

MICROSTRATEGY INC  
Form 10-Q  
April 29, 2014  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**Washington, D.C. 20549**

**FORM 10-Q**

(Mark One)

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

**For the Quarterly Period Ended March 31, 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  No

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

Large accelerated filer  Accelerated filer

Non-accelerated filer  (Do not check if a smaller reporting company) Smaller reporting company

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

The number of shares of the registrant's class A common stock and class B common stock outstanding on April 22, 2014 was 9,073,710 and 2,227,327, respectively.

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

	<b>March 31, 2014</b>	<b>December 31, 2013</b>
	(unaudited)	
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 214,751	\$ 220,171
Restricted cash	1,123	583
Short-term investments	151,080	137,198
Accounts receivable, net	67,742	86,181
Prepaid expenses and other current assets	14,100	14,260
Deferred tax assets, net	13,566	21,555
<b>Total current assets</b>	<b>462,362</b>	<b>479,948</b>
Property and equipment, net	82,013	85,445
Capitalized software development costs, net	8,671	10,295
Deposits and other assets	6,230	6,622
Deferred tax assets, net	9,288	3,204
<b>Total assets</b>	<b>\$ 568,564</b>	<b>\$ 585,514</b>
<b>Liabilities and Stockholders Equity</b>		
Current liabilities:		
Accounts payable and accrued expenses	\$ 37,887	\$ 39,946
Accrued compensation and employee benefits	52,115	79,495
Deferred revenue and advance payments	138,205	113,656
Deferred tax liabilities	515	422
<b>Total current liabilities</b>	<b>228,722</b>	<b>233,519</b>
Deferred revenue and advance payments	9,069	8,970
Other long-term liabilities	23,469	25,511
Deferred tax liabilities	1,649	7,188
<b>Total liabilities</b>	<b>262,909</b>	<b>275,188</b>

**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	495,685	494,086
Treasury stock, at cost; 6,405 shares	(475,184)	(475,184)
Accumulated other comprehensive loss	(619)	(831)
Retained earnings	285,756	292,238
<b>Total stockholders equity</b>	<b>305,655</b>	<b>310,326</b>
<b>Total liabilities and stockholders equity</b>	<b>\$ 568,564</b>	<b>\$ 585,514</b>

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)

	<b>Three Months Ended</b>	
	<b>March 31,</b>	
	<b>2014</b>	<b>2013</b>
	(unaudited)	(unaudited)
<b>Revenues:</b>		
Product licenses and subscription services	\$ 32,297	\$ 30,823
Product support	71,481	65,350
Other services	34,126	34,010
<b>Total revenues</b>	<b>137,904</b>	<b>130,183</b>
<b>Cost of revenues:</b>		
Product licenses and subscription services	6,235	5,360
Product support	3,543	4,201
Other services	23,231	26,340
<b>Total cost of revenues</b>	<b>33,009</b>	<b>35,901</b>
<b>Gross profit</b>	<b>104,895</b>	<b>94,282</b>
<b>Operating expenses:</b>		
Sales and marketing	58,877	50,714
Research and development	28,062	25,817
General and administrative	26,303	26,412
<b>Total operating expenses</b>	<b>113,242</b>	<b>102,943</b>
<b>Loss from continuing operations</b>	<b>(8,347)</b>	<b>(8,661)</b>
Interest income, net	48	61
Other (expense) income, net	(1,118)	1,708
<b>Loss from continuing operations before income taxes</b>	<b>(9,417)</b>	<b>(6,892)</b>
Benefit from income taxes	(2,935)	(1,701)
<b>Loss from continuing operations, net of tax</b>	<b>(6,482)</b>	<b>(5,191)</b>
<b>Discontinued operations:</b>		

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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)
<b>Discontinued operations, net of tax</b>	0	56,782
<b>Net (loss) income</b>	\$ (6,482)	\$ 51,591
<b>Basic (loss) earnings per share (1)</b>		
From continuing operations	\$ (0.57)	\$ (0.46)
From discontinued operations	0	5.03
Basic (loss) earnings per share	\$ (0.57)	\$ 4.57
Weighted average shares outstanding used in computing basic (loss) earnings per share	11,301	11,295
<b>Diluted (loss) earnings per share (1)</b>		
From continuing operations	\$ (0.57)	\$ (0.46)
From discontinued operations	0	5.03
Diluted (loss) earnings per share	\$ (0.57)	\$ 4.57
Weighted average shares outstanding used in computing diluted (loss) earnings per share	11,301	11,295

(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.



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**MICROSTRATEGY INCORPORATED**  
**CONSOLIDATED STATEMENTS OF COMPREHENSIVE (LOSS) INCOME**

(in thousands)

	<b>Three Months Ended</b>	
	<b>March 31,</b>	
	<b>2014</b>	<b>2013</b>
	(unaudited)	(unaudited)
<b>Net (loss) income</b>	\$ (6,482)	\$ 51,591
Other comprehensive income (loss), net of applicable taxes:		
Foreign currency translation adjustment	203	(984)
Unrealized gain (loss) on short-term investments	9	(3)
<b>Total other comprehensive income (loss)</b>	<b>212</b>	<b>(987)</b>
<b>Comprehensive (loss) income</b>	<b>\$ (6,270)</b>	<b>\$ 50,604</b>

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)

	<b>Three Months Ended</b>	
	<b>March 31,</b>	
	<b>2014</b>	<b>2013</b>
	(unaudited)	(unaudited)
<b>Operating activities:</b>		
Net (loss) income	\$ (6,482)	\$ 51,591
Plus: (Income) from discontinued operations, net of tax	0	(56,782)
Loss from continuing operations, net of tax	(6,482)	(5,191)
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	6,702	6,456
Bad debt expense	1,687	845
Deferred taxes	(4,424)	(3,962)
Share-based compensation expense	1,598	0
Excess tax benefits from share-based compensation arrangements	0	(23,579)
Changes in operating assets and liabilities:		
Accounts receivable	16,563	17,394
Prepaid expenses and other current assets	110	419
Deposits and other assets	387	25
Accounts payable and accrued expenses	(1,843)	(354)
Accrued compensation and employee benefits	(27,260)	(19,466)
Deferred revenue and advance payments	24,582	19,482
Other long-term liabilities	(840)	(1,564)
Net cash provided by (used in) operating activities from continuing operations	10,780	(9,495)
Net cash used in operating activities from discontinued operations	0	(664)
Net cash provided by (used in) operating activities	10,780	(10,159)
<b>Investing activities:</b>		
Proceeds from redemption of short-term investments	83,200	0
Purchases of property and equipment	(1,676)	(5,497)
Purchases of short-term investments	(97,047)	0
Increase in restricted cash	(538)	(124)
Net cash used in investing activities from continuing operations	(16,061)	(5,621)
Net cash provided by investing activities from discontinued operations	0	99,633
Net cash (used in) provided by investing activities	(16,061)	94,012
<b>Financing activities:</b>		

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Proceeds from sale of class A common stock under exercise of employee stock options	0	339
Excess tax benefits from share-based compensation arrangements	0	23,579
Payments on capital lease obligations and other financing arrangements	(256)	(143)
Net cash (used in) provided by financing activities from continuing operations	(256)	23,775
Net cash provided by financing activities from discontinued operations	0	0
Net cash (used in) provided by financing activities	(256)	23,775
<b>Effect of foreign exchange rate changes on cash and cash equivalents</b>	117	(1,826)
<b>Net (decrease) increase in cash and cash equivalents</b>	(5,420)	105,802
<b>Cash and cash equivalents (including held-for-sale of \$0 and \$1,350, respectively), beginning of period</b>	220,171	224,393
<b>Cash and cash equivalents (including held-for-sale of \$0 and \$0, respectively), end of period</b>	\$ 214,751	\$ 330,195

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

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**Table of Contents****(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 and changes in accounts receivable 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 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 \$1.0 million were netted against deferred tax assets. The adoption of this guidance did not have a material effect on the Company's consolidated results of operations or 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.

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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.

