

MICROSTRATEGY INC  
Form 10-Q/A  
November 15, 2004  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

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**FORM 10-Q/A**

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

For the Quarterly Period Ended September 30, 2004

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

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**MICROSTRATEGY INCORPORATED**

(Exact name of registrant as specified in its charter)

**Delaware**

(State of incorporation)

**1861 International Drive, McLean, VA**

(Address of Principal Executive Offices)

**22102**

(Zip Code)

**51-0323571**

(I.R.S. Employer

Identification Number)

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

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

Indicate by check mark whether the registrant is an accelerated filer (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 November 1, 2004 was 12,523,750 and, 3,549,399 respectively.

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EXPLANATORY NOTE

This Form 10-Q/A is being filed to correct three line items in the Consolidated Statements of Operations for the three months ended September 30, 2004 and 2003. Specifically, the Consolidated Statements of Operations have been corrected to reflect the following: (i) Total financing and other income (expense) is \$197,000 for the three months ended September 30, 2004 and \$(30,993,000) for the three months ended September 30, 2003; (ii) Income (loss) before income taxes is \$19,023,000 for the three months ended September 30, 2004 and \$(24,016,000) for the three months ended September 30, 2003; and (iii) Net income (loss) is \$121,989,000 for the three months ended September 30, 2004 and \$(24,358,000) for the three months ended September 30, 2003. The three line items were reported correctly elsewhere in the related notes and in Management's Discussion and Analysis of Financial Condition and Results of Operations, which have not been amended.

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**MICROSTRATEGY INCORPORATED**

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	September 30, 2004 <u>(unaudited)</u>	December 31, 2003
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 74,793	\$ 51,882
Restricted cash	738	747
Accounts receivable, net	30,352	30,993
Prepaid expenses and other current assets	6,565	3,888
Deferred tax assets, net	16,730	1,807
	<u>129,178</u>	<u>89,317</u>
Total current assets	129,178	89,317
Property and equipment, net	16,121	16,113
Capitalized software development costs, net	3,302	3,693
Long-term investments	26,359	
Deposits and other assets	3,234	1,984
Deferred tax assets, net	113,748	3,686
	<u>291,942</u>	<u>114,793</u>
Total assets	\$ 291,942	\$ 114,793
<b>Liabilities and Stockholders Equity</b>		
Current liabilities:		
Accounts payable and accrued expenses	\$ 13,149	\$ 12,768
Accrued compensation and employee benefits	19,280	17,968
Accrued restructuring costs	1,961	2,599
Deferred revenue and advance payments	39,765	28,374
	<u>74,155</u>	<u>61,709</u>
Total current liabilities	74,155	61,709
Deferred revenue and advance payments	1,973	2,750
Other long-term liabilities	3,153	2,443
Accrued restructuring costs	2,237	3,544
	<u>81,518</u>	<u>70,446</u>
Total liabilities	81,518	70,446
Commitments and Contingencies		

**Stockholders Equity:**

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Preferred stock undesignated, par value \$0.001 per share, 4,971 shares authorized, no shares issued or outstanding		
Class A common stock, par value \$0.001 per share, 330,000 shares authorized, 12,535 issued and 12,467 outstanding, and 12,362 shares issued and outstanding, respectively	13	12
Class B common stock, \$0.001 par value, 165,000 shares authorized, 3,549 and 3,604 shares issued and outstanding, respectively	4	4
Additional paid-in capital	412,387	387,625
Treasury stock, at cost; 68 shares and 0 shares, respectively	(2,331)	
Accumulated other comprehensive income	2,469	2,619
Accumulated deficit	(202,118)	(345,913)
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Total stockholders' equity	210,424	44,347
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Total liabilities and stockholders' equity	\$ 291,942	\$ 114,793
	<hr/>	<hr/>

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)

(unaudited)

