

MICROSTRATEGY INC  
Form 10-K  
February 23, 2007  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

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**FORM 10-K**

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

**For the fiscal year ended December 31, 2006**

**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)**

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**Delaware**  
(State of Incorporation)

**1861 International Drive, McLean, VA 22102**  
(Address of Principal Executive Offices) (Zip Code)

**51-0323571**  
(IRS Employer  
Identification No.)

**Registrant's Telephone Number, Including Area Code: (703) 848-8600**

**Securities registered pursuant to Section 12(b) of the Act:**

<b>Title of each class</b>	<b>Name of each exchange on which registered</b>
<b>Class A common stock, par value \$0.001 per share</b>	<b>The Nasdaq Stock Market LLC</b>
<b>Warrants to Purchase Class A Common Stock, par value \$0.001 per share</b>	<b>The Nasdaq Stock Market LLC</b>

**Securities registered pursuant to Section 12(g) of the Act:**

**Not applicable**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ☒ No ☐

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ☐ No ☒

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☒

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

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Large accelerated filer ☒ x

Accelerated filer ☐ "

Non-accelerated filer ☐ "

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

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant (based on the last reported sale price of the registrant's class A common stock on June 30, 2006 on the Nasdaq National Market) was approximately \$928.1 million.

The number of shares of the registrant's class A common stock and class B common stock outstanding on February 1, 2007 was 9,919,402 and 2,775,244, respectively.

Documents incorporated by reference: Portions of the Proxy Statement for the 2007 Annual Meeting of Stockholders of the Registrant to be filed subsequently with the SEC are incorporated by reference into Part III of this report.

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**CERTAIN DEFINITIONS**

All references in this Annual Report on Form 10-K to MicroStrategy , Company , we , us and our refer to MicroStrategy Incorporated and its consolidated subsidiaries (unless the context otherwise indicates).

**FORWARD-LOOKING INFORMATION**

This Annual Report on Form 10-K 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 under Item 1. Business, Item 1A. Risk Factors and Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations and located elsewhere herein 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 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.

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### **PART I**

#### **ITEM 1. BUSINESS**

##### **Overview**

MicroStrategy® is a worldwide provider of business intelligence software that enables companies to report, analyze and monitor the data stored across their enterprise to reveal the trends and insights needed to make better business decisions. The MicroStrategy mission is to empower every business user to make more informed decisions by providing timely, relevant and accurate answers to their business questions. To achieve this mission, MicroStrategy's single, integrated platform is designed to support various styles of business intelligence through an easy-to-use interface. MicroStrategy provides sophisticated analytical performance to every business user in the format that suits them best, from high-level dashboards to custom reports and advanced analysis via e-mail, web, fax, wireless and voice communication channels. MicroStrategy engineers its software for reliability, scalability, security and ease of administration for organizations of all sizes.

Our software platform, MicroStrategy 8™, enables users to query and analyze the most detailed, transaction-level databases, turning data into business intelligence and delivering boardroom quality reports and alerts about the users' business processes. Our web-based architecture provides reporting, security, performance and standards that are critical for web deployment. Our products can be deployed on company intranets to provide employees with information to make better, more cost-effective business and management decisions. Leading companies and government organizations worldwide have chosen MicroStrategy as their enterprise business intelligence standard. By integrating information from across the enterprise, solutions built on the MicroStrategy platform are designed to give analysts, managers and executives the critical insight they need to make better business and management decisions and to optimize their operations. With extranet deployments, enterprises can use MicroStrategy 8 to build stronger relationships by linking customers and suppliers via the Internet. MicroStrategy facilitates customer success with a comprehensive offering of consulting, education, technical support and technical advisory services for our customers and strategic partners.

We were incorporated as a Delaware corporation on November 17, 1989.

##### **Industry Background**

Business intelligence software offers decision-makers the opportunity to ask and answer questions about data that has been captured but not yet fully exploited.

Four key business needs have driven demand for business intelligence solutions:

***Increase User Access and Scalability:*** In the past, dissemination of information has been limited to a few power users or analysts. Now a wide range of information customers—from customer service representatives to the CEO and from customers to suppliers—demand and can benefit from the insight that business intelligence can provide. The wide acceptance of the Internet as an information source also has fueled demand for enterprise data to be accessible over the web to tens of thousands of users across the enterprise.

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***Increase Data Scalability:*** Increasing information generation, and in particular, the need to capture electronically and store every business transaction has made terabyte-size data warehouses commonplace. Terabyte-size data warehouses store one trillion bytes of data or more and are among the largest databases in the world. Since transaction-level information is now routinely captured, organizations can struggle to make productive use of such massive data stores. Organizations need to view data within the operational context of the data making even the most detailed information meaningful to business users. As a result, users want to be able to discover easily trends hidden in these very large databases, and verify these trends by reviewing the underlying transaction detail.

***Improve Supply Efficiency:*** Supplier transactions become more efficient with direct access to inventory and other related data. However, for true vendor-managed inventory and collaborative

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commerce systems, vendors also need to have access to key information about how their products are performing against business metrics. For example, vendors should be able to see how their products are selling in each geographic region so as not to over-ship products that are slow-moving or under-ship products that are selling quickly. By opening vendor performance information to the vendors themselves, buyers and sellers of goods and services become partners in the quest to optimize sales, margin and inventory.

***Improve Distribution Efficiency:*** Business partners collaborate more effectively with access to shared data. By granting partners access to information such as the manufacturing pipeline and build schedule, partners can be more effective at satisfying demands of end customers and setting expectations. Furthermore, opening invoice and purchase order information to partners can enable them to reduce the overhead associated with channel management, resulting in cost savings and time efficiencies. For example, notifying channel sales partners of changes in the manufacturing schedule allows them to reset end customer expectations or to increase selling activity.

The emergence and widespread acceptance of the Internet as a medium of communication and commerce have changed the way businesses interact with each other and their customers by allowing businesses to establish new revenue streams, create new distribution channels and reduce costs. Simultaneously, the amount of corporate information stored in databases continues to grow exponentially, and companies are giving an increasing number of employees, customers and partners access to their information. Business intelligence tools are one of the gateways to this information. For example, companies are using Internet-based systems to facilitate business operations, including sales automation, supply-chain management, marketing, customer service and human resource management. Consumers are also becoming increasingly sophisticated in their use of the Internet, relying on the Internet not only to make online purchases, but also to perform price comparisons, analyze recommendations from like-minded individuals, educate themselves about relevant products and offerings and enter into transactions that were once conducted face-to-face or via the telephone. The integration of the Internet into business processes and increased consumer sophistication create opportunities for companies to use business intelligence applications as part of a more dynamic business model. Factors driving demand for these applications include:

***Increased Electronic Capture of Transaction, Operational and Customer Information.*** The rapid growth in the electronic capture of business information and the increased availability of related profile data on the parties or products involved in each transaction are providing businesses with a rich data foundation for performing various analyses and making decisions. Powerful data analysis and mining tools are required to sift through massive amounts of data to uncover information regarding customer interactions, trends, patterns and exceptions, in turn enabling organizations to provide superior service and products to customers.

***Need to Create a Personalized, One-to-One Customer and/or Supplier Experience While Maintaining Privacy.*** Many companies are initiating strategies that establish personalized relationships with each customer and/or supplier based on individual needs and preferences, and earn their loyalty by providing superior service, security and convenience. In order to successfully acquire, retain and upgrade customers, organizations need to understand their profiles, their transaction history, their past responses to marketing campaigns, and their interactions with customer service. Retrieving information from widely dispersed and complex data sources and providing a holistic view of the customer can be challenging. At the same time, while businesses have the opportunity to collect a variety of information that could improve targeting, customers are increasingly concerned about the potential for loss or abuse of their privacy.

***Need to Integrate Online and Traditional Operations.*** While there are substantial benefits to conducting business electronically, companies need to ensure that their online operations work in combination with their traditional operations. Companies are seeking to ensure that an order placed online can be reliably fulfilled according to the expectations of the customer and to develop and maintain consistent interactions with customers across different channels. Maintaining the integrity of, and enhancing, the customer experience is crucial to fostering customer loyalty and supply chain relationships.



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***Increased Openness of Business Intelligence Applications to Customers, Suppliers and Partners.*** Business intelligence systems are no longer confined to the organization. Today, companies are extending their business intelligence insight to suppliers, channel partners and customers via extranets. Business partners can have up-to-the-minute access to sales histories, inventory status and billing information through their web browsers.

***Emergence of Wireless Internet and Voice Technologies.*** Information can be more valuable if there is untethered, ubiquitous access to the information. An integrated platform reduces the need to rely on multiple vendors for these products and services. This development is expected to generate new business opportunities for companies by providing an additional channel for existing services and creating opportunities to provide new services that can be delivered to any place and at any time to anyone that has access to a wireless device.