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:

		<b>March 31, 2014</b>			
		<b>Fair Value Measurements</b>			
		<b>Using Input Types</b>			
<b>Line Item</b>		<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total</b>
<b>Non-hedging derivative assets:</b>					
Foreign currency forward contracts	Prepaid expenses and other current assets	\$ 0	\$ 1	\$ 0	\$ 1
<b>Non-hedging derivative liabilities:</b>					
Foreign currency forward contracts	Accounts payable and accrued expenses	\$ 0	\$ 82	\$ 0	\$ 82
		<b>December 31, 2013</b>			
		<b>Fair Value Measurements</b>			
		<b>Using Input Types</b>			
<b>Line Item</b>		<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total</b>
<b>Non-hedging derivative assets:</b>					
Foreign currency forward contracts	Prepaid expenses and other current assets	\$ 0	\$ 5	\$ 0	\$ 5
<b>Non-hedging derivative liabilities:</b>					

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Foreign currency forward contracts	Accounts payable and accrued expenses	\$ 0	\$ 46	\$ 0	\$ 46
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The fair value of our foreign currency forward contracts is determined using Level 2 observable market inputs to extrapolate forward points to be added to or subtracted from the closing market spot rate on the reporting date, and then discounted to present value. All foreign currency forward contracts outstanding as of March 31, 2014 were for durations of three months or less and consisted of the following sale contracts (in thousands):

		<b>Notional Value Local Currency</b>	<b>Notional Value U.S. Dollar</b>	<b>Fair Value Gain (Loss) U.S. Dollar</b>
<b>Forward contracts to sell:</b>				
Australian Dollar	AUD	980	\$ 900	\$ (4)
Brazilian Real	BRL	2,810	1,200	(13)
British Pound	GBP	963	1,600	(4)
Canadian Dollar	CAD	668	600	(3)
Chinese Renminbi	CNY	10,568	1,700	(4)
Euro	EUR	3,420	4,700	(10)
Indian Rupee	INR	20,238	330	(2)
Japanese Yen	JPY	144,288	1,400	1
Korean Won	KRW	1,080,320	1,000	(10)
Mexican Peso	MXN	3,965	300	(2)
Polish Zloty	PLN	4,288	1,400	(10)
Russian Rouble	RUB	9,532	260	(6)
Singapore Dollar	SGD	379	300	(1)
South African Rand	ZAR	6,469	600	(6)
Swedish Krona	SEK	1,631	250	(2)
Swiss Franc	CHF	302	340	(2)
Turkish New Lira	TRY	226	100	(3)
United Arab Emirates Dirham	AED	589	160	0
			\$ 17,140	\$ (81)

Changes in the fair value of our foreign currency forward contracts (in thousands) for the three months ended March 31, 2014 and 2013 were as follows:

		<b>Gains (Losses) on Derivative Instruments Recognized in Income</b>	
		<b>Three Months Ended</b>	
		<b>March 31,</b>	
	<b>Location</b>	<b>2014</b>	<b>2013</b>
<b>Non-hedging derivative instruments:</b>			
Foreign currency forward contracts outstanding	Other (expense) income, net	\$ (81)	\$ 0
Foreign currency forward contracts settled	Other (expense) income, net	\$ (255)	\$ 0



There were no transfers among the levels within the fair value hierarchy during the three months ended March 31, 2014 and 2013. As of March 31, 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).

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The amortized cost, carrying value, and fair value of held-to-maturity investments at March 31, 2014 were \$151.0 million, \$151.0 million, and \$151.1 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 the three months ended March 31, 2014 and 2013. No other-than-temporary impairments related to these investments have been recognized in accumulated other comprehensive loss as of March 31, 2014 and December 31, 2013. As of March 31, 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:

	<b>March 31, 2014</b>	<b>December 31, 2013</b>
Billed and billable	\$ 144,979	\$ 190,446
Less: unpaid deferred revenue	(72,360)	(100,276)
Accounts receivable, gross	72,619	90,170
Less: allowance for doubtful accounts	(4,877)	(3,989)
Accounts receivable, net	\$ 67,742	\$ 86,181

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

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.

**Table of Contents****(6) Deferred Revenue and Advance Payments**

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

	<b>March 31, 2014</b>	<b>December 31, 2013</b>
<b>Current:</b>		
Deferred product licenses revenue	\$ 14,315	\$ 14,538
Deferred subscription services revenue	12,515	10,923
Deferred product support revenue	167,261	167,771
Deferred other services revenue	13,129	17,056
Gross current deferred revenue and advance payments	207,220	210,288
Less: unpaid deferred revenue	(69,015)	(96,632)
Net current deferred revenue and advance payments	\$ 138,205	\$ 113,656
<b>Non-current:</b>		
Deferred product licenses revenue	\$ 3,965	\$ 4,401
Deferred subscription services revenue	975	1,161
Deferred product support revenue	6,405	5,877
Deferred other services revenue	1,069	1,175
Gross non-current deferred revenue and advance payments	12,414	12,614
Less: unpaid deferred revenue	(3,345)	(3,644)
Net non-current deferred revenue and advance payments	\$ 9,069	\$ 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 March 31, 2014 or December 31, 2013.

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

The Company leases office space and computer and other equipment under operating lease agreements. It also leases certain computer and other equipment under capital lease agreements and licenses certain software under other financing arrangements. Under the lease agreements, in addition to base rent, the Company is generally responsible for certain taxes, utilities and maintenance costs, and other fees; and several leases include options for renewal or purchase. The Company leases approximately 190,000 square feet of office space at a location in Northern Virginia that began serving as its corporate headquarters in October 2010. 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 March 31, 2014 and December 31, 2013, deferred rent of \$19.4 million and \$20.1 million, respectively, is included in other long-term liabilities, and \$2.8 million and \$2.8 million, respectively, is included in current accrued expenses.

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**Table of Contents*****(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 April 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 April 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 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.

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

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

**Table of Contents****(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 the three months ended March 31, 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 March 31, 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.

As of March 31, 2014, the Company had recorded unrecognized tax benefits of \$1.6 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 expected to increase by approximately \$0.1 million for additional accrued interest. As of March 31, 2014, the amount of cumulative accrued interest expense on unrecognized income tax benefits was approximately \$0.3 million.

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

	<b>March 31, 2014</b>	<b>December 31, 2013</b>
Deferred tax assets, net of deferred tax liabilities	\$ 20,872	\$ 17,226
Valuation allowance	(182)	(77)
	<b>\$ 20,690</b>	<b>\$ 17,149</b>

Deferred tax assets, net of deferred tax  
liabilities and valuation allowance

The valuation allowance as of March 31, 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.



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The Company has estimated its annual effective tax rate for the full fiscal year 2014 and applied that rate to its income from continuing operations before income taxes in determining its benefit for income taxes for the three months ended March 31, 2014. The Company also records discrete items in each respective period as appropriate.

For the three months ended March 31, 2014, the Company recorded a benefit for income taxes from continuing operations of \$2.9 million that resulted in an effective tax rate of 31.2%, as compared to a benefit for income taxes from continuing operations of \$1.7 million that resulted in an effective tax rate of 24.7% for the three months ended March 31, 2013. The change in the effective tax rate is mainly due to the change in the proportion of U.S. versus foreign income, the expiration of the U.S. research and development tax credit on December 31, 2013, and the 2012 U.S. research and development tax credit that was retrospectively reinstated and taken as a benefit in the three months ended March 31, 2013. 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.

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 March 31, 2014 and December 31, 2013, the amount of cash and cash equivalents and short-term investments held by U.S. entities was \$136.6 million and \$160.5 million, respectively, and by non-U.S. entities was \$229.2 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.

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. 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 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.

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**Table of Contents****(10) Share-based Compensation**

In September 2013, the Board of Directors approved, subject to stockholder approval, 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. No awards may be issued more than ten years after the 2013 Plan's effective date. As of March 31, 2014, there were no remaining shares of class A common stock authorized for issuance under the 2013 Plan. In April 2014, the Board of Directors authorized, subject to stockholder approval, an increase in 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.

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 of the Board of Directors (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 March 31, 2014, there were no outstanding share-based awards granted under the Other Stock Incentive Plans.



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The following table summarizes the Company's stock option activity (in thousands, except per share data and years) for the three months ended March 31, 2014:

	<b>Stock Options Outstanding</b>			
	<b>Shares</b>	<b>Weighted Average Exercise Price Per Share</b>	<b>Aggregate Intrinsic Value</b>	<b>Weighted Average Remaining Contractual Term (Years)</b>
Balance as of January 1, 2014	600	\$ 92.84		
Granted	0	0		
Exercised	0	0		
Forfeited/Expired	0	0		
Balance as of March 31, 2014	600	\$ 92.84		
Exercisable as of March 31, 2014	0	\$ 0	\$ 0	0.0
Expected to vest as of March 31, 2014	600	\$ 92.84	\$ 12,396	9.4
Total	600	\$ 92.84	\$ 12,396	9.4

No stock options vested during the three months ended March 31, 2014. The Company expects all unvested options at March 31, 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 Company recognized approximately \$1.6 million in share-based compensation expense for the three months ended March 31, 2014 from stock options granted under the 2013 Plan. The Company did not recognize any share-based compensation expense for the three months ended March 31, 2013 from stock options granted under the Other Stock Incentive Plans as all such options fully vested in prior years. As of March 31, 2014, there was approximately \$21.5 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 3.3 years.

During the three months ended March 31, 2014, no windfall tax benefits were realized from the exercise of stock options. During the three months ended March 31, 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 three months ended March 31, 2013.

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 months ended March 31, 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 March 31, 2014 and December 31, 2013, there were no shares of preferred stock issued or outstanding.