	Three Months Ended September 30,	
	2004	2003
Revenues:		
Product licenses	\$ 25,761	\$ 17,652
Product support and other services	34,865	25,185
<b>Total revenues</b>	<b>60,626</b>	<b>42,837</b>
Cost of revenues:		
Product licenses	1,051	812
Product support and other services	7,451	5,980
<b>Total cost of revenues</b>	<b>8,502</b>	<b>6,792</b>
<b>Gross profit</b>	<b>52,124</b>	<b>36,045</b>
Operating expenses:		
Sales and marketing	17,227	13,667
Research and development	7,347	6,905
General and administrative	8,706	8,478
Amortization of intangible assets	18	18
<b>Total operating expenses</b>	<b>33,298</b>	<b>29,068</b>
<b>Income from operations</b>	<b>18,826</b>	<b>6,977</b>
Financing and other income (expense):		
Interest income	378	174
Interest expense, including discount amortization expense on notes payable of \$0 and \$281, respectively	(19)	(701)
Loss on early extinguishment of notes payable		(30,229)
Other expense, net	(162)	(237)
<b>Total financing and other income (expense)</b>	<b>197</b>	<b>(30,993)</b>
<b>Income (loss) before income taxes</b>	<b>19,023</b>	<b>(24,016)</b>
(Benefit) provision for income taxes	(102,966)	342
<b>Net income (loss)</b>	<b>\$ 121,989</b>	<b>\$ (24,358)</b>
<b>Basic earnings (loss) per share</b>	<b>\$ 7.60</b>	<b>\$ (1.59)</b>

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Diluted earnings (loss) per share	\$ 7.22	\$ (1.59)
Basic weighted average shares outstanding	16,053	15,359
Diluted weighted average shares outstanding	16,903	15,359

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)

(unaudited)

	Nine Months Ended September 30,	
	2004	2003
<b>Revenues:</b>		
Product licenses	\$ 62,895	\$ 53,818
Product support and other services	96,721	70,087
<b>Total revenues</b>	<b>159,616</b>	<b>123,905</b>
<b>Cost of revenues:</b>		
Product licenses	2,765	2,341
Product support and other services	21,631	18,357
<b>Total cost of revenues</b>	<b>24,396</b>	<b>20,698</b>
<b>Gross profit</b>	<b>135,220</b>	<b>103,207</b>
<b>Operating expenses:</b>		
Sales and marketing	49,171	40,629
Research and development	20,593	21,636
General and administrative	24,162	23,625
Restructuring and impairment charges		1,699
Amortization of intangible assets	53	166
<b>Total operating expenses</b>	<b>93,979</b>	<b>87,755</b>
<b>Income from operations</b>	<b>41,241</b>	<b>15,452</b>
<b>Financing and other income (expense):</b>		
Interest income	667	545
Interest expense, including discount amortization expense on notes payable of \$0 and \$2,137, respectively	(44)	(5,048)
Loss on investments	(85)	
Loss on early extinguishment of notes payable		(31,069)
Other income (expense), net	403	(142)
<b>Total financing and other income (expense)</b>	<b>941</b>	<b>(35,714)</b>
<b>Income (loss) before income taxes</b>	<b>42,182</b>	<b>(20,262)</b>
(Benefit) provision for income taxes	(101,613)	1,135
<b>Net income (loss)</b>	<b>\$ 143,795</b>	<b>\$ (21,397)</b>

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Basic earnings (loss) per share	\$ 8.97	\$ (1.48)
Diluted earnings (loss) per share	\$ 8.41	\$ (1.48)
Basic weighted average shares outstanding	16,039	14,418
Diluted weighted average shares outstanding	17,094	14,418

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

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## MICROSTRATEGY INCORPORATED

## CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(unaudited)

	<u>Nine months ended September 30,</u>	
	<u>2004</u>	<u>2003</u>
<b>Operating activities:</b>		
Net income (loss) from continuing operations	\$ 143,795	\$ (21,397)
Adjustments to reconcile net income (loss) from continuing operations to net cash provided by operating activities:		
Depreciation and amortization	6,210	6,829
Bad debt recovery	60	256
Loss on investments	85	
Loss on early extinguishment of notes payable		31,069
Discount amortization expense on notes payable		2,137
Change in deferred tax assets, net, including release of deferred tax asset valuation allowance	(103,180)	(123)
Other, net	65	176
Changes in operating assets and liabilities:		
Accounts receivable	648	1,219
Prepaid expenses and other current assets	(2,727)	(1,771)
Deposits and other assets	(1,301)	(623)
Accounts payable and accrued expenses, compensation and employee benefits	1,875	1,298
Accrued restructuring costs	(1,969)	(2,102)
Deferred revenue and advance payments	10,356	7,087
Other long-term liabilities	712	(299)
<b>Net cash provided by operating activities</b>	<b>54,629</b>	<b>23,756</b>
<b>Investing activities:</b>		
Purchases of property and equipment, net	(4,436)	(3,240)
Capitalized software development costs	(1,414)	(205)
Purchase of long-term investments	(26,353)	
(Increase) decrease in restricted cash	(4)	5,445
<b>Net cash (used in) provided by investing activities</b>	<b>(32,207)</b>	<b>2,000</b>
<b>Financing activities:</b>		
Proceeds from sale of class A common stock under employee stock purchase plan and exercise of employee stock options	2,976	2,817
Purchases of treasury stock	(2,331)	
Net cash payments on promissory notes issued to former preferred stockholders		(5,000)
<b>Net cash provided by (used in) financing activities</b>	<b>645</b>	<b>(2,183)</b>
Effect of foreign exchange rate changes on cash and cash equivalents	(181)	518
<b>Net increase in cash and cash equivalents from continuing operations</b>	<b>22,886</b>	<b>24,091</b>
Net cash received from (advanced to) discontinued operations	25	(406)

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Net increase in cash and cash equivalents	22,911	23,685
Cash and cash equivalents, beginning of period	51,882	15,036
Cash and cash equivalents, end of period	\$ 74,793	\$ 38,721
Supplemental disclosure of cash flow information:		
Cash paid during the year for income taxes:	\$ 1,653	\$ 1,504
Supplemental disclosure of noncash investing and financing activities:		
Early extinguishment of notes payable	\$	\$ (46,875)
Issuance of class A common stock in connection with early extinguishment of notes payable	\$	\$ 78,533

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

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**MICROSTRATEGY INCORPORATED**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

**(1) Basis of Presentation**

Except for the consolidated balance sheet of MicroStrategy Incorporated ( MicroStrategy or the Company ) as of December 31, 2003, which is derived from audited financial statements, the accompanying consolidated financial statements are unaudited. In the opinion of management, all adjustments (consisting of normal recurring items) necessary for a fair presentation of such financial statements have been included. Interim results are not necessarily indicative of results for a full year.

The consolidated financial statements and notes are presented as required by Form 10-Q and do not contain certain information included in the Company's annual financial statements and notes. These financial statements should be read in conjunction with the Company's audited financial statements and the notes thereto filed with the Securities and Exchange Commission ( SEC ) in the Company's Annual Report on Form 10-K for the year ended December 31, 2003.

**(2) Recent Accounting Standards**

In March 2004, the Financial Accounting Standards Board ( FASB ) issued a proposed statement, Share-Based Payment , which addresses the accounting for share-based payment transactions in which an enterprise receives employee services in exchange for equity instruments of the enterprise or liabilities that are based on the fair value of the enterprise's equity instruments or that may be settled by the issuance of such equity instruments. The proposed statement would eliminate the ability to account for share-based compensation transactions using Accounting Principles Board ( APB ) Opinion No. 25, Accounting for Stock Issued to Employees , and generally would require instead that such transactions be accounted for using a fair-value-based method. In October 2004, the FASB delayed the effective date of the proposed statement from periods ending after January 1, 2005 until periods ending after June 30, 2005. The Company continues to monitor the potential impact of the proposed statement on its financial condition and results of operations.

In March 2004, the FASB approved Emerging Issues Task Force ( EITF ) Issue No. 03-1, The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments. The objective of this issue is to provide guidance for identifying other-than-temporarily impaired investments. EITF No. 03-1 also provides new disclosure requirements for investments that are deemed to be temporarily impaired. In September 2004, the FASB issued EITF No. 03-1-1, which delayed the effective date of EITF No. 03-1, with the exception of certain disclosure requirements. The Company does not believe that EITF No. 03-1 will have a material impact on its financial condition and results of operations.