### **MicroStrategy Solution: Business Intelligence for the Whole Enterprise**

MicroStrategy offers MicroStrategy 8, an integrated, industrial-strength business intelligence platform designed to enable organizations to consolidate business intelligence applications onto a single platform for reporting, analysis and monitoring of real-time business information. The platform provides reliable and maintainable solutions with a low total cost of ownership and can be used in departmental, enterprise or extranet deployments. The MicroStrategy 8 business intelligence platform can be used to identify trends, improve operational efficiencies, reduce costs and increase profitability. Since businesses integrate information from across the enterprise, solutions built on the MicroStrategy 8 platform give analysts, managers and executives critical insight they need in optimizing their business operations. Integrated web-based reporting, report delivery and real-time alerting capabilities can enable the entire enterprise to work smarter, faster and better.

MicroStrategy's business intelligence platform provides the functionality users need to make better business and management decisions. The MicroStrategy 8 platform delivers a high-performance solution that meets users' demands and is highly functional, simple to use, scalable and easy to administer. With one platform, users are able to report, analyze and monitor their business with all of the five most popular styles of business intelligence, which consist of:

1. **Scorecards and Dashboards** Reports are formatted with broad visual appeal and can easily convey information at-a-glance. This style of business intelligence targets the business monitoring needs of managers and executives.
2. **Reporting** Report formats can have more detailed operational information than is conveyed on a scorecard or dashboard. These reports serve critical information to all personnel across the enterprise.
3. **OLAP Analysis** Slice-and-dice analysis with drilling, pivoting, page-by and sorting capabilities serves business users whose analytical needs exceed the content of the operational reports and require a simple environment for basic exploration within a limited range of data.
4. **Advanced and Predictive Analysis** Investigative queries that can analyze data in the database, down to the transaction level detail if necessary. This style provides extensive predictive and statistical treatment of the data for correlation analysis, trend analysis, financial analysis and projections.
5. **Alerts and Proactive Reporting** Information that needs continuous monitoring requires alerts and proactive reporting to serve large populations on set schedules, business exceptions or on-demand. This style of business intelligence targets large user populations both internal and external to the enterprise.

Specific benefits of the MicroStrategy 8 business intelligence platform include:

***Flexibility to Report, Analyze and Monitor.*** MicroStrategy's business intelligence platform unifies reporting, analysis and real-time business monitoring into one experience for the business user, one efficient and scalable architecture for the IT professional, and one economical and extensible utility for the CIO.

***Industrial-Strength Business Intelligence.*** The MicroStrategy platform enables industrial-strength business intelligence with enterprise-caliber IT, high user scalability and high database scalability. It enables

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centralized administration, operations and operations maintenance in a unified interface and unified backplane. This enterprise-caliber infrastructure allows for data scalability and user scalability with a zero footprint web product, where business intelligence can expand across and grow with the enterprise.

***Five Styles of Business Intelligence.*** Through MicroStrategy 8's integration of the five styles of business intelligence, users are no longer bound to departmental reporting or solutions that offer only one style of business intelligence or combine individual styles of business intelligence. The need for multiple business intelligence or reporting tools is minimized when users have access to all five styles for their enterprise business intelligence needs.

***Easy-to-use Interface for Business Users.*** MicroStrategy 8 exposes all the sophisticated business intelligence applications to end users through easy to use intuitive what-you-see-is-what-you-get (WYSIWYG) web interfaces. This enables deployment to large user populations with minimal training required. The user interface includes an array of one-click actions embedded throughout the interface. It uses dialog boxes, mouse-over tool tips, and undo/redo buttons to make it easy for business people to explore the software without prior training.

***Interactive Reporting.*** MicroStrategy 8 has extended the MicroStrategy reporting capability by making all reports and scorecards fully interactive. Business users can rearrange the organization of any report with simple drag-n-drop actions or by clicking on the toolbar icons to get views of the data, all from the same report and without requiring assistance from IT.

***Integration of Analysis in Every Report or Scorecard.*** MicroStrategy 8 makes the same powerful analytic capability available directly from enterprise reports or scorecards automatically. MicroStrategy 8 delivers analytic integration to reporting users in two ways. The first is by providing on-line analytical processing (OLAP) capabilities directly to tables embedded within report documents, allowing business users to analyze the data within the table while staying within the bigger report document. The second way allows users to drill from a report document to a dedicated analysis view that is optimized for conducting detailed analysis. In both cases, the integration of reporting with analysis is automatic.

***Direct Access to SAP® BW, Microsoft Analysis Services and Hyperion® Essbase .*** MicroStrategy 8 incorporates a dynamic data access engine designed to access multi-dimensional databases (MDDBs or OLAP Cube Databases), such as those from SAP Business Warehouse (BW), Microsoft Analysis Services and Hyperion Essbase.

MicroStrategy 8's Dynamic Multi-Dimensional Expressions (MDX) Engine generates MDX syntax that is fully certified with SAP BW using SAP's high performance Business API interfaces. Because MicroStrategy's MDX is dynamically generated using the multidimensional models implicit in SAP InfoCubes, QueryCubes and ODS databases, users can automatically and transparently drill back into SAP BW for more data, without any prior programming or prior design of drill paths. MicroStrategy 8 can also join data across SAP BW Infocubes and QueryCubes as well as access multiple instances of SAP BW and non-SAP sources at once.

In addition, MicroStrategy 8's Dynamic MDX Engine generates MDX syntax against Microsoft Analysis Services and Hyperion Essbase using the XMLA (XML for Analysis) standard for communication. XMLA is a new standard for accessing multidimensional data jointly developed by members of the XMLA council. As with SAP BW, MicroStrategy's MDX is dynamically generated using the multidimensional models implicit in Microsoft Analysis Services and Hyperion Essbase cubes. Because of this, users can automatically drill back to underlying source data without any additional programming or drill-path design.

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Users of SAP BW, Microsoft Analysis Services and Hyperion Essbase databases each can access these reports through all of the MicroStrategy interfaces, MicroStrategy Web, Office, Narrowcast Server, and Desktop, just like any other MicroStrategy report. These reports offer standard OLAP functionality including graphing, subtotals, pivot, sort and page-by.

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***Direct Access to Operational Data From Enterprise Resource Planning (ERP) Systems.*** MicroStrategy 8 extends the MicroStrategy metadata architecture to include attributes and facts accessed directly from non-modeled databases, instantly on a query-by-query basis. MicroStrategy 8's Operational SQL Engine enables MicroStrategy reports to include data from any operational system using either completely free-form structured query language (SQL) or a graphical query builder interface, including stored procedures and views. Since the attributes and facts from operational database sources are managed by the MicroStrategy metadata architecture, MicroStrategy's security architecture and other reusable objects such as prompts can be applied automatically.

***Heterogeneous Joining of Data From Across the Enterprise.*** MicroStrategy 8 extends the MicroStrategy data modeling flexibility to include integrated views of data across heterogeneous data stores. By mapping conforming dimensions from different sources within the MicroStrategy object model, MicroStrategy 8 can automatically join data from multiple different sources in the same report document. Data can come from any source accessible by MicroStrategy 8, including the data warehouse, data marts, SAP BW, Microsoft Analysis Services, Hyperion Essbase and any number of operational system databases.

***Integrating Data Mining into Mainstream Reports & Analyses.*** MicroStrategy 8 extended its analytic engine to include predictive capabilities in every MicroStrategy report or analysis. MicroStrategy 8's analytic engine can calculate four of the primary data mining functions, including neural network algorithms, clustering algorithms, regression algorithms, and tree algorithms. Hand-in-hand with this calculation capability, MicroStrategy 8 also includes the ability to import data mining models directly from data mining products from vendors like IBM®, Teradata®, SAS, and SPSS using the predictive modeling mark-up language standard. With this capability, data mining models can be imported through a single click and automatically converted into a standard MicroStrategy metric. After that, MicroStrategy's Data Mining Service extension enables these metrics to be used freely and calculated quickly in reports, analyses and alerts.

***Support for Large Data Volumes and All Major Relational Database/Hardware Combinations.*** The MicroStrategy platform supports systems with very large data volumes and is specifically optimized to support all major relational database platforms commonly used for business intelligence systems as well as multi-dimensional databases like SAP BW. Important features of our solution in this area include:

SQL optimization drivers that improve performance of each major database;

The ability to support very large user populations;

Highly reliable up-time, even in high volume applications; and

The ability to work with and support nine languages for international applications.