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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. Stock options issued under the 2013 Plan to purchase an aggregate of 600,000 shares of class A common stock were excluded from the diluted earnings per share computation for the three months ended March 31, 2014 because their impact would have been anti-dilutive. For the three months ended March 31, 2013, 4,046 potential shares of common stock 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 months ended March 31, 2013, in addition to the pre-tax gain on the sale of Angel.com recorded by the Company during the three months ended March 31, 2013 (in thousands):

	<b>Three Months Ended March 31, 2013</b>	
Angel.com revenues	\$	6,320
Angel.com pre-tax loss	\$	986
MicroStrategy pre-tax gain on sale	\$	94,925

**Table of Contents****(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 months ended March 31, 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:

<b>Geographic regions:</b>	<b>Domestic</b>		<b>EMEA</b>		<b>Other Regions</b>		<b>Consolidated</b>
<b>Three months ended</b>							
<b>March 31, 2014</b>							
Total revenues	\$	80,605	\$	43,137	\$	14,162	\$ 137,904
Gross profit	\$	61,310	\$	31,940	\$	11,645	\$ 104,895
<b>Three months ended</b>							
<b>March 31, 2013</b>							
Total revenues	\$	77,308	\$	37,936	\$	14,939	\$ 130,183
Gross profit	\$	56,126	\$	25,929	\$	12,227	\$ 94,282
<b>As of March 31, 2014</b>							
Long-lived assets	\$	84,601	\$	6,380	\$	5,933	\$ 96,914
<b>As of March 31, 2013</b>							
Long-lived assets	\$	95,489	\$	8,620	\$	6,537	\$ 110,646

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

For the three months ended March 31, 2014 and 2013, no individual customer accounted for 10% or more of total consolidated revenues from continuing operations.

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

**(14) Subsequent Events**

As discussed in Note 7, the Company leased an additional 43,000 square feet of office space at its corporate headquarters location in April 2014. The total future minimum rent payments associated with the additional leased space amount to \$12.4 million through December 2020.



As discussed in Note 10, the Company's stockholders approved the 2013 Plan at the Company's annual meeting in April 2014. Also in April 2014, the Board of Directors authorized, subject to stockholder approval, an increase in 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.

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**Table of Contents****Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations****FORWARD-LOOKING INFORMATION**

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

**Overview**

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

The MicroStrategy Analytics Platform enables organizations to analyze vast amounts of data and distribute actionable business insight throughout 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. The MicroStrategy Analytics Platform is comprised of MicroStrategy Analytics Enterprise™, MicroStrategy Analytics Express™, and MicroStrategy Analytics Desktop™. MicroStrategy Analytics Enterprise lies at the core of the MicroStrategy Analytics Platform and combines the agility and productivity of self-service visual data discovery with the security, scalability, and governance features of enterprise-grade business intelligence. MicroStrategy Analytics Desktop is 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 Analytics Express is a cloud-based service that is designed to be the fastest way for companies, departments, and small businesses to build and deploy MicroStrategy-caliber analytics with little or no assistance from IT professionals. MicroStrategy Analytics Express guides business people through a streamlined flow from data-to-discovery-to-dashboard-to-distribution.

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.

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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.

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 the three months ended March 31, 2014 and 2013, we did not generate significant revenues from the MicroStrategy Loyalty Platform or the MicroStrategy Identity Platform.

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The following table sets forth certain operating highlights (in thousands) for the three months ended March 31, 2014 and 2013:

	<b>Three Months Ended March 31,</b>	
	<b>2014</b>	<b>2013</b>
<b>Revenues</b>		
Product licenses and subscription services	\$ 32,297	\$ 30,823
Product support	71,481	65,350
Other services	34,126	34,010
<b>Total revenues</b>	<b>137,904</b>	<b>130,183</b>
<b>Cost of revenues</b>		
Product licenses and subscription services	6,235	5,360
Product support	3,543	4,201
Other services	23,231	26,340
<b>Total cost of revenues</b>	<b>33,009</b>	<b>35,901</b>
<b>Gross profit</b>	<b>104,895</b>	<b>94,282</b>
<b>Operating expenses</b>		
Sales and marketing	58,877	50,714
Research and development	28,062	25,817
General and administrative	26,303	26,412
<b>Total operating expenses</b>	<b>113,242</b>	<b>102,943</b>
<b>Loss from continuing operations</b>	<b>\$ (8,347)</b>	<b>\$ (8,661)</b>

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. Organizations recently 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, companies with industry leading positions in certain software markets, such as Microsoft, Oracle, IBM, and SAP, have incorporated analytics capabilities into their product suites. We also face competition from various independent analytics software providers, such as Qlik, Tableau Software, TIBCO, Actuate, Information Builders, and the SAS Institute. As a result, our offerings need to be sufficiently differentiated from both the bundled software offerings as well as the offerings of independent analytics software providers to create customer demand for our platform, products, and services and to maintain and grow our market share.

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

enhancement of our ability to support new enterprise-scale requirements for 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 recent 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; and

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.

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 quarter 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 the three months ended March 31, 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 March 31, 2014, we had a total of 3,221 employees, of whom 1,455 were based in the United States and 1,766 were based internationally. Of our 3,221 employees, 861 were engaged in sales and marketing, 992 in research and development, 889 in subscription, product support, consulting, and education services, and 479 in finance, administration, and corporate operations.



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

In September 2013, the Board of Directors approved, subject to stockholder approval, our 2013 Stock Incentive Plan (the 2013 Plan ) authorizing the grant of an aggregate of 600,000 shares of our class A common stock. Also in September 2013, the Compensation Committee approved, subject to stockholder approval of the 2013 Plan, the grant of stock options to purchase an aggregate of 600,000 shares of our class A common stock to certain of our executives. In April 2014, the Company s stockholders approved the 2013 Plan at the Company s annual meeting. We estimate that related share-based compensation expense for these options will be recognized at a rate of approximately \$1.6 million per quarter over the remaining weighted average vesting period of approximately 3.3 years. Share-based compensation expense (in thousands) was recognized in the following operating expense line items in our Consolidated Statements of Operations for the periods indicated:

	<b>Three Months Ended March 31,</b>	
	<b>2014</b>	<b>2013</b>
Research and development	\$ 266	\$ 0
General and administrative	1,332	0
<b>Total share-based compensation expense</b>	<b>\$ 1,598</b>	<b>\$ 0</b>

Also in April 2014, the Board of Directors authorized, subject to stockholder approval, an increase in 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.

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.

**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 three years and is an important part of the compensation provided to certain executives. Our non-GAAP financial measure is not meant to be considered in isolation

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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:

	<b>Three Months Ended March 31,</b>	
	<b>2014</b>	<b>2013</b>
<b>Reconciliation of non-GAAP loss from continuing operations:</b>		
Loss from continuing operations	\$(8,347)	\$(8,661)
Share-based compensation expense	1,598	0
Non-GAAP loss from continuing operations	\$(6,749)	\$(8,661)

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**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.

The section **Critical Accounting Policies** included in Item 7 and the section **Summary of Significant Accounting Policies** (Note 2) included in Item 15 of our Annual Report on Form 10-K for the year ended December 31, 2013 provide a more detailed explanation of the judgments made in these areas and a discussion of our accounting estimates and policies. There have been no significant changes in such estimates and policies since December 31, 2013.

**Table of Contents****Impact of Foreign Currency Exchange Rate Fluctuations on Results of Operations**

We conduct a significant portion of our business in currencies other than the U.S. dollar, the currency in which we report our Consolidated Financial Statements. As currency rates change from quarter to quarter and year over year, our results of operations may be impacted. The table below summarizes the impact (in thousands) of fluctuations in foreign currency exchange rates on certain components of our Consolidated Statements of Operations by showing the increase (decrease) in revenues or expenses, as applicable, from the same period in the prior year. The term international refers to operations outside of the United States and Canada.

	<b>Three Months Ended</b>	
	<b>March 31,</b>	
	<b>2014</b>	<b>2013</b>
International product licenses and subscription services revenues	\$ (211)	\$ (378)
International product support revenues	(213)	(465)
International other services revenues	(95)	(332)
Cost of product support revenues	7	(40)
Cost of other services revenues	(21)	(80)
Sales and marketing expenses	(242)	(409)
Research and development expenses	204	38
General and administrative expenses	(146)	(91)

For example, if there had been no change to foreign currency exchange rates from 2013 to 2014, international product licenses and subscription services revenues would have been \$14.2 million rather than \$14.0 million for the three months ended March 31, 2014. If there had been no change to foreign currency exchange rates from 2013 to 2014, sales and marketing expenses would have been \$59.1 million rather than \$58.9 million for the three months ended March 31, 2014.