**(3) Accounts Receivable**

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

	<b>September 30,</b>	<b>December 31,</b>
	<b>2004</b>	<b>2003</b>
	<u>          </u>	<u>          </u>
Billed and billable	\$ 57,077	\$ 61,118
Less: billed and unpaid deferred revenue	(24,635)	(27,621)
	<u>          </u>	<u>          </u>
	32,442	33,497
Less: allowance for doubtful accounts	(2,090)	(2,504)
	<u>          </u>	<u>          </u>
	<b>\$ 30,352</b>	<b>\$ 30,993</b>
	<u>          </u>	<u>          </u>

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

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

**(4) Long-term Investments**

On June 30, 2004, the Company purchased a \$26.4 million U.S. Treasury note which matures on June 30, 2006. In accordance with Statement of Financial Accounting Standards ( SFAS ) No. 115, Accounting for Certain Investments in Debt and Equity Securities, and based on the Company's intentions regarding this instrument, the Company has classified this investment in the long-term debt security as held-to-maturity and has accounted for this investment at amortized cost.

The following table sets forth a summary of the long-term U.S. Treasury note investment as of September 30, 2004 (in thousands):

	Amortized Cost	Discount Amortization	Balance as of September 30, 2004
U.S. Treasury Note	\$ 26,353	\$ 6	\$ 26,359

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

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

	September 30, 2004	December 31, 2003
<b>Current:</b>		
Deferred product revenue	\$ 3,231	\$ 4,490
Deferred product support and other services revenue	60,075	50,497
	<u>63,306</u>	<u>54,987</u>
Less: billed and unpaid deferred revenue	(23,541)	(26,613)
	<u>\$ 39,765</u>	<u>\$ 28,374</u>
<b>Non-current:</b>		
Deferred product revenue	\$ 425	\$ 378

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Deferred product support and other services revenue	2,642	3,380
	<u>3,067</u>	<u>3,758</u>
Less: billed and unpaid deferred revenue	(1,094)	(1,008)
	<u>\$ 1,973</u>	<u>\$ 2,750</u>

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

### (6) Treasury Stock

On July 27, 2004, the Company announced that its Board of Directors had authorized the repurchase of up to an aggregate of \$35.0 million of the Company's class A common stock from time to time in the open market or in privately negotiated transactions. During August 2004, the Company repurchased 67,800 shares on the open market at an approximate cost of \$2.3 million. The Company will determine the timing and amount of any shares repurchased in future periods pursuant to this authorization based on its evaluation of market conditions and other factors. The repurchase program will be funded using our working capital and may be suspended or discontinued at any time.

### (7) Litigation

#### (a) Business Objects Litigation

On October 2, 2001, the Company filed a lawsuit in the Virginia Circuit Court for Fairfax County against



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**MICROSTRATEGY INCORPORATED**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

two field employees of Business Objects, S.A. This lawsuit alleged that these employees, who previously worked for the Company, breached their fiduciary and contractual obligations to the Company by, among other things, misappropriating its trade secrets and confidential information and soliciting its employees and customers. The complaint sought injunctive relief and damages. On October 17, 2001, Business Objects filed suit against the Company in the United States District Court for the Northern District of California, claiming that the Company's software infringes a patent issued to Business Objects relating to relational database access (the 403 patent). The suit sought injunctive relief and monetary damages. On August 29, 2003, the Court granted the Company's motion for summary judgment and dismissed the lawsuit, ruling as a matter of law that MicroStrategy's products do not infringe the 403 patent. Business Objects has filed an appeal, on which oral arguments were heard on September 9, 2004.