***Powerful Analytics to Customer- and Transaction-Levels of Detail.*** We believe that the MicroStrategy 8 platform incorporates one of the most sophisticated analysis engines available today, capable of answering highly detailed business questions. It offers support for information beyond the summary level to include information at the customer- and transaction- levels. This capability is critical to a wide range of applications, including highly targeted direct marketing, e-commerce site personalization, customer and product affinity analysis, call detail analysis, fraud detection, credit analysis forecasting, trend metrics and campaign management. The MicroStrategy 8 platform allows the creation of highly sophisticated systems that take maximum advantage of the detail available in a company's databases.

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**Powerful Personalization Engine.** The MicroStrategy 8 platform includes a customer- and transaction-level personalization engine. The underlying architecture is designed to generate personalization parameters based on data gathered by an organization from a variety of sources, including past customers' transactions, customer clickstream information, stated user preferences and demographic information. In addition, the MicroStrategy personalization engine is able to determine when and under what circumstances a person is automatically provided with a set of information that proves useful in fraud detection and homeland security applications.

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***Powerful Narrowcast Server Distribution Engine for Information Delivery.*** Our technology offers a high performance personalized narrowcast engine for delivering periodic and alert-based information to users via Internet, e-mail, wireless devices, printer and fax. The narrowcast engine includes drivers for all major device types used in both domestic and international markets, enabling the delivery of information to users when and where it is needed.

***Highly Stylized and Consolidated Reporting and Formatting Capabilities.*** MicroStrategy Report Services technology delivers a wide range of enterprise reports via the web, including production and operational reports, managed metrics reports and scorecards. The design capabilities provide the precision necessary to deliver reports with boardroom presentation quality, without any programming. By dragging and dropping report components, users can create high quality reports with complete formatting flexibility. Unlike other conventional reporting products, the modern architecture delivers both traditional hierarchical banded reports and newer, web-oriented zone-based reports.

## **Strategy**

Our business objective is to become the leading provider of business intelligence software and related services to the largest enterprises, governments and the largest databases and data providers in the world. The key elements of our strategy to achieve this objective are as follows:

***Marketing Strategy.*** Our business intelligence platform marketing strategy is designed to increase our footprint in the business intelligence market by increasing awareness of the MicroStrategy 8 platform. Our marketing programs target five principal constituencies:

Our historical base of corporate technology buyers and departmental technology buyers in Global 2000 enterprises;

Corporate and departmental technology buyers in mid-sized enterprises, with annual revenues between \$250 million and \$1 billion;

Government technology buyers and the vendors to the government community;

Independent software vendors who want to embed analytical tools in their solutions; and

System integrators who have technology relationships with the largest 2,500 enterprises, governments and information intensive businesses.

We continually seek to increase our brand awareness by focusing our messaging on the possibilities for value creation with our business intelligence platform, the benefits of using our platform and competitive differentiators. The channels we use to communicate with these constituencies include:

Print ads

Online ads

Direct e-mail

Industry events

User conferences

Strategic partners

Word of mouth and peer references

Industry awards

Our website

Coverage in print and broadcast media.



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**Technology Strategy.** Our technology strategy is focused on expanding our support for large information stores, enhancing our analysis and segmentation capabilities, strengthening our personalization technology and enhancing our report delivery and alerting functionality to all commonly used devices. We continue to enhance our technology for use with a broad range of operating systems and databases to enable our customers to leverage their existing technology investments to achieve faster query times with fewer required resources. In addition, we continue to develop our platform for easy integration with a wide spectrum of ERP systems. As part of this strategy, we are developing technology that further differentiates our product offerings by increasing functionality along the following key dimensions:

Capacity the volume of information that can be efficiently analyzed and utilized;

Concurrency the number of users that can be supported simultaneously;

Sophistication the range of analytical methods available to the application designer;

Performance the response time of the system;

Database Flexibility the range of data sources, data warehouses and online transaction processing databases which the software is capable of efficiently querying without modification;

Robustness the reliability and availability of the software in mission critical environments;

Deployability the ease with which applications can be deployed, modified, upgraded and tuned;

Personalization the quality and sophistication of a one-to-one user experience;

Content Flexibility the range of content, both structured and unstructured, that can be efficiently utilized; and

Media Channel and Interface Flexibility the range of media channels, interface options and display features supported.

**Sales Strategy.** Our sales strategy focuses on direct sales through our dedicated sales force and relationships with indirect channel partners in order to increase market share in both domestic and international markets. We also seek to increase sales to our existing base of customers by offering a range of software and services utilizing our integrated business intelligence platform. Furthermore, we offer a comprehensive set of educational programs that enhance our potential customers' and channel partners' understanding of the power of our platform.

## **Products**

We offer an integrated business intelligence platform, known as MicroStrategy 8, which is designed to enable businesses to turn information into strategic insight and make more effective business decisions.

**MicroStrategy 8.** MicroStrategy 8 was released for general availability on February 1, 2005 and includes a number of major enhancements from its predecessor, MicroStrategy 7i. MicroStrategy 8's major enhancements include a redesigned web interface, interactive reporting in Report Services, improved integrated analysis to facilitate drilling into more-detailed analysis, WYSIWYG report design over the web, direct access to SAP BW metadata, direct access to operational data, improved reporting by joining heterogeneous databases, and improved predictive reporting and analysis including enhanced integration with third party data mining products.

MicroStrategy 8 is designed for business executives, report consumers and business managers, as well as power users and analysts with simplicity and high productivity in mind. MicroStrategy 8 integrates a full range of reporting, analysis and monitoring capabilities into a single platform providing central management of security, administration, development and deployment.

MicroStrategy 8 is designed to integrate the two leading business intelligence approaches, ad hoc query and reporting (ROLAP) and cube analysis (MOLAP), delivering quick response time against almost any size data set,

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full access to transaction-level data and a myriad of options for complex analysis. MicroStrategy 8 enables organizations to consolidate business intelligence applications onto a single platform, resulting in reliable and maintainable solutions with a low total cost of ownership.

The MicroStrategy 8 platform consists of the following product components:

***MicroStrategy Intelligence Server.*** MicroStrategy Intelligence Server is the foundation for our business intelligence platform. We believe that MicroStrategy Intelligence Server is the most advanced business intelligence server available in the market, capable of answering highly sophisticated business questions. Its robust ROLAP technology enables organizations to conduct large-scale product affinity and product profitability analyses, research customer preferences through sales, contribution and pricing analysis, and compare present and historical customer retention data with forecasting and trend metrics. MicroStrategy Intelligence Server generates highly optimized queries through its very large database drivers, enabling high throughput and fast response times.

MicroStrategy Intelligence Server has been built with the scalability and fault tolerance required for sophisticated analysis of multi-terabyte databases and can be deployed to thousands of users through complete user, object and data security and management. It contains thousands of specific optimizations for all major relational databases and multi-dimensional databases like SAP BW and includes the load distribution, prioritization and system tuning capabilities demanded by large-scale implementations.

MicroStrategy Intelligence Server contains an analytical engine with over 240 different sophisticated mathematical, financial and statistical data mining functions with the flexibility for further function extensions. MicroStrategy Intelligence Server combines the power of its analytical engine with the scalability of a relational database to perform complex data analysis with maximum efficiency. All of the other products in the MicroStrategy 8 platform integrate with the MicroStrategy Intelligence Server and benefit from its broad functionality.

MicroStrategy Intelligence Server is designed to be fault-tolerant to ensure system availability and high performance. Through an enterprise management console, MicroStrategy Intelligence Server provides a sophisticated array of enterprise management tools, such as caching and query prioritization to streamline performance and batch job scheduling, which helps to maintain disparate and diverse user communities. Administrators can automate the dynamic adjustments of system and user governing settings, such as user thresholds and database thread priorities, in order to smooth the database workload and ensure the high performance that large user communities require.

MicroStrategy Intelligence Server is designed as a services oriented architecture to easily augment functionality and capabilities throughout the platform. MicroStrategy Intelligence Server Universal Edition uses an optimized 64-bit architecture and runs on a 64-bit Unix platform for even greater performance. MicroStrategy OLAP Services and Report Services employ this services-oriented architecture design.

***MicroStrategy Report Services.*** MicroStrategy Report Services is the enterprise reporting engine of the MicroStrategy business intelligence platform that delivers an entire range of enterprise reports, including production and operational reports, managed metrics reports and scorecards. The WYSIWYG design capabilities on the web provide the precision necessary to deliver these reports with desktop publishing quality and drag-and-drop simplicity. Users can create reports using intuitive design features without programming or outside help.