**Table of Contents****Results of Operations****Comparison of the three months ended March 31, 2014 and 2013****Revenues**

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

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

	<b>Three Months Ended March 31,</b>		<b>%</b>
	<b>2014</b>	<b>2013</b>	<b>Change</b>
<b>Product Licenses and Subscription Services Revenues:</b>			
<b>Product Licenses</b>			
Domestic	\$ 14,469	\$ 16,556	12.6%
International	13,387	11,812	13.3%
<b>Total product licenses revenues</b>	<b>27,856</b>	<b>28,368</b>	<b>1.8%</b>
Subscription Services	4,441	2,455	80.9%
<b>Total product licenses and subscription services revenues</b>	<b>\$ 32,297</b>	<b>\$ 30,823</b>	<b>4.8%</b>

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

	<b>Three Months Ended March 31,</b>	
	<b>2014</b>	<b>2013</b>
<b>Product Licenses Transactions with Recognized Licenses Revenue in the Applicable Period:</b>		
More than \$1.0 million in licenses revenue recognized	4	3
Between \$0.5 million and \$1.0 million in licenses revenue recognized	5	8
<b>Total</b>	<b>9</b>	<b>11</b>
<i>Domestic:</i>		

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More than \$1.0 million in licenses revenue recognized	4	2
Between \$0.5 million and \$1.0 million in licenses revenue recognized	1	6
Total	5	8

*International:*

More than \$1.0 million in licenses revenue recognized	0	1
Between \$0.5 million and \$1.0 million in licenses revenue recognized	4	2
Total	4	3

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

	<b>Three Months Ended March 31,</b>		<b>% Change</b>
	<b>2014</b>	<b>2013</b>	
<b>Product Licenses Revenue Recognized in the Applicable Period:</b>			
More than \$1.0 million in licenses revenue recognized	\$ 5,717	\$ 3,834	49.1%
Between \$0.5 million and \$1.0 million in licenses revenue recognized	3,076	5,948	48.3%
Less than \$0.5 million in licenses revenue recognized	19,063	18,586	2.6%
<b>Total</b>	<b>27,856</b>	<b>28,368</b>	<b>1.8%</b>
<i>Domestic:</i>			
More than \$1.0 million in licenses revenue recognized	5,717	2,757	107.4%
Between \$0.5 million and \$1.0 million in licenses revenue recognized	697	4,224	83.5%
Less than \$0.5 million in licenses revenue recognized	8,055	9,575	15.9%
<b>Total</b>	<b>14,469</b>	<b>16,556</b>	<b>12.6%</b>
<i>International:</i>			
More than \$1.0 million in licenses revenue recognized	0	1,077	100.0%
Between \$0.5 million and \$1.0 million in licenses revenue recognized	2,379	1,724	38.0%
Less than \$0.5 million in licenses revenue recognized	11,008	9,011	22.2%
<b>Total</b>	<b>\$ 13,387</b>	<b>\$ 11,812</b>	<b>13.3%</b>

Product licenses revenues decreased \$0.5 million for the three months ended March 31, 2014, as compared to the same period in the prior year. For the three months ended March 31, 2014 and 2013, product licenses transactions with more than \$0.5 million in recognized revenue represented 31.6% and 34.5%, respectively, of our product licenses revenues. For the three months ended March 31, 2014, our top three product licenses transactions totaled \$4.7 million in recognized revenue, or 16.8% of total product licenses revenues, compared to \$3.8 million, or 13.4% of total product licenses revenues, for the three months ended March 31, 2013.

**Domestic product licenses revenues.** Domestic product licenses revenues decreased \$2.1 million for the three months ended March 31, 2014, as compared to the same period in the prior year, primarily due to a decrease in the number and average deal size of transactions with recognized revenue between \$0.5 million and \$1.0 million and a decrease in the number and average deal size of transactions with less than \$0.5 million in recognized revenue, partially offset by an increase in the number and average deal size of transactions with more than \$1.0 million in recognized revenue.



***International product licenses revenues.*** International product licenses revenues increased \$1.6 million for the three months ended March 31, 2014, as compared to the same period in the prior year, primarily due to an increase in the number and average deal size of transactions with less than \$0.5 million in recognized revenue and an increase in the number of transactions with recognized revenue between \$0.5 million and \$1.0 million, partially offset by the fact that we did not recognize revenue on any transaction in excess of \$1.0 million during the three months ended March 31, 2014.

***Subscription services revenues.*** Subscription services revenues are derived primarily from MicroStrategy Cloud services offerings that are recognized on a subscription basis over the service period of the contract. Subscription services revenues increased \$2.0 million for the three months ended March 31, 2014, as compared to the same period in the prior year, primarily due to an increase in the number of new customers as our MicroStrategy Cloud business has continued to grow.

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

	<b>Three Months Ended March 31,</b>		<b>%</b>
	<b>2014</b>	<b>2013</b>	<b>Change</b>
<b>Product Support Revenues:</b>			
Domestic	\$ 41,406	\$ 37,726	9.8%
International	30,075	27,624	8.9%
<b>Total product support revenues</b>	<b>\$ 71,481</b>	<b>\$ 65,350</b>	<b>9.4%</b>

Product support revenues are derived from providing technical software support and software updates and upgrades to customers. Product support revenues are recognized ratably over the term of the contract, which is generally one year. Product support revenues increased \$6.1 million for the three months ended March 31, 2014, as compared to the same period in the prior year, primarily due to an increase in the number of new product support contracts and more timely renewals at quarter-end.

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

	<b>Three Months Ended March 31,</b>		<b>%</b>
	<b>2014</b>	<b>2013</b>	<b>Change</b>
<b>Other Services Revenues:</b>			
<b>Consulting</b>			
Domestic	\$ 18,523	\$ 18,477	0.2%
International	11,865	11,509	3.1%
<b>Total consulting revenues</b>	<b>30,388</b>	<b>29,986</b>	<b>1.3%</b>
Education	3,738	4,024	7.1%
<b>Total other services revenues</b>	<b>\$ 34,126</b>	<b>\$ 34,010</b>	<b>0.3%</b>

**Consulting revenues.** Consulting revenues are derived from helping customers plan and execute the deployment of our software. Consulting revenues increased for the three months ended March 31, 2014, as compared to the same period in the prior year, primarily due to an increase in revenue from one new major client implementation, partially offset by an overall decrease in billable hours.

**Education revenues.** Education revenues are derived from the education and training that we provide to our customers to enhance their ability to fully utilize the features and functionality of our software. These offerings include

self-tutorials, custom course development, joint training with customers internal staff, and standard course offerings, with pricing dependent on the specific offering delivered. Education revenues decreased for the three months ended March 31, 2014, as compared to the same period in the prior year, primarily due to lower overall contract values, a decrease in private and custom courses delivered, and shifting demand from traditional classroom training to virtual training within our perennial education pass program.

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

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

	<b>Three Months Ended March 31,</b>		<b>%</b>
	<b>2014</b>	<b>2013</b>	<b>Change</b>
<b>Cost of Revenues:</b>			
<b>Product licenses and subscription services:</b>			
Product licenses	\$ 1,828	\$ 1,593	14.8%
Subscription services	4,407	3,767	17.0%
<b>Total product licenses and subscription services</b>	<b>6,235</b>	<b>5,360</b>	<b>16.3%</b>
Product support	3,543	4,201	15.7%
<b>Other services:</b>			
Consulting	21,723	24,636	11.8%
Education	1,508	1,704	11.5%
<b>Total other services</b>	<b>23,231</b>	<b>26,340</b>	<b>11.8%</b>
<b>Total cost of revenues</b>	<b>\$ 33,009</b>	<b>\$ 35,901</b>	<b>8.1%</b>

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

Cost of product licenses revenues increased \$0.2 million for the three months ended March 31, 2014, as compared to the same period in the prior year, primarily due to a \$0.5 million increase in amortization of capitalized software development costs related to the release of MicroStrategy 9.4 in October 2013, partially offset by a \$0.2 million decrease in amortization of capitalized software development costs related to MicroStrategy Mobile, which became fully amortized in June 2013. We expect to amortize the remaining balance of our products' capitalized software development costs as of March 31, 2014 ratably over the applicable remaining amortization periods as follows:

	<b>Capitalized Software Development Costs, Net, as of March 31, 2014 (in thousands)</b>	<b>Remaining Amortization Period (in months)</b>
MicroStrategy 9.2.1	\$ 202	3
MicroStrategy 9.3	3,938	18

MicroStrategy 9.4		4,531	30
Total capitalized software development costs	\$	8,671	

All of the above software now form part of the MicroStrategy Analytics Platform.

**Cost of subscription services revenues.** Cost of subscription services revenues consists of equipment, facility and other related support costs, and personnel and related overhead costs. Cost of subscription services revenues increased \$0.6 million for the three months ended March 31, 2014, as compared to the same period in the prior year, due to a \$0.5 million increase in compensation and related costs due to an increase in staffing levels and a \$0.3 million increase in equipment depreciation and facility and other related support costs, partially offset by a \$0.2 million decrease in consulting and advisory costs. Subscription services headcount increased 147.4% to 47 at March 31, 2014 from 19 at March 31, 2013.