On October 31, 2001, the Company filed suit against Business Objects, S.A. and its subsidiary, Business Objects Americas, Inc., in the United States District Court for the Eastern District of Virginia, claiming that Business Objects' software infringes two patents held by the Company relating to asynchronous control of report generation using a web browser (the 033 patent) and a system and method of adapting automatic output of OLAP reports to disparate user output devices (the 050 patent). The complaint sought monetary damages and injunctive relief. On March 13, 2002, the Company voluntarily dismissed without prejudice its lawsuit pending in the Virginia Circuit Court for Fairfax County against the two field employees of Business Objects. The complaint against Business Objects was amended to add claims for violations of the federal Computer Fraud and Abuse Act, misappropriation of trade secrets, tortious interference with contractual relations, and violations of the Virginia Conspiracy Act. As a result of pre-trial rulings, certain of these claims were dismissed. The Company's claims for tortious interference and misappropriation of trade secrets proceeded to trial on October 20, 2003. On October 28, 2003, the Court dismissed the tortious interference claim. In July 2003, the United States Patent & Trademark Office confirmed the validity of all the claims in the 033 and 050 patents and terminated reexamination proceedings that Business Objects had requested as to those patents. The Company agreed to dismissal of the 033 patent claims without prejudice. On June 8, 2004, the Court advised the parties that it intended to issue an order and opinion granting Business Objects' motion for summary judgment of non-infringement on the Company's 050 patent claims, and that the trial of the 050 patent claims previously scheduled to begin on June 15, 2004 would not occur. On August 6, 2004, the Court granted Business Objects' motion for summary judgment on the 050 patent claims, ruling that Business Objects had not infringed the Company's patent. The Court ruled in the Company's favor on its claims of trade secret misappropriation, finding that Business Objects had misappropriated certain of the Company's trade secrets. The Company has filed a notice of appeal to the United States Court of Appeals for the Federal Circuit. The outcome of this litigation is not presently determinable, and as such, the Company is currently unable to estimate a potential range of gain or loss, if any, relating to these actions. Accordingly, no provision for these matters has been made in the accompanying consolidated financial statements.

*(b) ePlus Legal Matter*

On February 2, 2004, ePlus Group, Inc. (ePlus) filed suit against the Company claiming breach of contract relating to the master lease agreement that the companies had entered into on November 1, 1999, under which the Company leased equipment from ePlus. ePlus claimed that equipment returned by the Company upon expiration of the lease term was not in satisfactory condition and sought damages of approximately \$2.0 million plus interest, taxes and attorneys' fees. In September 2004, ePlus and the Company entered into an agreement settling the lawsuit. The settlement did not have a material impact on the Company's financial position or results of operations.

*(c) Other Matters*

The Company is also involved in other legal proceedings through the normal course of business. Management believes that any unfavorable outcome related to these other proceedings will not have a material effect on the Company's financial position, results of operations or cash flows.

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**MICROSTRATEGY INCORPORATED**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

**(8) Borrowings**

On May 19, 2003, the Company entered into a \$10 million secured credit facility (the Credit Facility ) with a bank. On May 19, 2004, the Company renewed the Credit Facility and modified the terms to increase the size of the commitment from \$10 million to \$15 million. As a result, the Credit Facility, which matures in May 2005, consists of a \$15 million revolving line of credit, including a letter of credit sub-limit of \$10 million, and is secured by substantially all of the assets of the Company. During the three and nine months ended September 30, 2004 and 2003, the Company had not drawn any cash against the Credit Facility, and no amounts were outstanding under the Credit Facility as of September 30, 2004. After consideration of outstanding letters of credit of \$5.1 million, the Company had \$9.9 million of borrowing capacity under the Credit Facility as of September 30, 2004.

At the Company's option, borrowings under the Credit Facility bear interest at a variable rate equal to LIBOR plus 1.5% to 2.0%, depending on certain debt to earnings ratios, or the prime rate. The Credit Facility also includes a 1.0% letter of credit fee.

Under the terms of the Credit Facility, the Company is required to maintain compliance with certain financial covenants, the most restrictive of which include achieving certain minimum earnings amounts and maximum debt to earnings ratios, maintaining minimum liquidity amounts and limiting the ability to invest further in subsidiaries. As of September 30, 2004, the Company was in compliance with all covenants contained in the Credit Facility.