***MicroStrategy 8 OLAP Services.*** MicroStrategy 8 combines the speed and interactivity of multi-dimensional OLAP analysis with the analytical power and depth of relational OLAP. MicroStrategy 8 OLAP Services is an extension of MicroStrategy Intelligence Server that allows MicroStrategy Web and Desktop users to manipulate Intelligent Cubes databases. End users can add or remove report objects, add derived

metrics and modify the filter, all with speed-of-thought response time against Intelligent Cubes. MicroStrategy 8

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OLAP Services enables full multi-dimensional OLAP analysis within Intelligent Cubes, while retaining the ability of users to seamlessly drill through to the full breadth and depth of the data warehouse.

**MicroStrategy Web and MicroStrategy Web Universal.** MicroStrategy Web is a proprietary zero-footprint, browser independent web interface providing query, reporting and analysis through a platform independent architecture. MicroStrategy Web's interface provides a familiar look and features drag-and-drop report creation, one-click tool bars, dialogue boxes, spreadsheet formatting, advanced printing and exporting, and right-click menus for drilling, pivoting and sorting. All of this is accomplished without ActiveX, Java Applets or client side installations or downloads, helping to ensure the highest levels of security.

MicroStrategy Web provides users with a highly interactive environment and low maintenance interface for reporting and analysis. Using this intuitive HTML-only web solution, users access, analyze and share corporate data. MicroStrategy Web provides ad hoc querying, analysis, quick deployment and rapid customizability, making it even easier for users to make informed business and management decisions on virtually any web browser.

MicroStrategy Web Universal features the same powerful functionality that users are familiar with in MicroStrategy Web with the added benefit of working with all major operating systems, application servers and web servers.

**MicroStrategy Narrowcast Server.** MicroStrategy Narrowcast Server is a proactive report delivery and alerting server that distributes personalized business information to recipients via e-mail, printers, file servers, portals, wireless devices, fax and phone. MicroStrategy Narrowcast Server delivers targeted information to individuals on an event-triggered or scheduled basis through the communication device that is most convenient. It provides an engine for implementing targeted messaging to acquire and retain customers and a platform for distributing information to corporate departments, the entire enterprise and other stakeholders including customers and suppliers.

MicroStrategy Narrowcast Server has a web-based interface that can be used with existing web applications. Users can subscribe to information services by providing personal information and preferences, enabling them to receive personalized information relevant to them.

In addition to proactively delivering reports from the MicroStrategy 8 platform, MicroStrategy Narrowcast Server's open information source modules enable it to deliver information from a multitude of information sources to the business user. The multiple information sources can be combined to provide users with requested information in one personalized e-mail, message or document.

**MicroStrategy Office.** MicroStrategy Office lets every Microsoft® Office user run, edit and format any MicroStrategy report directly from within Microsoft applications such as Excel, PowerPoint and Word. MicroStrategy Office is designed using Microsoft .NET technology and accesses the MicroStrategy business intelligence platform using XML and web services. MicroStrategy Office gives business users open and straightforward access to the full functionality of the MicroStrategy platform—all from familiar Microsoft Office applications. MicroStrategy Office serves as a Microsoft add-in, with MicroStrategy functionality expressed as a single tool bar in Microsoft.

**MicroStrategy Desktop.** MicroStrategy Desktop is a business intelligence software component that provides integrated query and reporting, powerful analytics and decision support workflow on the personal computing desktop. MicroStrategy Desktop provides a rich set of features for online analysis of corporate data. Even complex reports are easy to create and can be viewed in various presentation formats, polished into production reports, distributed to other users and extended through a host of ad hoc features including drilling, pivoting and data slicing. The

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interface itself can be customized to different users' skill levels and security profiles. MicroStrategy Desktop comes in two versions:

*Desktop Analyst.* A simplified version that provides interactive slice and dice required by managers; and

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*Desktop Designer.* A full-featured version that lets users design complex and sophisticated reports.

Applications developed within MicroStrategy Desktop can be easily deployed throughout the MicroStrategy architecture bringing integrated query and reporting capabilities, powerful analytics and decision support workflow to analysts, quantitative users and end users throughout the enterprise and beyond.

***MicroStrategy Architect.*** MicroStrategy Architect is the MicroStrategy 8 product in which applications are modeled through an intuitive graphical user interface. MicroStrategy Architect provides a unified environment for creating and maintaining business modules and their relations to underlying data for business intelligence applications. MicroStrategy Architect is highly automated and is based on an open, flexible architecture, which can greatly reduce the cost and time required to implement and maintain systems.

***MicroStrategy Administrator.*** MicroStrategy Administrator enables administrators to efficiently develop, deploy, monitor and maintain small and medium systems as well as enterprise-scale systems supporting thousands of users. Project migration utilities help administrators develop, test and deploy systems. Performance analysis enables administrators to monitor and tune systems for maximum performance and availability. MicroStrategy Administrator has been designed to ensure easy management of application objects and users across multiple development, testing and production environments. MicroStrategy Administrator eases the burden of maintaining users and security by using textual commands that can be saved as scripts. These commands and scripts can be executed from either a graphical interface or from the command line giving system administrators the flexibility and ease-of-use necessary for efficient systems management. MicroStrategy Administrator tools consist of Object Manager, Enterprise Manager and Command Manager.

***MicroStrategy SDK.*** MicroStrategy SDK is a comprehensive development environment that enables integration of MicroStrategy 8 features and functionality into any application on multiple platforms, including UNIX-based systems using a Java-based web API. Through sample code, documentation and reference guides, the MicroStrategy SDK enables an application developer to quickly learn to use the APIs to implement easy-to-use web reporting and powerful business intelligence applications.

All API interfaces within the MicroStrategy SDK reflect XML architecture. MicroStrategy SDK's Portal Integration Kit includes pre-built samples for embedding MicroStrategy 8 analysis into a corporate portal. The Web Services Development Kit provides sample code that enables MicroStrategy 8 functionality to be accessed via standard web services.

***MicroStrategy BI Developer Kit.*** MicroStrategy BI Developer Kit is a package of products that includes MicroStrategy Desktop Designer, MicroStrategy Architect and modular analytic applications. The analytic modules are starter kits designed to streamline business processes through the use of business intelligence. Each of the modules ships with a sample data-model and numerous reports and key performance indicators. The analytic modules are designed to enable portability and the ability to work against existing data warehouses without the need for additional data extraction and loading concerns. The modules are easy to extend and modify and reflect a decade of business intelligence implementation experience and best practices of the most common business analysis applications.

## **Product Support and Other Services**

***MicroStrategy Technical Support.*** MicroStrategy Technical Support provides a diverse set of support options to meet the needs of customers and projects and offers product upgrades when available. Our product experts help support MicroStrategy implementation across the development, test and production environments. Our support offerings include access to our highly skilled support team during standard business

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hours, around the clock access to our online support site, and options to secure dedicated technical support at any time of the day. Technical support services are provided to customers for a maintenance fee, which is charged in addition to the initial product license fee.



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**MicroStrategy Consulting.** MicroStrategy Consulting offers customers a broad range of business intelligence and data warehousing expertise gathered from helping thousands of customers across diverse industries implement departmental, enterprise and extranet applications across various types of databases. Our Consulting staff identifies the optimal design and implementation strategy that includes detailed business requirements, user interface requirements and performance tuning. By leveraging our best practices, strategic visioning, project planning and platform expertise, we assist customers' technical staff in completing projects and developing solutions that business users will adopt.

**MicroStrategy Education.** MicroStrategy Education offers goal-oriented, comprehensive education solutions for customers and partners. Through the use of self-tutorials, custom course development, joint training with customers' internal staff or standard course offerings, MicroStrategy's Education consultants develop an ongoing education program that meets our customers' specific education needs. Our team of education consultants delivers quality, cost-effective instruction and skill development for administrators, developers and analysts. MicroStrategy offers the Perennial Education Pass Program which allows customers to train named individuals through an unlimited number of public MicroStrategy instructor-led courses and online courses under this annual program.

**MicroStrategy Technical Advisory Services.** MicroStrategy also offers Technical Advisory Services as an advisory service for enterprise customers seeking to maximize their investment in the MicroStrategy business intelligence platform. MicroStrategy Technical Advisory Services provides members with a comprehensive program of advisory services, knowledge capital and corporate support. MicroStrategy Technical Advisory Services has been designed to help provide the optimal opportunity to experience success and the highest return on investment on MicroStrategy's business intelligence platform. MicroStrategy Technical Advisory Services delivers subject matter expertise, project management, strategic consulting and expedited resources to enhance the success of customer deployments. Revenues from MicroStrategy Technical Advisory Services are included within revenues from consulting services as discussed above.

**Angel.com and Alarm.com.** We also have two businesses, Angel.com and Alarm.com, that do not focus on the business intelligence market. Angel.com is a provider of interactive voice response telephony systems. Alarm.com is a provider of web-enabled security and activity monitoring technology.