**Cost of product support revenues.** Cost of product support revenues consists of product support personnel and related overhead costs. Cost of product support revenues decreased \$0.7 million for the three months ended March 31, 2014, as compared to the same period in the prior year, due to a \$0.5 million decrease in compensation and related costs due to a decrease in staffing levels, a \$0.1 million decrease in travel and entertainment expenditures, and a \$0.1 million decrease in facility and other related support costs. Product support headcount decreased 15.3% to 149 at March 31, 2014 from 176 at March 31, 2013.

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**Cost of consulting revenues.** Cost of consulting revenues consists of personnel and related overhead costs. Cost of consulting revenues decreased \$2.9 million for the three months ended March 31, 2014, as compared to the same period in the prior year, due to a \$1.4 million decrease in compensation and related costs due to a decrease in staffing levels, a \$0.8 million decrease in travel and entertainment expenditures, a \$0.5 million decrease in subcontractor costs, and a \$0.2 million decrease in facility and other related support costs. Consulting headcount decreased 15.5% to 653 at March 31, 2014 from 773 at March 31, 2013.

**Cost of education revenues.** Cost of education revenues consists of personnel and related overhead costs. Cost of education revenues decreased \$0.2 million for the three months ended March 31, 2014, as compared to the same period in the prior year, due to a \$0.1 million decrease in compensation and related costs due to a decrease in staffing levels and a \$0.1 million decrease in facility and other related support costs. Education headcount decreased 7.0% to 40 at March 31, 2014 from 43 at March 31, 2013.

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

	<b>Three Months Ended March 31,</b>		<b>%</b>
	<b>2014</b>	<b>2013</b>	<b>Change</b>
Sales and marketing expenses	\$ 58,877	\$ 50,714	16.1%

Sales and marketing expenses increased \$8.2 million for the three months ended March 31, 2014, as compared to the same period in 2013, primarily due to a \$4.5 million increase in compensation, variable compensation, and related costs, a \$1.3 million increase due to previously disputed variable compensation, a \$1.0 million increase in marketing and advertising costs, a \$0.8 million increase in travel and entertainment expenditures, and a \$0.3 million increase in facilities and other related support costs. Sales and marketing headcount increased 7.1% to 861 at March 31, 2014 from 804 at March 31, 2013.

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

	<b>Three Months Ended March 31,</b>		<b>%</b>
	<b>2014</b>	<b>2013</b>	<b>Change</b>
General and administrative expenses	\$ 26,303	\$ 26,412	0.4%

General and administrative expenses decreased \$0.1 million for the three months ended March 31, 2014, as compared to the same period in the prior year, primarily due to a \$1.4 million decrease in legal, consulting, and other advisory costs and a \$1.3 million decrease in variable compensation primarily due to the fact that variable compensation in the

prior year included additional amounts incurred as a result of the sale of Angel.com, partially offset by a \$1.3 million increase in share-based compensation expense related to the grant of stock options under the 2013 Plan, a \$1.0 million increase in compensation and related costs due to an increase in staffing levels, and a \$0.2 million increase in facility and other related support costs. General and administrative headcount increased 7.2% to 479 at March 31, 2014 from 447 at March 31, 2013. We do not expect to increase general and administrative headcount significantly in the near term.

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

	<b>Three Months Ended March 31,</b>		<b>%</b>
	<b>2014</b>	<b>2013</b>	<b>Change</b>
Gross research and development expenses before capitalized software development costs	\$ 28,062	\$ 25,817	8.7%
Capitalized software development costs	0	0	n/a
<b>Total research and development expenses</b>	<b>\$ 28,062</b>	<b>\$ 25,817</b>	<b>8.7%</b>
 Amortization of capitalized software development costs included in cost of product licenses revenues	 \$ 1,624	 \$ 1,353	 20.0%

Research and development expenses, before capitalization of software development costs, increased \$2.2 million for the three months ended March 31, 2014, as compared to the same period in the prior year, primarily due to a \$2.6 million increase in compensation and related costs due to an increase in staffing levels, a \$0.5 million increase in recruiting costs, and a \$0.3 million increase in share-based compensation expense related to the grant of stock options under the 2013 Plan, partially offset by a \$1.0 million decrease in consulting and advisory costs and a \$0.1 million decrease in facilities and other related support costs. We did not capitalize any software development costs during each of the three months ended March 31, 2014 and 2013. Research and development headcount increased 9.0% to 992 at March 31, 2014 from 910 at March 31, 2013.

For the three months ended March 31, 2014, our research and development personnel were focused on the following: 71.9% on the MicroStrategy Analytics Platform, MicroStrategy Mobile, MicroStrategy Cloud, and internal information technology initiatives and 28.1% on other research and development, including the MicroStrategy Loyalty Platform and the MicroStrategy Identity Platform.

**Other (Expense) Income, Net**

Other (expense) income, net is comprised primarily of realized gains and losses on our foreign currency forward contracts and foreign currency transaction gains and losses. For the three months ended March 31, 2014, other expense, net, of \$1.1 million was comprised primarily of \$0.8 million in foreign currency transaction net losses, arising mainly from the revaluation of U.S. dollar denominated cash balances held at international locations and \$0.3 million in realized losses from the settlement of certain foreign currency forward contracts.

**Provision for Income Taxes**

For the three months ended March 31, 2014, we recorded a benefit for income taxes from continuing operations of \$2.9 million that resulted in an effective tax rate of 31.2%, as compared to a benefit for income taxes from continuing operations of \$1.7 million that resulted in an effective tax rate of 24.7% for the three months ended March 31, 2013.



The change in the effective tax rate is mainly due to the change in the proportion of U.S. versus foreign income and the expiration of the U.S. research and development tax credit on December 31, 2013. 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 our period to period results, fluctuations in our effective tax rate and respective tax provisions or benefits may occur.

As of March 31, 2014, we estimated that we had U.S. federal net operating loss carryforwards of \$27.7 million and foreign net operating loss carryforwards of \$4.3 million. As of March 31, 2014, we estimated that we had U.S. and foreign net operating loss carryforwards, other temporary differences and carryforwards, and credits resulted in deferred tax assets, net of valuation allowances and deferred tax liabilities, of \$20.7 million. As of March 31, 2014, we had a valuation allowance of \$0.2 million primarily related to certain foreign net operating loss carryforwards that, in our present estimation, more likely than not will not be realized.

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Over the course of 2013 and the first quarter of 2014, we increased our headcount as part of our initiatives to focus on specific research and development 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. If we are unable to achieve profitability in the future, particularly relating to our U.S. operations, we may be required to increase the valuation allowance against our deferred tax assets. We will continue to regularly assess the realizability of deferred tax assets.

**Discontinued Operations**

On March 15, 2013, we completed the sale of our equity interest in our Angel.com business and received consideration of approximately \$111.2 million, resulting in a net cash inflow of \$100.7 million after \$10.5 million in transaction costs. The sale resulted in a gain of \$57.4 million, net of tax. 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.

**Deferred Revenue and Advance Payments**

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

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

	<b>March 31, 2014</b>	<b>December 31, 2013</b>	<b>March 31, 2013</b>
<b>Current:</b>			
Deferred product licenses revenue	\$ 14,315	\$ 14,538	\$ 10,297
Deferred subscription services revenue	12,515	10,923	8,049
Deferred product support revenue	167,261	167,771	150,687
Deferred other services revenue	13,129	17,056	12,933
Gross current deferred revenue and advance payments	207,220	210,288	181,966
Less: unpaid deferred revenue	(69,015)	(96,632)	(63,048)
Net current deferred revenue and advance payments	\$ 138,205	\$ 113,656	\$ 118,918
<b>Non-current:</b>			
Deferred product licenses revenue	\$ 3,965	\$ 4,401	\$ 3,037
Deferred subscription services revenue	975	1,161	845
Deferred product support revenue	6,405	5,877	7,661
Deferred other services revenue	1,069	1,175	1,125

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Gross non-current deferred revenue and advance payments	12,414	12,614	12,668
Less: unpaid deferred revenue	(3,345)	(3,644)	(3,485)
Net non-current deferred revenue and advance payments	\$ 9,069	\$ 8,970	\$ 9,183

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

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Total gross deferred revenue and advance payments decreased \$3.3 million as of March 31, 2014, as compared to December 31, 2013, primarily due to the recognition of previously deferred product licenses and other services revenues, partially offset by an increase in the number of subscription services contracts. Total gross deferred revenue and advance payments increased \$25.0 million as of March 31, 2014, as compared to March 31, 2013, due to an increase in the number of product licenses, subscription services, product support, and other services contracts.