**(9) Income Taxes**

As of June 30, 2004, the Company's U.S. and Canadian net operating losses ( NOLs ) and other deferred tax assets were fully offset by a valuation allowance primarily because, at the time, pursuant to SFAS No. 109, "Accounting for Income Taxes", the Company did not have sufficient history of taxable income to conclude that it was more likely than not that the Company would be able to realize the tax benefits of those deferred tax assets. Based upon the Company's cumulative operating results through September 30, 2004 and an assessment of the Company's expected future results of operations, during the third quarter of 2004, the Company determined that it is more likely than not that it would be able to realize a substantial portion of its U.S. and Canadian net operating loss carryforward tax assets prior to their expiration and other deferred tax assets. As a result, at September 30, 2004, the Company released a total of \$125.4 million of its U.S. and Canadian deferred tax asset valuation allowance. Of the \$125.4 million, \$103.6 million of the valuation release was recorded as an income tax benefit on the Company's statement of operations, and \$21.8 million of the valuation release was attributable to stock option exercises, which was recorded as an increase in additional paid in capital on the balance sheet.

As of September 30, 2004, the Company has a remaining valuation allowance of approximately \$11 million, including \$7.2 million attributable to certain of its domestic and other deferred tax assets where the realization of such deferred tax assets does not meet the more likely than not criteria under SFAS No. 109. This portion of the valuation allowance as of September 30, 2004 primarily relates to certain Canadian NOLs and

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U.S. capital loss carryforward tax assets that, as of September 30, 2004, the Company expected will expire unused. The remaining \$3.8 million of the valuation allowance will be released during the fourth quarter of 2004 as a result of the requirement under SFAS No. 109 to use an annualized effective tax rate for each interim period during the year including current year interim periods after a valuation allowance release has occurred.

As of September 30, 2004, the Company had domestic net operating loss carryforwards of approximately \$278.2 million, which will begin to expire in 2019. The Company has research and development tax credit carryforward tax assets of \$3.7 million, which will begin to expire in 2018. As of September 30, 2004, the Company has foreign net operating loss carryforwards of \$17.7 million, which will begin to expire in 2005.

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

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

	<b>September 30, 2004</b>	<b>December 31, 2003</b>
	<u>          </u>	<u>          </u>
Deferred tax assets	\$ 141,506	\$ 151,127
Valuation allowance	(11,028)	(145,634)
	<u>          </u>	<u>          </u>
Deferred tax assets, net	\$ 130,478	\$ 5,493
	<u>          </u>	<u>          </u>
Short-term deferred tax assets, net	\$ 16,730	\$ 1,807
Long-term deferred tax assets, net	113,748	3,686
	<u>          </u>	<u>          </u>
Deferred tax assets, net	\$ 130,478	\$ 5,493
	<u>          </u>	<u>          </u>

The aggregate change in the Company's valuation allowance from December 31, 2003 to September 30, 2004 was \$134.6 million, which included the valuation allowance release of \$125.4 million discussed above and \$9.2 million related to year-to-date operations.

The Company does not have any plans to reinvest indefinitely undistributed foreign earnings. Accordingly, the Company expects to accrue a deferred tax liability on undistributed foreign earnings at such time as the Company has undistributed foreign earnings. Deferred tax liabilities have not been provided to account for basis differences and undistributed earnings of foreign subsidiaries because the tax basis of such foreign subsidiaries exceeds the Company's book basis. In accordance with SFAS No. 109, such excess tax basis has not been recognized as a deferred tax asset.

The following table summarizes the Company's (benefit) provision for income taxes included in its statements of operations for the periods indicated (in thousands):

	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<u>2004</u>	<u>2003</u>	<u>2004</u>	<u>2003</u>
Interim period provision for income taxes	\$ 647	\$ 342	\$ 2,000	\$ 1,135

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Release of valuation allowance	(103,613)	(103,613)		
(Benefit) provision for income taxes	\$ (102,966)	\$ 342	\$ (101,613)	\$ 1,135

**(10) Comprehensive Income (Loss)**

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

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## MICROSTRATEGY INCORPORATED