## **Customers**

MicroStrategy customers include many of the leading companies from a diverse group of industries, including retail, telecommunications, financial services, insurance, pharmaceutical and healthcare, manufacturing, technology, and government and public services.

Below is a representative list of domestic and international firms that use the MicroStrategy business intelligence platform:

*Retail:* Applebee's International, The Container Store, CSK Auto, Hudson's Bay Company, Lowe's Companies, Payless ShoeSource Worldwide, Inc., PetSmart, and Starbucks Corporation

*Telecommunications:* Cingular Wireless, Comcast Corporation, Interoute, Telecom Italia, Telefónica, and Telephia

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*Financial Services:* Bank of Montreal, Bank of the West, Fieldstone Mortgage, First American Financial Corp., H&R Block, KeyBank, Samsung Capital, and Wells Fargo Bank

*Insurance:* 21<sup>st</sup> Century Insurance, Grange Insurance, Nationwide Insurance, and Pacific Life Insurance

*Pharmaceutical and Healthcare:* Caremark Rx, ImpactRx, Lloydspharmacy, PMSI-Tmesys, Premier, Wyeth Pharmaceuticals, and Upsher-Smith Laboratories

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*Manufacturing:* Oakwood Homes, Porsche Cars North America, Rite-Hite Corporation, and Wilton Industries, Inc.

*Technology:* Iridium Satellite LLC, Solucient, TRX Data Services, Inc., and XM Satellite Radio

*Government/Public Services:* Centers for Medicare and Medicaid Services, Department of Homeland Security, Department of Housing and Urban Development, National Institutes of Health, Ohio Department of Education, State of Tennessee, Texas Department of Agriculture, U.S. Air Force and U.S. Army, U.S. Census Bureau, and U.S. Postal Service

## **Customer Case Studies**

### **Consortium Health Plans**

Consortium Health Plans (CHP), which positions Blue Cross® Blue Shield® Plans as the preferred choice for national employers, selected MicroStrategy to support its web portal, MarketQuest. Anchored by MicroStrategy, MarketQuest provides a comprehensive source of information and collaboration for Blue Cross Blue Shield personnel who support the sale and retention of national accounts. MarketQuest users include national account sales executives and other sales personnel, proposal writers, underwriters and medical directors. With MarketQuest, users develop a more consultative approach towards sales activities and a deeper understanding of competitors, consultants and the healthcare industry. CHP conducted a thorough evaluation and request for proposal with several vendors before selecting MicroStrategy for its robust analytical and reporting capabilities and its user-friendly Web interface.

### **CSK Auto Corporation**

CSK Auto Corporation is the parent company of CSK Auto, Inc., a specialty retailer in the automotive aftermarket, operating more than 1,300 retail stores. For more than three years, Phoenix, Arizona-based CSK Auto has been a MicroStrategy customer. CSK Auto expanded its deployment of MicroStrategy to enhance its reporting and analysis capabilities and enable more users to tap into vital business performance data. Corporate management, business analysts and field personnel use MicroStrategy for a wide range of applications, including analyzing consumer purchasing trends, loss prevention reporting, monitoring vendor performance and compliance, and conducting detailed analyses of the sales, replenishment and purchasing functions.

### **Porsche Cars North America, Inc.**

Porsche Cars North America, Inc. (PCNA), based in Atlanta, GA, and its subsidiary, Porsche Cars Canada, Ltd., are the exclusive importers of Porsche sports cars and Cayenne sport utility vehicles for the United States and Canada, Ltd, and is a wholly owned, indirect subsidiary of Dr. Ing. h.c. F. Porsche AG. PCNA uses MicroStrategy to help report, analyze and monitor sales and marketing information. PCNA uses this information to be as responsive as possible to its customers, increase dealership productivity and support the company's business objectives. PCNA selected the MicroStrategy Business Intelligence Platform for its ease-of-use, advanced analytical capabilities and scalability.

### **Rite-Hite Corporation**

Rite-Hite Corporation, headquartered in Milwaukee, Wisconsin, is a worldwide leader in the development, manufacture and sale of loading dock safety systems and industrial door solutions. Using MicroStrategy, Rite-Hite introduced a new scorecard for executives, which provides a snapshot of critical company information such as forecasted revenue and balance sheet analysis. Monitoring business performance using MicroStrategy's at-a-glance scorecards gives Rite-Hite users timely insights into key business metrics. Rite-Hite also uses MicroStrategy to streamline and automate its planning data to make more strategic and analytically-based decisions.

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### **Sales and Marketing**

*Direct Sales Organization.* We market our software and services primarily through our direct sales force. We have sales offices in locations throughout the United States, Canada, Mexico, Europe, South America and the Pacific Rim. We are represented by distributors in several countries where we do not have sales offices.

*Indirect Sales Channels.* We have entered into relationships with nearly 300 reseller, value-added reseller, system integration, original equipment manufacturers ( OEM ) and technology partners who utilize the MicroStrategy platform for a variety of commercial purposes. Agreements with these partners generally provide non-exclusive rights to market our products and services and allow access to our marketing materials, product training and direct sales force for field level assistance. In addition, we offer product discounts to our sales partners. Favorable product recommendations from our partners to potential customers, which include leading system integration, application development and platform manufacturers, facilitate the sale of our products. We believe that such indirect sales channels allow us to leverage sales and service resources as well as marketing and industry-specific expertise to expand our user base and increase our market coverage. In addition, we have entered into agreements with resellers who resell our software on a stand-alone basis.

*Reseller/System Integration Partners.* Our resellers/systems integration alliances include partners who can resell our software on a stand-alone basis, value-added resellers who resell the MicroStrategy 8 platform software bundled with their own software applications and system integrators who deploy MicroStrategy solutions to their customers, including:

Accenture	AIM Computer Consultants	Alliance Consulting
AlphaBay	Annams Systems Corporation	Armeta
BearingPoint	Bellsoft	BI-Basics
Biltmore Technologies	CadenceQuest	CGI
Claraview, Inc.	Cognizant	Covansys
CSC	DataFactz	Data Management Group
Dataspace	DB Works	Deloitte
DoubleClick	E2E Technologies	EDS
Fujitsu	Hewlett-Packard Company	High Impact Technologies, Inc.
Hitachi	IBM	InfoCepts
Infosys	Integrant Inc.	iOLAP, Inc.
JCB Partners	Jeledes	Keyrus
Lancet Software Development, Inc.	Lodestar	Lunexa
Momentum Consulting	Prithvi Information Solutions LLC	Pros Revenue Management
QuantiSense, Inc.	SAIC	Satyam
Sybase	Syntel	Systech Solutions
SYSTIME Computer Corporation	Teradata	Thomas & Herbert Consulting LLC
Visioneer, Inc.	Wipro	XeoMatrix
Z Y Solutions Corporation		

*OEM Partners.* Our OEM partners integrate the MicroStrategy 8 Business Intelligence Platform or some of its components into their applications. A selection of these OEM partners includes:

Activant Solutions Inc	Affiliated Computer Services, Inc.	AlphaBay
Amadeus International, Inc.	Amdocs, Inc.	Aperio CI
Blazent, Inc.	Clarabridge	Coradiant

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Data 911 Systems  
Energy Softworx  
Fathom Online  
Instill Corporation  
Ketera Technologies, Inc

Electronic Arts  
Epicor/CRS  
IBM/iPhrase  
Intelliworks  
Kurt Salmon Associates

EmpowerMx  
Escalate Retail  
InQuira  
Jaros Technology  
LexisNexis Examen

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Marketing Direct, Inc.	MarketStance	MI9 Business Intelligence Systems Inc.
OATSystems	Oracle/JD Edwards	Oracle/Retek
Pinnacle Corporation	Plan Data Management	Prescient
Razor Knowledge Systems	Rivermine Software	SAP Khimetrics
SirsiDynix	Siterra	SmartOps
SPSS	SPSS NetGenesis	SQLiaison
Target Software	TradeBeam, Inc.	Verisign
Vestmark	Vision Chain	

*Technology Partners.* In order to deliver even higher value to our customers, MicroStrategy has integrated its business intelligence platform with the leading data warehouse and related technology platforms and software. We have integrated our platform with leading portal technology, extranet, transform and load technology and specialized display technology products to name just a few. Through our Technology Partner program, we continue our efforts to help ensure that customers can easily implement the MicroStrategy 8 business intelligence platform alongside other chosen corporate technology standards. Our technology partners include:

Ab Initio	Adobe	Attunity
BEA	DATALlegro	ESRI
Hewlett-Packard Company	HyperRoll	IBM
Informatica Corporation	Intel	MapInfo
Microsoft	Netezza Corporation	Oracle
Red Hat	SPSS	Sun Microsystems
Sybase	Teradata	Visual Crossing
WhereScape		

## **Competition**

The markets for business intelligence software, analytical applications and information delivery are intensely competitive and subject to rapidly changing technology. In addition, many companies in these markets are offering, or may soon offer, products and services that may compete with MicroStrategy products.