We expect to recognize approximately \$207.2 million of deferred revenue and advance payments over the next 12 months. However, the timing and ultimate recognition of our deferred revenue and advance payments depend on our performance of various service obligations, and the amount of deferred revenue and advance payments at any date should not be considered indicative of revenues for any succeeding period.

As of March 31, 2014, we had entered into certain additional agreements that include future minimum commitments by our customers to purchase products, subscription services, product support, or other services through 2019 totaling approximately \$126.3 million. Revenue relating to such future commitments by our customers is not included in our deferred revenue balances. Revenue relating to such agreements will be recognized during the period in which all revenue recognition criteria are met. The timing and ultimate recognition of any revenue from such customer purchase commitments depend on our customers meeting their future purchase commitments and our meeting our associated performance obligations related to those purchase commitments.

## **Liquidity and Capital Resources**

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

As of March 31, 2014 and December 31, 2013, the amount of cash and cash equivalents and short-term investments held by U.S. entities were \$136.6 million and \$160.5 million, respectively, and by non-U.S. entities were \$229.2 million and \$196.9 million, respectively. We earn a significant amount of our revenues outside the U.S. and, except for Subpart F deemed dividends, we intend to indefinitely reinvest undistributed earnings of certain non-U.S. entities. We do not anticipate needing to repatriate the cash or cash equivalents held by non-U.S. entities to the U.S. to finance our U.S. operations. However, if we were to elect to repatriate these amounts, we would generate U.S. taxable income to the extent of our undistributed foreign earnings, which amounted to \$192.7 million at December 31, 2013. Although the tax impact of repatriating these earnings is difficult to determine and our effective tax rate could increase as a result of any such repatriation, we would not expect the maximum effective tax rate that would be applicable to such repatriation to exceed the U.S. statutory rate of 35.0%, after considering applicable foreign tax credits.

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

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

	<b>Three Months Ended</b>		<b>% Change</b>
	<b>March 31, 2014</b>	<b>2013</b>	
Net cash provided by (used in) operating activities from continuing operations	\$ 10,780	\$ (9,495)	213.5%
Net cash used in investing activities from continuing operations	\$ (16,061)	\$ (5,621)	185.7%
Net cash (used in) provided by financing activities from continuing operations	\$ (256)	\$ 23,775	101.1%

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

Net cash provided by operating activities from continuing operations was \$10.8 million for the three months ended March 31, 2014. Net cash used in operating activities from continuing operations was \$9.5 million for the three months ended March 31, 2013. The increase in net cash provided by operating activities from continuing operations during the three months ended March 31, 2014, as compared to the same period in the prior year, was due to a \$25.8 million increase from changes in non-cash items, partially offset by a \$4.2 million change in operating assets and liabilities and a \$1.3 million increase in loss from continuing operations, net of tax. Non-cash items primarily consist of depreciation and amortization, bad debt expense, deferred taxes, share-based compensation expense, and excess tax benefits from share-based compensation arrangements.

**Net Cash Used in Investing Activities from Continuing Operations.** The changes in net cash used in investing activities from continuing operations primarily relate to purchases and redemptions of short-term investments and expenditures on property and equipment. Net cash used in investing activities from continuing operations was \$16.1 million and \$5.6 million for the three months ended March 31, 2014 and 2013, respectively. The increase in net cash used in investing activities from continuing operations for the three months ended March 31, 2014, as compared to the same period in the prior year, was primarily due to \$97.0 million increase in purchases of short-term investments and a \$0.4 million increase in restricted cash, partially offset by a \$83.2 million increase in proceeds from the redemption of U.S. Treasury securities and a \$3.8 million decrease in purchases of property and equipment, comprised primarily of decreases in expenditures for computer equipment and software.

**Net Cash Provided by Financing Activities from Continuing Operations.** The changes in net cash provided by financing activities from continuing operations primarily relate to the exercise of employee stock options. Net cash used in financing activities from continuing operations was \$0.3 million for the three months ended March 31, 2014. Net cash provided by financing activities from continuing operations was \$23.8 million for the three months ended March 31, 2013. The increase in net cash used in financing activities from continuing operations for the three months ended March 31, 2014, as compared to the same period in the prior year, was primarily due to a \$23.6 million

decrease in excess tax benefits, generated primarily from stock option exercises in previous years, that were recognized in 2013 due to the taxable gain arising from the sale of Angel.com, a \$0.3 million decrease in proceeds from the exercise of employee stock options, and a \$0.1 million increase in payments on capital lease obligations and other financing arrangements.

***Contractual Obligations.*** As disclosed in Note 7, Commitments and Contingencies, to the Consolidated Financial Statements, we lease office space and computer and other equipment under operating lease agreements. We also lease certain computer and other equipment under capital lease agreements and license certain software under other financing arrangements. Under the lease agreements, in addition to base rent, we are generally responsible for certain taxes, utilities and maintenance costs, and other fees; and

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several leases include options for renewal or purchase. The following table shows future minimum rent payments under noncancellable operating and capital leases and agreements with initial terms of greater than one year, net of total future minimum rent payments to be received under noncancellable sublease agreements (in thousands), based on the expected due dates of the various installments as of March 31, 2014:

	<b>Payments due by period ended March 31,</b>				
	<b>Total</b>	<b>2015</b>	<b>2016-2017</b>	<b>2018-2019</b>	<b>Thereafter</b>
<i>Contractual Obligations:</i>					
Operating leases	\$ 120,527	\$ 25,088	\$ 37,925	\$ 29,781	\$ 27,733
Capital leases and other financing arrangements	3,724	2,274	1,450	0	0
<b>Total</b>	<b>\$ 124,251</b>	<b>\$ 27,362</b>	<b>\$ 39,375</b>	<b>\$ 29,781</b>	<b>\$ 27,733</b>

The above table does not include total future minimum rent payments of \$12.4 million related to the lease of an additional 43,000 square feet of office space at our corporate headquarters location entered into during April 2014.

**Unrecognized Tax Benefits.** As of March 31, 2014, we had \$1.6 million of total gross unrecognized tax benefits, including interest accrued. The unrecognized tax benefits have been netted against deferred tax assets upon adoption of Accounting Standards Update No. 2013-11, *Income Taxes (Topic 740)*, and are recorded in other long-term liabilities. The timing of any payments that could result from these unrecognized tax benefits will depend on a number of factors, and accordingly the amount and period of any future payments cannot be estimated. We do not expect a significant tax payment related to these obligations during 2014.

**Off-Balance Sheet Arrangements.** As of March 31, 2014, we did not have any off-balance sheet arrangements that had or were reasonably likely to have a current or future material impact on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures, or capital resources.

**Recent Accounting Standards**

In July 2013, the 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 \$1.0 million were netted against deferred tax assets. The adoption of this guidance did not have a material effect on the Company's consolidated results of operations or cash flows.

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

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

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

**Interest Rate Risk.** We face exposure to changes in interest rates primarily relating to our investments. We generally invest our excess cash in short-term, highly-rated, fixed-rate financial instruments. These fixed-rate instruments are subject to interest rate risk and may fall in value if interest rates increase. As of March 31, 2014, we held approximately \$151.0 million of investments in U.S. Treasury securities with stated maturity dates between three months and one year from the purchase date, and we intend to hold these investments until maturity.

**Foreign Currency Risk.** We conduct a significant portion of our business in currencies other than the U.S. dollar, the currency in which we report our Consolidated Financial Statements. International revenues accounted for 41.5% and 40.6% of our total revenues from continuing operations for the three months ended March 31, 2014 and 2013, respectively. We anticipate that international revenues will continue to account for a significant portion of our total revenues. The functional currency of each of our foreign subsidiaries is the local currency.

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

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

We cannot predict the effect of exchange rate fluctuations upon our future results. We attempt to minimize our foreign currency risk by converting our excess foreign currency held in foreign jurisdictions to U.S. dollar denominated cash and investment accounts. In addition, beginning in the second quarter of 2013, we entered into foreign currency forward contracts to hedge certain risks associated with foreign currency exchange exposure. We manage the use of foreign exchange derivative instruments centrally, and we do not hold or enter into derivative financial instruments for speculative trading purposes. See Note 3, Fair Value Measurements, to the Consolidated Financial Statements for further information on foreign currency forward contracts held. We cannot be sure that our hedging techniques will be successful or that our business, results of operations, financial condition, and cash flows will not be materially adversely affected by exchange rate fluctuations.

