financial measure is also useful to investors and analysts in comparing our performance across reporting periods on a consistent basis because it excludes a significant non-cash expense that we believe is not reflective of the Company s general business performance. In addition, accounting for share-based compensation arrangements requires significant management judgment and the resulting expense could vary significantly in comparison to other companies. Therefore, we believe the use of this non-GAAP financial measure can also facilitate comparison of our operating results to those of our competitors.

Non-GAAP financial measures are subject to material limitations as they are not in accordance with, or a substitute for, measurements prepared in accordance with GAAP. For example, we expect that share-based compensation expense, which is excluded from our non-GAAP financial measure, will continue to be a significant recurring expense over the next four years and is an important part of the compensation provided to certain executives and directors. Our non-GAAP financial measure is not meant to be considered in isolation and should be read only in conjunction with our Consolidated Financial Statements, which have been prepared in accordance with GAAP. We rely primarily on such Consolidated Financial Statements to understand, manage, and evaluate our business performance, and use the non-GAAP financial measure only supplementally.

The following is a reconciliation of our non-GAAP financial measure to its most directly comparable GAAP measure (in thousands) for the periods indicated:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Reconciliation of non-GAAP loss from continuing operations:				
Loss from continuing operations	$ (12,726)	$ (2,048)	$ (21,073)	$ (10,709)
Share-based compensation expense	3,084	0	4,682	0
Non-GAAP loss from continuing operations	$ (9,642)	$ (2,048)	$ (16,391)	$ (10,709)

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, valuation of net deferred tax assets, share-based compensation, and fair value measurements of our derivative financial instruments 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, 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.

We do 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, we do not have any material related party transactions.