MicroStrategy faces competitors in several broad categories, including business intelligence software, analytical processes, query and web-based reporting tools, and report delivery. Our competitors that are primarily focused on business intelligence products include, among others, Actuate, Business Objects, Cognos, Hyperion Solutions, Information Builders and the SAS Institute. We also compete with large software corporations, including suppliers of enterprise resource planning software that provide one or more capabilities competitive with our products, such as IBM, Microsoft, Oracle, SAP AG, Infor and others, and with open source business intelligence vendors, including Pentaho, JasperSoft and others.

Many of our competitors have longer operating histories, significantly greater financial, technical, marketing or other resources, and greater name recognition than we do. In addition, many of our competitors have strong relationships with current and potential customers and extensive knowledge of the business intelligence industry. 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 and sale of their products than we can. 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.

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Current and future competitors may also make strategic acquisitions or establish cooperative relationships among themselves or with others. By doing so, they may increase their ability to meet the needs of our potential customers. Our current or prospective indirect channel partners may establish cooperative relationships with our



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current or future competitors. These relationships may limit our ability to sell our products 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 maintain technical support revenues from our installed customer base.

## **Research and Product Development**

We have made, and continue to make, substantial investments in research and product development. We believe that our future performance will depend in large part on our ability to maintain and enhance our current product line, develop new products that achieve market acceptance, maintain technological competitiveness and meet an expanding range of customer requirements. As of December 31, 2006, our research and product development staff consisted of 240 employees, 212 of whom are working on our core business intelligence projects and 28 of whom are working on research and development relating to our Angel.com and Alarm.com businesses.

## **Employees**

As of December 31, 2006, we had a total of 1,274 employees, of whom 824 were based in the United States and 450 were based internationally. Of the total of 1,274 employees, 455 were engaged in sales and marketing, 240 in research and development, 327 in technical support, consulting and education services, and 252 in finance, administration and corporate operations. None of our employees is represented by a labor union. We have not experienced any work stoppages and consider our relations with our employees to be good.

We believe that effective recruiting, education and nurturing of human resources are critical to our success and 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.

All newly hired technical and sales professionals complete a professional orientation course that ranges from one day to four weeks long, presented by MicroStrategy University, our in-house education function. The curriculum consists of lectures, problem sets and independent and group projects, covering data on our products, competitors and customers. Certain lectures also deal with general business practices, ethics and teamwork. Throughout this training, students typically must pass a number of oral and written examinations in order to begin their assignments. Course content for MicroStrategy University is created by experienced members of our professional staff, who generally have an annual obligation to update course content based upon the best practices they have most recently observed in the field. This expert content is then used to upgrade and revitalize our education, consulting, support, technology and marketing operations.

## **Available Information**

MicroStrategy's website is located at [www.microstrategy.com](http://www.microstrategy.com). MicroStrategy makes available free of charge, on or through our website, our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and all amendments to those reports, as soon as reasonably practicable after electronically filing such reports with the Securities and Exchange Commission (SEC). Information found on our website is not part of this report or any other report filed with the SEC.

**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 trading price of our class A common stock could decline and you may lose all or part of your investment.

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**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 of customer orders, which can affect whether we recognize revenue upon the signing and delivery of our software products or whether revenue must be recognized as work progresses or over the entire contract period;

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

changes in our pricing policies or those of our competitors;

market acceptance of business intelligence software generally and of new and enhanced versions of our products in particular;

the length of our sales cycles;

changes in our operating expenses;

personnel changes;

our use of direct and indirect distribution channels;

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;

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;

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seasonal factors, such as our traditionally lower pace of new license transactions in the summer; 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 trading price of our class A common stock may fall.

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

The trading price of our class A common stock historically has been volatile and may continue to be volatile. The trading 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:

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

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announcements by us or our competitors of acquisitions, new products, 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 and market new and enhanced products 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 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 our competitors of their earnings that are not in line with analyst expectations;

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

sales of stock by us or by our stockholders;

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

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

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 those 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.

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

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

material adverse effect on our results of operations.

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

We are subject to income taxes and non-income taxes in a variety of jurisdictions. Our future income taxes could be 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, 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. Any adverse outcome of such a review could have an adverse effect on our operating result 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.

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

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

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

Nearly all of our revenues to date have come from sales of business intelligence software and related technical support, consulting and education services. We expect these sales to account for a large portion of our revenues for the foreseeable future. Although demand for business intelligence software has grown in recent years, the market for business intelligence software applications is still evolving. Resistance from consumer and privacy groups to increased commercial collection and use of data on spending patterns and other personal behavior and European and other governmental restrictions on the collection and use of personal data may impair the further growth of this market, as may other developments. We cannot be sure that this market will continue to grow or, even if it does grow, that businesses will adopt our solutions. We have spent, and intend to keep spending, considerable resources to educate potential customers about business intelligence software in general and our solutions in particular. However, we cannot be sure that these expenditures will help our products achieve any additional market acceptance. If the market fails to grow or grows more slowly than we currently expect, our business, operating results and financial condition would be materially adversely affected.

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

A significant portion of our research and development activities and certain other critical business operations are concentrated in a single facility in northern Virginia. 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 and adversely affected.

### **We face the risk of a decrease in our cash balances and losses in our investment portfolio**

Our cash balances are held in numerous locations throughout the world. A portion of our cash is invested in marketable securities as part of our investment portfolio. Among other factors, changes in interest rates, foreign currency fluctuations and macroeconomic conditions could cause fluctuations in our cash balances and losses in our investment portfolio. Most amounts held outside the United States could be repatriated to the United States, but, under current law, would be subject to U.S. federal and state income tax, less applicable foreign tax credits.

### **We use strategic 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 strategic channel partners such as value-added resellers, system integrators and original equipment manufacturers to license and support our products. For the year ended December 31, 2006, transactions by channel partners for which we recognized revenues accounted for 13.0%, of our total product licenses revenues. Our channel partners generally offer customers the products of several different companies, including products 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



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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 products.

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 indirect sales activities through our strategic channel partners. There can be no assurance that our strategic partners will continue to cooperate with us when our distribution agreements expire or are up for renewal. In addition, there can be no assurance that actions taken or omitted to be taken by such parties will not adversely affect us. Our ability to achieve revenue growth in the future will depend in part on our success in maintaining successful relationships with our strategic partners. If we are unable to maintain our relationships with these strategic partners, our business, operating results and financial condition could 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 long-term deferred revenue and advance payments totaled \$113.4 million as of December 31, 2006. We offset our accounts receivable and deferred revenue for any billed and unpaid items, which totaled \$55.7 million, resulting in net deferred revenue and advance payments of \$57.7 million as of December 31, 2006. 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 also entered into certain additional agreements that include future commitments by our customers to purchase products, product support or other services through 2011 totaling approximately \$45.2 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 services, deferred revenue and advance payments at any particular date may not be representative of actual revenue for any succeeding period.

### **We may not be able to sustain or increase profitability in the future**

We generated net income for each of the years ended December 31, 2006, 2005 and 2004; however, we may not be able to sustain or increase profitability on a quarterly or annual basis in the future. If operating expenses exceed our expectations or cannot be adjusted accordingly or revenues fall below our expectations, we may cease to be profitable and our business, results of operations and financial condition may be materially and adversely affected. We have significant deferred tax assets, and if we are unable to sustain profitability, we may be required to establish a valuation allowance against these deferred tax assets, which would result in a charge that would adversely affect net income in the period in which the charge is incurred.

### **Managing our international operations is complex and our failure to do so successfully or in a cost-effective manner 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 from foreign direct and indirect operations. International sales accounted for 36.3%, 38.4% and 40.7% of our total revenues for the years ended December 31, 2006, 2005 and 2004, respectively. Our international operations require significant management attention and financial resources.

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

changes in foreign currency exchange rates;

unexpected changes in regulatory requirements;

tariffs, export restrictions and other trade barriers;

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costs of localizing products;

lack of acceptance of localized products;

longer accounts receivable payment cycles;

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

tax issues, including restrictions on repatriating earnings;

weaker intellectual property protection;

economic weakness or currency related crises;

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

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

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

political instability in the countries where we are doing business.

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, U.S. laws such as the Foreign Corrupt Practices 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 international sales and, consequently, on our business, operating results and financial condition.