As of March 31, 2014 and December 31, 2013, a 10% adverse change in foreign currency exchange rates versus the U.S. dollar, before applying the impact of our foreign currency forward contracts, would have decreased our aggregate reported cash and cash equivalents and short-term investments by 0.3% and 0.4%, respectively. The decrease in exposure to an adverse change in foreign currency rates as of March 31, 2014 was primarily due to a decrease of cash balances in our non-U.S. dollar based bank accounts as compared to December 31, 2013. Our foreign currency forward contracts further decrease the negative impact that a 10% adverse change in foreign currency exchange rates would have on our aggregate reported cash and cash equivalents and short-term investments from 0.3% to 0.1% as of March 31, 2014. If average exchange rates during the three months ended March 31, 2014 had changed unfavorably by 10%, our revenues for the three months ended March 31, 2014 would have decreased by 3.8%. During the three



months ended March 31, 2014, our revenues decreased 0.4% as a result of a 0.1% unfavorable change in weighted average exchange rates, as compared to the same period in the prior year.

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**Item 4. Controls and Procedures**

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

***Changes in internal controls.*** No change in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) occurred during the fiscal quarter ended March 31, 2014 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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**Table of Contents****PART II - OTHER INFORMATION****Item 1. Legal Proceedings**

In December 2011, DataTern, Inc. ( DataTern ) filed a complaint for patent infringement against the Company in the United States District Court for the District of Massachusetts. The complaint alleged that the Company infringes U.S. Patent No. 6,101,502 (the 502 Patent ), allegedly owned by DataTern, by making, selling, or offering for sale several of the Company's products and services including MicroStrategy 9, MicroStrategy Intelligence Server, MicroStrategy Business Intelligence Platform, MicroStrategy Cloud Personal, and other MicroStrategy applications for creating or using data mining, dashboards, business analytics, data storage and warehousing, and Web hosting support. The complaint accused the Company of willful infringement and sought an unspecified amount of damages, an award of attorneys' fees, and preliminary and permanent injunctive relief. In October 2012, the case was stayed pending final judgment in a separate action involving the 502 Patent filed by DataTern in the Southern District of New York, in which MicroStrategy was not a party. Final judgment in that separate action was entered against DataTern in December 2012 (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 April 2014, the Federal Circuit affirmed the New York Judgment in part and reversed it in part. We expect to file a letter with the Federal Circuit regarding the status of the stayed appeal in light of the Federal Circuit's April 2014 ruling. We have received indemnification requests from certain of our 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.

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 outcome of this matter on appeal is not presently determinable.

We are also involved in various other legal proceedings arising in the normal course of business. Although the outcomes of these other legal proceedings are inherently difficult to predict, we do not expect the resolution of these other legal proceedings to have a material adverse effect on our financial position, results of operations, or cash flows.



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**Item 1A. Risk Factors**

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

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

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

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

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

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

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

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

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

changes in our pricing policies or those of our competitors;

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

the length of our sales cycles;

seasonal or other buying patterns of our customers;

changes in our operating expenses;

planned major maintenance activities related to our owned corporate aircraft;

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

personnel changes;

our use of channel partners;

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

changes in foreign currency exchange rates;

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

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

changes in customer budgets.

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

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

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

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

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

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

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

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

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

commencement of, or our involvement in, litigation;

any major change in our board or management;

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

recommendations by securities analysts or changes in earnings estimates;

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

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

sales or purchases of stock by us or by our stockholders, and issuances of awards under our stock incentive plan;

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

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



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

### **We may not be able to achieve profitability in the future**

We generated a loss from continuing operations, net of tax, for the three months ended March 31, 2014, and we may not be able to achieve profitability on a quarterly or annual basis in the future.

Over the course of 2013 and the first quarter of 2014, we increased our headcount as part of our initiatives to focus specific research and development efforts on providing our customers with high levels of performance for analytics applications of all sizes and introducing a number of innovative technologies designed to enable companies to capitalize on Big Data, mobile applications, cloud-based services, loyalty, and identity trends in the marketplace. As a result of these initiatives, our operating expenses have increased. In addition, option awards granted under our stock incentive plan adopted in 2013 are expected to result in our recognizing share-based compensation expense at a rate of approximately \$1.6 million per quarter over the remaining weighted average vesting period of approximately 3.3 years. If our revenues 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 continue to incur operating losses. As a result, our business, results of operations, and financial condition may be materially adversely affected.

As of March 31, 2014, we had \$22.9 million of deferred tax assets, net of a \$0.2 million valuation allowance, and if we are unable to achieve profitability in the future, we may be required to increase the valuation allowance against these deferred tax assets, which could result in a charge that would materially adversely affect net income in the period in which the charge is incurred.

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

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

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

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

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

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

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

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

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

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

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

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

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

The analytics platform market is intensely competitive and subject to rapidly changing technology paradigms. Within the analytics space, we compete with many different vendors, including (1) large software vendors (megavendors), such as IBM, SAP, Microsoft, and Oracle, that provide one or more products that directly compete with our offerings; (2) open source analytics vendors like



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JasperSoft and Pentaho; (3) various independent analytics software providers, such as Qlik, Tableau Software, TIBCO, Actuate, Information Builders, and the SAS Institute; (4) pure-play mobile analytics vendors, such as MeLLmo (Roambi), that do not offer an analytics platform but offer a mobile user interface that can be used as an extension to existing analytics platforms; and (5) other analytics SaaS vendors, such as GoodData and Birst. Our future success depends on the effectiveness with which we can compete across all different sizes of implementations. Failure to maintain adequate technology differentiation from these competitors could materially adversely affect our recurring software maintenance revenue, as well as new license revenue, from existing and prospective customers.

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

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

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

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

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

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

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

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

our ability to maintain and improve our current offerings; and

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

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

### **A substantial customer shift from our MicroStrategy Analytics Platform to our MicroStrategy Cloud offerings could affect the timing of revenue recognition and materially adversely affect our operating results**

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

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

We have invested, and in the future may invest, in new business strategies and initiatives. For example, in recent years we have introduced a number of innovative technologies designed to enable companies to capitalize on Big Data, mobile applications, cloud-based services, loyalty, and identity trends in the marketplace. These endeavors may involve significant risks and uncertainties, including distraction of management from other business operations, the dedication of significant research and development, sales and marketing, and other resources to these new initiatives at the expense of our other business operations, generation of insufficient revenue to offset expenses associated with new initiatives, incompatibility of our new technologies with third party platforms, inadequate return of capital, and other risks that we may not have adequately anticipated. For example, we have expended significant resources in the development and marketing of the MicroStrategy Loyalty Platform and the MicroStrategy Identity Platform, neither of which has generated significant revenues to date. Because new strategies and initiatives are inherently risky, these strategies and initiatives may not be successful and could materially adversely affect our financial condition and operating results.

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

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

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

In addition to our direct sales force, we use channel partners such as resellers, value-added resellers, system integrators and consulting firms, original equipment manufacturers, and technology partners to license and support our products. For the three months ended March 31, 2014, transactions by channel partners for which we recognized revenues accounted for 29.5% of our total product licenses revenues. Our channel partners may offer customers the products and services of several different companies, including offerings that compete with ours. Because our channel partners generally do not have an exclusive relationship with us, we cannot be certain that they will prioritize or provide adequate resources to selling our products. Moreover, divergence in strategy or contract defaults by any of these channel partners may materially adversely affect our ability to develop, market, sell, or support our offerings.

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

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

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

Our gross current and non-current deferred revenue and advance payments totaled \$219.6 million as of March 31, 2014. We offset our accounts receivable and deferred revenue for any unpaid items, which totaled \$72.4 million, resulting in net current and non-current deferred revenue and advance payments of \$147.3 million as of March 31, 2014. The timing and ultimate recognition of our deferred revenue and advance payments depend on various factors, including our performance of various service obligations.

We have entered into certain additional agreements that include future minimum commitments by our customers to purchase products, subscription services, product support, or other services through 2019 totaling approximately \$126.3 million. These future commitments are not included in our deferred revenue balances. Because of the



possibility of customer changes or delays in customer development or implementation schedules or budgets, and the need for us to satisfactorily perform product support and other services, deferred revenue and advance payments at any particular date may not be representative of actual revenue for any succeeding period.

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

We receive a significant portion of our total revenues from international sales, and are seeking to expand our business activities in various foreign countries, including some emerging markets where we have limited experience, where the challenges of conducting our business can be significantly different from those we have faced in more developed markets, and where business practices may create internal control risks. International revenues accounted for 41.5% and 40.6% of our total revenues from continuing operations for the three months ended March 31, 2014 and 2013, respectively. Our international operations require significant management attention and financial resources.

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

fluctuations in foreign currency exchange rates;

new, or changes in, regulatory requirements;

tariffs, export and import restrictions, restrictions on foreign investments, and other trade barriers or protection measures;

costs of localizing offerings;

lack of acceptance of localized offerings;

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

tax issues, including restrictions on repatriating earnings;

weaker intellectual property protection;

economic weakness or currency related crises;

the burden of complying with a wide variety of laws, including those relating to labor matters, consumer and data protection, privacy, network security, and encryption;

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

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

corporate espionage; and

political instability and security risks in the countries where we are doing business.