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

Comprehensive income (loss) for the three and nine months ended September 30, 2004 and 2003, respectively, is calculated as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2004	2003	2004	2003
Net income (loss)	\$ 121,989	\$ (24,358)	\$ 143,795	\$ (21,397)
Foreign currency translation adjustment	415	75	(217)	678
Net unrealized gain on short-term investments, net of applicable taxes		22	67	11
Comprehensive income (loss)	\$ 122,404	\$ (24,261)	\$ 143,645	\$ (20,708)

**(11) Earnings (Loss) per Share and Pro Forma Earnings (Loss) per Share***(a) Basic and diluted earnings (loss) per share*

Basic earnings per share is determined by dividing net income by the weighted average number of common shares outstanding during the period. Diluted earnings per share is determined by dividing net income by the weighted average number of common shares and potential common shares outstanding during the period. Potential common shares are included in the diluted earnings per share calculation when dilutive. Potential common shares consisting of common stock issuable upon exercise of outstanding employee stock options and warrants are computed using the treasury stock method.

The diluted loss per share calculation for the three and nine months ended September 30, 2003 excluded potential common shares issuable upon exercise of outstanding employee stock options of 1,109,680 and 743,523, respectively, because their effect would have been anti-dilutive.

*(b) Pro forma basic and diluted earnings (loss) per share*

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As all options granted under the Company's stock-based employee compensation plans had an exercise price equal to the market value of the underlying common stock on the date of grant, no stock-based employee compensation cost is reflected in net income (loss). If compensation expense had been recorded based on the fair value of awards under the stock option and purchase plans as set forth in SFAS No. 123, as amended, the Company's net income (loss) would have been adjusted to the pro forma amounts presented below, for the three and nine months ended September 30, 2004 and 2003, respectively (in thousands, except per share data):

	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2004</b>	<b>2003</b>	<b>2004</b>	<b>2003</b>
Net income (loss), as reported	\$ 121,989	\$ (24,358)	\$ 143,795	\$ (21,397)
Stock-based employee compensation expense under fair value based method, net of tax	(2,136)	(3,478)	(7,447)	(10,557)
<b>Pro forma net income (loss)</b>	<b>\$ 119,853</b>	<b>\$ (27,836)</b>	<b>\$ 136,348</b>	<b>\$ (31,954)</b>
Basic earnings (loss) per share, as reported	\$ 7.60	\$ (1.59)	\$ 8.97	\$ (1.48)
Diluted earnings (loss) per share, as reported	\$ 7.22	\$ (1.59)	\$ 8.41	\$ (1.48)
Basic earnings (loss) per share, pro forma	\$ 7.47	\$ (1.81)	\$ 8.50	\$ (2.22)
Diluted earnings (loss) per share, pro forma	\$ 7.09	\$ (1.81)	\$ 7.98	\$ (2.22)



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The fair value of each option is estimated using the Black-Scholes option-pricing model with the following assumptions used for option grants issued during the three and nine months ended September 30, 2004 and 2003, respectively, under MicroStrategy's stock option plans: volatility factors of 53%, 51%, 97% and 97%, risk-free interest rates of 3% for all periods, weighted-average expected life of 5 years, and no dividend yields.

The following assumptions were used for shares issued during the three and nine months ended September 30, 2004 and 2003, respectively, under MicroStrategy's employee stock purchase plan: volatility factors of 53%, 51%, 97% and 97%, risk-free interest rates of 3% for all periods, weighted-average expected life of 6 months, and no dividend yields.

The weighted average fair value of grants made under MicroStrategy's stock option plans during the three and nine months ended September 30, 2004 and 2003 were \$28.64, \$28.64, \$31.23, and \$15.61 per share, respectively.