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

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To date, our customers have typically invested substantial time, money and other resources and involved many people in the decision to license our software products and purchase our consulting and other services. As a result, we may wait nine months or more after the first contact with a customer for that customer to place an order while it seeks internal approval for the purchase of our products and/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 products, or the customer's own budget and purchasing priorities may change.

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

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

As existing and potential customers seek to standardize on a single business intelligence vendor, our business may experience larger transactions at the enterprise level and larger transactions may account for a

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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 example, during 2006, our top three product license transactions, including one transaction with \$4.3 million in revenue recognized, totaled approximately \$10.2 million in revenue recognized, compared with \$5.5 million for the top three product license transactions in 2005 or 9.5% and 5.5% of total product licenses revenues in the years ended December 31, 2006 and 2005, respectively. These transactions represent significant business and financial decisions for our customers and require considerable effort on the part of customers to assess alternative products and require additional levels of management approval before being concluded. They are also often more complex than smaller transactions. These factors generally lengthen the typical sales cycle and increase the risk that the customer's purchasing decision may be postponed or delayed from one period to another subsequent or later period or that the customer will alter his purchasing requirements. The sales effort and service delivery scope for larger transactions also require additional resources to execute the transaction. These factors could result in lower than anticipated revenue and earnings for a particular period or in the reduction of estimated revenue and earnings in future periods.

### **Our customers include the U.S. government and a number of state and local governments or agencies**

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

*Procurement.* Contracting with public sector customers is highly competitive and can be time-consuming and expensive, requiring that we incur significant upfront 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 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.

*Audits.* The U.S. government and state and local governments and agencies routinely investigate and audit government contractors for compliance with a variety of complex laws, regulations, and contract provisions relating to the formation, administration or performance of government contracts, including provisions governing reports of and remittances of fees based on sales under government contracts, price protection, compliance with socio-economic policies, and other terms that are particular to government contracts. If, as a result of an audit or review, it is determined that we have failed to comply with such laws, regulations or contract provisions, 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.

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

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The markets for business intelligence software, analytical applications and information delivery are intensely competitive and subject to rapidly changing technology. In addition, many companies in these markets are offering, or may soon offer, products and services that may compete with MicroStrategy products.

MicroStrategy faces competitors in several broad categories, including business intelligence software, analytical processes, query and web-based reporting tools, and report delivery. Our competitors that are primarily

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focused on business intelligence products include, among others, Actuate, Business Objects, Cognos, Hyperion Solutions, Information Builders and the SAS Institute. We also compete with large software corporations, including suppliers of enterprise resource planning software that provide one or more capabilities competitive with our products, such as IBM, Microsoft, Oracle, SAP AG, Infor and others, and with open source business intelligence vendors, including Pentaho, JasperSoft and others.

Many of our competitors have longer operating histories, significantly greater financial, technical, marketing or other resources, and greater name recognition than we do. In addition, many of our competitors have strong relationships with current and potential customers and extensive knowledge of the business intelligence industry. 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 and sale of their products than we can. 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, they may increase their ability to meet the needs of our potential customers. Our current or prospective indirect channel partners may establish cooperative relationships with our current or future competitors. These relationships may limit our ability to sell our products 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 maintain technical support revenues from our installed customer base.

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

We license third-party technologies that we incorporate into our existing products. 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 products. 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 products 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 products, and we may experience a decreased demand for our products.

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

Our MicroStrategy 8 suite of products accounts 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 8 software as a result of, among other factors, any change in our pricing model, increased competition, a maturation in the markets for these products or other risks described in this document.

### **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**

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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, President and Chief Executive Officer, and Sanju K. Bansal, our Vice Chairman, Executive Vice President and Chief Operating Officer. If we lose the services of one or both of these individuals or other key



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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.

**If we are unable to develop and release product enhancements and new products 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 products is characterized by rapid technological change, frequent new product introductions and enhancements, changing customer demands and evolving industry standards. The introduction of products embodying new technologies can quickly make existing products 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 product line; and

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

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

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

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

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

Software products as complex as ours may contain errors and/or defects. Although we test our products extensively, we have in the past discovered software errors in our products after their introduction. Despite testing by us and by our current and potential customers, errors may be found in new products or releases after

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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.

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

We rely on a combination of copyright, patent, trade secrets, confidentiality procedures and contractual commitments to protect our proprietary information. 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. In addition, the laws of some countries do not provide the same level of protection of our proprietary rights as do the laws of the United States. If we cannot protect our proprietary technology against unauthorized copying or use, we may not remain competitive.

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

We periodically receive notices from others claiming we are infringing their intellectual property rights, principally patent rights. We expect the number of such claims will increase as the number of products and competitors in our industry segments grows, the functionality of products overlap, and the volume of issued software patents and patent applications 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 products;

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

require us to satisfy indemnification obligations to our customers.

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

**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. 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. In addition to the related cost and use of cash, pending or future litigation could cause the diversion of management's attention and resources.

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### **We could face liability claims relating to Alarm.com products and services and these claims could result in significant costs and liabilities**

Our Alarm.com subsidiary provides web-enabled security and activity monitoring technology. We face exposure to liability claims in the event that any Alarm.com product or service results in personal injury or property damage. Although we maintain insurance policies to provide certain coverage for general liability claims, such insurance may not continue to be available on terms acceptable to us and such coverage may not be adequate for liabilities actually incurred. In addition, in the event that any Alarm.com product or service is proved to be defective, we may be required to recall or redesign such products or services, which could result in significant unexpected costs. Any liability claim or product recall could result in harm to our reputation and have a material adverse effect on our business, operating results and financial condition.

### **Government regulations or other standards could have an adverse effect on the operations of our Alarm.com business**

The operations of our Alarm.com subsidiary may become subject to certain federal, state, and local regulations and licensing requirements. Many jurisdictions have licensing laws directed specifically toward the home alarm and monitoring industry. We believe that the products and services provided by our Alarm.com subsidiary do not require certain licenses or permits required of traditional providers of home protection and monitoring services. If laws, regulations or licensing requirements in the jurisdictions in which Alarm.com operates were to change or if existing laws, regulations and licensing requirements were to be construed to require Alarm.com to obtain licenses or permits to provide its products and services, we may be required to modify our operations or to utilize resources to maintain compliance with such rules and regulations, or we may become subject to adverse regulatory action, any of which could have a material adverse effect on the business and operating results of our Alarm.com business.

### **Our Alarm.com subsidiary relies on third-party manufacturers to produce and assemble its products. If these manufacturers experience an interruption in their operations or are otherwise unable to successfully deliver the products to meet our production demands, our business, operating results and financial condition could be materially adversely affected**

We have outsourced the production and assembly of our Alarm.com products to third-party manufacturers. Any interruption in the operations of our manufacturers could materially adversely affect our ability to meet scheduled deliveries to customers and business partners. In addition, these manufacturing facilities may not be able to increase production on a timely basis, or on terms acceptable to us, to keep up with the requirements of the Alarm.com business. As a result, we may not be able to satisfy customer orders or contractual commitments, leading to the termination of one or more of our contracts or resulting in litigation against us, any of which could have a material adverse effect on our business, operations and financial results. Alternative manufacturers may be difficult to find on terms acceptable to us or in a timely manner.

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

We have two classes of common stock: class A common stock and class B common stock. Holders of our class A common stock generally have the same rights as holders of our class B common stock, except that holders of class A common stock have one vote per share while holders of class B common stock have ten votes per share. As of February 1, 2007, holders of our class B common stock owned 2,775,244 shares of class B common stock, or 73.7% of the total voting power. Michael J. Saylor, our Chairman, President and Chief Executive Officer, beneficially owned 317,800 shares of class A common stock and 2,429,582 shares of class B common stock, or 65.3% of the total voting power, as of February 1, 2007. Accordingly, Mr. Saylor is able to control MicroStrategy through his ability to determine the outcome of elections of our directors, amend

our

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certificate of incorporation and by-laws and take other actions requiring the vote or consent of stockholders, including mergers, going-private transactions and other extraordinary transactions and their terms.

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

### **ITEM 1B. UNRESOLVED STAFF COMMENTS**

None.

### **ITEM 2. PROPERTIES**

Our principal office is located in Northern Virginia and consists of approximately 201,000 square feet of leased facilities, including 30,000 square feet that has been subleased. The term of the lease expires in 2010 but may be extended at our option for two additional five-year terms.

In addition, we lease approximately 27,000 square feet of sales and administrative offices domestically and approximately 88,000 square feet of sales and administrative offices internationally in a variety of locations.