Various corporate tax reform bills and other proposals are currently under consideration by Congress and the Obama Administration. These proposals include, among other items, corporate income tax rate changes in varying, uncertain, or unspecified amounts, the reduction or elimination of certain corporate tax incentives, modifications to the existing regime for taxing overseas earnings, and measures to prevent base erosion and profit shifting. It is not clear whether, or to what extent, these proposals may be enacted. Significant changes to the U.S. taxation of our international income could have a material adverse effect on our results of operations.

From time to time, we may undertake various potential intercompany transactions and legal entity restructurings that involve our international subsidiaries. We consider various factors in evaluating these potential transactions and restructurings, including the alignment of our corporate structure with our organizational objectives, the operational and tax efficiency of our corporate

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structure, and the long-term cash flows and cash needs of our business. Such transactions and restructurings could negatively impact our overall tax rate and result in additional tax liabilities.

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

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

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

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

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

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

As existing and potential customers seek to standardize on a single analytics vendor or require greater vendor capacity to meet their growing analytics needs, our business may experience larger transactions at the enterprise level and larger transactions may account for a greater proportion of our business. The presence or absence of one or more large transactions in a particular period may have a material positive or negative effect on our revenue and operating results for that period. For the three months ended March 31, 2014 and 2013, our top three product licenses transactions with recognized revenue totaled \$4.7 million, and \$3.8 million respectively, or 16.8%, and 13.4% of total product licenses revenues, respectively. These transactions represent significant business and financial decisions for our customers, require considerable effort on the part of customers to assess alternative products, and often require additional levels of management approval. In addition, large transactions are often more complex than smaller transactions. These factors generally lengthen the typical sales cycle and increase the risk that customers may postpone or delay

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

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

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

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

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

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

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

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

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

We license third-party technologies that we incorporate into our existing offerings. There can be no assurance that the licenses for such third-party technologies will not be terminated or that we will be able to license third-party software for future offerings. In addition, we may be unable to renegotiate acceptable third-party license terms. Changes in or the loss of third-party licenses could lead to a material increase in the costs of licensing or to our software offerings becoming inoperable or their performance being materially reduced, with the result that we may need to incur

additional development costs to ensure continued performance of our offerings, and we may experience a decreased demand for our offerings.

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

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

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

The emergence of new industry standards in related fields may materially adversely affect the demand for our existing offerings. This could happen if new Web standards and technologies or new standards in the field of operating system support emerged that were incompatible with customer deployments of our software offerings. For example, if we are unable to adapt our software offerings on a timely basis to new standards in database access technology, the ability of our software offerings to access customer databases could be impaired.

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

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

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

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

Aspects of our business, including MicroStrategy Cloud, the MicroStrategy Loyalty Platform, and the MicroStrategy Identity Platform, involve processing, storing, and transmitting personal data, which is subject to our privacy policies and certain federal, state, and foreign laws and regulations relating to privacy and data protection. The amount of data that we store for our customers in our cloud, networks, and other systems, including personal data, is increasing. In recent years, the collection and use of personal information by companies have come under increased regulatory and public scrutiny. Any systems failure or security breach that results in the release of, or unauthorized access to, personal data, or any failure or perceived failure by us to comply with our privacy policies or any applicable laws or regulations relating to privacy or data protection, could result in proceedings against us by governmental entities or



others. Such proceedings could result in the imposition of fines, penalties, liabilities, and/or governmental orders requiring that we change our data practices, any of which could have a material adverse effect on our business, operating results, and financial condition.

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Various federal, state, and foreign legislative or regulatory bodies may enact new or additional laws or regulations concerning privacy and data protection that could materially adversely impact our business. Complying with these varying requirements could cause us to incur substantial costs or require us to change our business practices, either of which could materially adversely affect our business and operating results. For example, legislation and regulation regarding mobile data collection continue to evolve and if laws or regulations restricting or limiting the collection or use of mobile data are enacted, they may reduce demand for certain of our services or require changes to our business practices, which could materially adversely affect our business and operating results.

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

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

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

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

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

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

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

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

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

require us to stop selling certain of our offerings;

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

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

require us to satisfy indemnification obligations to our customers.

Additionally, while we monitor our use of open source software, we cannot assure you that our processes for controlling such use in our products will be effective. If we inadvertently embed certain types of open source software into one or more of our products, we could subject ourselves to infringement liability and be required to re-engineer our products, to discontinue the sale of our products if re-engineering could not be accomplished on a timely or cost-effective basis, or to make available to certain third parties or generally available, in source code form, our proprietary code, any of which could materially adversely affect our business, operating results, and financial condition.

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

For example, in December 2011, we were sued by two separate parties who alleged that certain of our analytics products infringe their respective patents, and we have received indemnification requests from certain of our resellers and customers who were also named as defendants in connection with one of those matters. These matters are described in further detail in this Quarterly Report on Form 10-Q under Part II. Item 1. Legal Proceedings.

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

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

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**Because of the rights of our two classes of common stock, and because we are controlled by Michael J. Saylor, who beneficially owns the majority of our class B common stock, Mr. Saylor could transfer control of MicroStrategy to a third party without the approval of our Board of Directors or our other stockholders, prevent a third party from acquiring MicroStrategy, or limit your ability to influence corporate matters**

We have two classes of common stock: class A common stock and class B common stock. Holders of our class A common stock generally have the same rights as holders of our class B common stock, except that holders of class A common stock have one vote per share while holders of class B common stock have ten votes per share. As of April 22, 2014, holders of our class B common stock owned 2,227,327 shares of class B common stock, or 71.1% of the total voting power. Michael J. Saylor, our Chairman and Chief Executive Officer, beneficially owned 2,011,668 shares of class B common stock, or 64.2% of the total voting power, as of April 22, 2014. Accordingly, Mr. Saylor is able to control MicroStrategy through his ability to determine the outcome of elections of our directors, amend our certificate of incorporation and by-laws, and take other actions requiring the vote or consent of stockholders, including mergers, going-private transactions, and other extraordinary transactions and their terms.

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

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

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

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

compensation committee, except that certain executive officer compensation that is intended to qualify as performance-based compensation for purposes of Section 162(m) of the Internal Revenue Code is determined by the compensation committee pursuant to the requirements of Section 162(m). Awards under our 2013 Stock Incentive Plan are also

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approved by the compensation committee. Additionally, while our Compensation Committee is empowered with the authority to retain and terminate outside counsel, compensation consultants, and other experts or consultants, it is not required to assess their independence.

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

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

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

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

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

During the three months ended March 31, 2014, we did not repurchase any equity securities registered by us pursuant to Section 12 of the Exchange Act. See Note 8, Treasury Stock, to the Consolidated Financial Statements in Part I. Item 1. Financial Statements for further information regarding the Company's share repurchase plan.

### **Item 6. Exhibits**

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

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

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**SIGNATURES**

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

**MICROSTRATEGY INCORPORATED**

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

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

Date: April 29, 2014



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<b>Exhibit Number</b>	<b>Description</b>
3.1	Second Restated Certificate of Incorporation of the registrant (filed as Exhibit 3.1 to the registrant's Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2003 (File No. 000-24435) and incorporated by reference herein).
3.2	Amended and Restated By-Laws of the registrant (filed as Exhibit 3.2 to the registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 2003 (File No. 000-24435) and incorporated by reference herein).
4.1	Form of Certificate of Class A Common Stock of the registrant (filed as Exhibit 4.1 to the registrant's Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2003 (File No. 000-24435) and incorporated by reference herein).
10.1	Summary of Perquisites and Associated Other Compensation Arrangements for Named Executive Officers (filed as Exhibit 10.3 to the registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 2013 (File No. 000-24435) and incorporated by reference herein).
10.2	Summary of Director Fees and Perquisites and Associated Other Compensation Arrangements for Non-Employee Directors.
10.3	Summary of 2014 Cash Bonus Arrangements for Michael J. Saylor, Jonathan F. Klein, and Paul N. Zolfaghari (set forth in Item 5.02 of the registrant's Current Report on Form 8-K (File No. 000-24435) filed on March 7, 2014 under the headings "2014 CEO Bonus Formula" and "2014 President Bonus Formulas" and incorporated by reference herein).
10.4	Amendment No. 1 to the MicroStrategy Incorporated 2013 Stock Incentive Plan (filed as Exhibit 10.1 to the registrant's Current Report on Form 8-K (File No. 000-24435) filed on April 28, 2014 and incorporated by reference herein).
31.1	Certification pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Chairman of the Board of Directors and Chief Executive Officer.
31.2	Certification pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Senior Executive Vice President & Chief Financial Officer.
32.1	Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema
101.CAL	XBRL Taxonomy Extension Calculation Linkbase
101.DEF	XBRL Taxonomy Extension Definition Linkbase
101.LAB	XBRL Taxonomy Extension Label Linkbase
101.PRE	XBRL Taxonomy Extension Presentation Linkbase

Management contracts and compensatory plans or arrangements

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