**(12) Segment Information**

The Company operates in one significant business segment—business intelligence software and services. The following summary discloses total revenues and long-lived assets, excluding long-term investments and long-term deferred tax assets, according to geographic region (in thousands):

	<u>Domestic</u>	<u>International</u>	<u>Consolidated</u>
<b>Three Months Ended September 30, 2004</b>			
Total license and service revenues	\$ 36,948	\$ 23,678	\$ 60,626
Long-lived assets	19,832	2,825	22,657
<b>Three Months Ended September 30, 2003</b>			
Total license and service revenues	\$ 27,576	\$ 15,261	\$ 42,837
Long-lived assets	19,105	2,990	22,095
<b>Nine Months Ended September 30, 2004</b>			
Total license and service revenues	\$ 96,511	\$ 63,105	\$ 159,616
Long-lived assets	19,832	2,825	22,657
<b>Nine Months Ended September 30, 2003</b>			
Total license and service revenues	\$ 81,358	\$ 42,547	\$ 123,905
Long-lived assets	19,105	2,990	22,095

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The domestic region includes operations in the U.S. and Canada. The international region includes operations in all other foreign countries. For the three and nine months ended September 30, 2004 and 2003, respectively, Germany accounted for 15% and 10% of total consolidated revenues, representing the only individual country to account for 10% or more of total consolidated revenues in these periods. For the three and nine months ended September 30, 2003, no individual foreign country accounted for 10% or more of total consolidated revenues.

Transfers related to intercompany software fees from international to domestic operations of \$10.2 million and \$29.5 million for the three and nine months ended September 30, 2004, respectively, and transfers relating to intercompany software fees from international to domestic operations of \$6.0 million and \$16.0 million for the three and nine months ended September 30, 2003, respectively, have been excluded from the above tables and eliminated in the consolidated financial statements.

For the three and nine months ended September 30, 2004 and 2003, no individual customer accounted for 10% or more of total consolidated revenues.

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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**(13) Restructuring and Impairment Charges**

During 2001, the Company adopted restructuring plans which included a strategic decision to focus operations on business intelligence software and services, the elimination or reduction of speculative technology initiatives, a reduction of the Company's workforce and a consolidation of its multiple Northern Virginia facilities into a single location in McLean, Virginia.

The following table sets forth a summary of the accrued restructuring costs as of September 30, 2004 (in thousands):

	<b>Accrued Restructuring Costs at December 31, 2003</b>	<b>2004 Cash Payments</b>	<b>Accrued Restructuring Costs at September 30, 2004</b>
Estimated sublease losses and other facility closing costs	\$ 6,054	\$ (1,918)	\$ 4,136
Terminations of equipment leases	89	(27)	62
<b>Total accrued restructuring costs</b>	<b>\$ 6,143</b>	<b>\$ (1,945)</b>	<b>\$ 4,198</b>

As of September 30, 2004, unpaid amounts of \$2.0 million and \$2.2 million have been classified as current and long-term accrued restructuring costs, respectively, in the accompanying consolidated balance sheet. During the second quarter of 2003, the Company updated its accrued restructuring costs by recording additional sublease losses of \$1.7 million due to a sustained increase in vacancy rates in the commercial real estate market and difficulties experienced in subleasing idle space at that time. The Company did not record any adjustments to its restructuring reserve during the first nine months of 2004. Amounts related to the estimated sublease losses associated with exiting facilities and terminations of equipment leases will be paid over the respective lease terms through February 2009. As a result of the restructuring, the Company has approximately 77,000 square feet of office space that is not occupied by the Company with the following expiration dates: 46,000 square feet expire in August 2006 and 31,000 square feet expire in February 2009. As of September 30, 2004, 66,000 square feet of the 77,000 square feet of office space not occupied by the Company has been subleased. At September 30, 2004, the Company had \$7.5 million in gross lease obligations and \$868,000 in estimated commissions, concessions and other costs, partially offset by \$4.2 million in estimated gross sublease income recoveries during the remaining lease terms. The Company estimated its sublease losses based upon current sublease arrangements and current information available relating to estimated sublease commission costs, sub-tenant concession costs, sublease rental income and the length of time expected to sublease current excess space and excess space as it becomes available after the expiration of existing sublease arrangements. Except for estimated sublease losses and other facility closing costs and equipment leases, the restructuring plans have been substantially completed.

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**PART II. OTHER INFORMATION**

**ITEM 6. EXHIBITS**

<b>Exhibit Number</b>	<b>Description</b>
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 President and Chief Financial Officer.
32	Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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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/ Eric F. Brown

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Eric F. Brown  
President and Chief Financial Officer

Dated: November 12, 2004