### **ITEM 3. LEGAL PROCEEDINGS**

In October 2006, our subsidiary in Spain received notice of an adverse judgment from a commercial court in Spain requiring us to pay \$1.1 million, plus interest and certain costs of the proceeding, in connection with a commercial dispute. As a result of the judgment, the Company recorded a liability of \$1.1 million in the third quarter of 2006. We are appealing the ruling. In February 2007, the court granted provisional execution of the judgment, requiring us immediately to pay in cash \$1.1 million, which includes interest through the end of 2006, plus additional estimated interest and costs relating to the execution proceeding of \$0.2 million, while the appeal is pending.

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

### **ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

No matters were submitted to a vote of security holders during the fourth quarter of 2006.



**Table of Contents****PART II****ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES**

Our class A common stock is traded on the Nasdaq Global Market under the symbol MSTR. The following table sets forth the high and low sales prices for the class A common stock for the periods indicated as reported by the Nasdaq Global Market:

	<u>High</u>	<u>Low</u>
Year ended December 31, 2006		
First Quarter	\$ 109.00	\$ 82.78
Second Quarter	109.50	86.10
Third Quarter	102.50	75.00
Fourth Quarter	129.88	98.75
Year ended December 31, 2005		
First Quarter	\$ 79.75	\$ 53.45
Second Quarter	59.95	43.20
Third Quarter	82.05	53.00
Fourth Quarter	84.91	64.66

There is no established public trading market for our class B common stock. As of February 1, 2007, there were approximately 1,923 stockholders of record of our class A common stock and 5 stockholders of record of our 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.

We have never declared or paid any cash dividends on either our class A or class B common stock and have no current plans to declare or pay any such dividends.

The following table provides information about our repurchases during the periods indicated of equity securities that are registered by us pursuant to Section 12 of the Exchange Act.

<u>Period</u>	(a) <u>Total Number of Shares (or Units) Purchased</u>	(b) <u>Average Price Paid per Share (or Unit)</u>	(c) <u>Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs (1)</u>	(d) <u>Maximum Number (or Approximate Dollar Value) of Shares (or Units) that May Yet Be Purchased Under</u>
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					the Plans or Programs (1)
October 1, 2006	October 31, 2006	0	N/A	N/A	\$ 161,116,531
November 1, 2006	November 30, 2006	0	N/A	N/A	\$ 161,116,531
December 1, 2006	December 31, 2006	0	N/A	N/A	\$ 161,116,531
Total:		0	N/A	N/A	\$ 161,116,531

- (1) On July 28, 2005, we announced that our Board of Directors had authorized our repurchase of up to an aggregate of \$300.0 million of our class A common stock from time to time on the open market (the 2005 Share Repurchase Program ). The timing and amount of any shares repurchased is determined by our management based on its evaluation of market conditions and other factors. The 2005 Share Repurchase Program has a five-year term, but may be suspended or discontinued by us at any time. The 2005 Share Repurchase Program may be funded using our working capital, as well as proceeds from any credit facilities and other borrowing arrangements which we may enter into in the future.

**Table of Contents****Performance Graph**

The following graph compares the cumulative total stockholder return on the class A common stock of the Company from December 31, 2001 (the last trading day before the beginning of the Company's fifth preceding fiscal year) to December 29, 2006 (the last trading day of the fiscal year ended December 31, 2006) with the cumulative total return of (i) the Total Return Index for The Nasdaq Stock Market (U.S. Companies) (the Nasdaq Index) and (ii) a peer group of companies consisting of Business Objects S.A., Cognos Incorporated and Actuate Corporation (the Peer Index). This graph assumes the investment of \$100.00 on December 31, 2001 in the class A common stock of the Company, the Nasdaq Index and the Peer Index, and assumes any dividends are reinvested. Measurement points are December 31, 2001, December 31, 2002, December 31, 2003, December 31, 2004, December 30, 2005 and December 29, 2006.

	<u>12/31/01</u>	<u>12/31/02</u>	<u>12/31/03</u>	<u>12/31/04</u>	<u>12/30/05</u>	<u>12/29/06</u>
MicroStrategy Incorporated	\$ 100.00	\$ 39.21	\$ 136.30	\$ 156.48	\$ 214.77	\$ 296.21
Nasdaq Index	\$ 100.00	\$ 68.76	\$ 103.68	\$ 113.18	\$ 115.57	\$ 128.38
Peer Index	\$ 100.00	\$ 67.34	\$ 109.60	\$ 121.52	\$ 131.91	\$ 146.67

**Table of Contents****ITEM 6. SELECTED FINANCIAL DATA**

The following selected consolidated financial data should be read in conjunction with Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations, the consolidated financial statements and notes thereto, and other financial information appearing elsewhere in this Annual Report on Form 10-K.

	Years Ended December 31,				
	2006	2005	2004	2003	2002
	(in thousands)				
Statements of Operations Data					
Revenues:					
Product licenses	\$ 107,383	\$ 99,926	\$ 96,995	\$ 77,221	\$ 62,865
Product support and other services	206,440	168,736	134,213	98,356	84,962
Total revenues	313,823	268,662	231,208	175,577	147,827
Cost of revenues:					
Product licenses	2,763	3,535	3,710	3,240	2,925
Product support and other services	41,623	32,916	29,161	24,745	24,975
Total cost of revenues	44,386	36,451	32,871	27,985	27,900
Gross profit	269,437	232,211	198,337	147,592	119,927
Operating expenses:					
Sales and marketing	88,416	70,420	69,924	57,475	48,179
Research and development	34,133	31,471	24,915	27,684	26,297
General and administrative	47,028	36,382	34,977	32,580	27,635
Restructuring and impairment charges				1,699	4,198
Amortization of goodwill and intangible assets	71	71	71	182	3,195
Total operating expenses	169,648	138,344	129,887	119,620	109,504
Income from operations	99,789	93,867	68,450	27,972	10,423
Financing and other income (expense):					
Interest income (expense), net	2,820	2,880	1,168	(4,465)	(7,685)
Gain (loss) on investments	14	(127)	(83)		(523)
Reduction in estimated cost of litigation settlement					11,396
(Loss) gain on early extinguishment of notes payable				(31,069)	6,750
Gain on contract termination					16,837
Other (expense) income, net	(1,262)	1,550	(215)	307	2,109
Total financing and other income (expense)	1,572	4,303	870	(35,227)	28,884
Income (loss) from continuing operations before income taxes	101,361	98,170	69,320	(7,255)	39,307
Provision (benefit) for income taxes	30,485	33,427	(98,993)	(2,587)	1,190
Net income (loss) from continuing operations	70,876	64,743	168,313	(4,668)	38,117

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Discontinued operations:					
Gain from abandonment				765	
Income from discontinued operations				765	
Net income (loss)	70,876	64,743	168,313	(3,903)	38,117
Dividends, accretion and beneficial conversion feature on convertible preferred stock					(6,874)
Net gain on refinancing of series B, C and D convertible preferred stock					36,135
Net income (loss) attributable to common stockholders	\$ 70,876	\$ 64,743	\$ 168,313	\$ (3,903)	\$ 67,378

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	Years Ended December 31,				
	2006	2005	2004	2003	2002
	(in thousands, except per share data)				
Basic earnings (loss) per share (2):					
Continuing operations	\$ 5.46	\$ 4.38	\$ 10.48	\$ (0.31)	\$ 3.20
Discontinued operations				0.05	
Net income (loss) attributable to common stockholders	\$ 5.46	\$ 4.38	\$ 10.48	\$ (0.26)	\$ 3.20
Weighted average shares outstanding used in computing basic earnings (loss) per share	12,987	14,768	16,055	14,804	11,676
Diluted earnings (loss) per share (2):					
Continuing operations	\$ 5.20	\$ 4.19	\$ 9.83	\$ (0.31)	\$ 3.12
Discontinued operations				\$ 0.05	\$
Net income (loss) attributable to common stockholders	\$ 5.20	\$ 4.19	\$ 9.83	\$ (0.26)	\$ 3.12
Weighted average shares outstanding used in computing diluted earnings (loss) per share	13,633	15,436	17,119	14,804	11,986

	As of December 31,				
	2006	2005	2004	2003	2002
	(in thousands)				
<b>Balance Sheet Data</b>					
Cash and cash equivalents	\$ 78,980	\$ 42,318	\$ 68,314	\$ 51,882	\$ 15,036
Restricted cash	3,799	5,076	1,210	747	6,173
Short-term investments	16	53,761	37,816	36	44
Net working capital (deficit) (3)	62,578	80,705	85,543	27,608	(6,920)
Long-term investments			26,365		
Deferred tax assets, net, short-term	29,510	22,971	20,583	1,807	495
Deferred tax assets, net, long-term	57,944	86,393	110,818	3,686	
Total assets	248,816	277,773	336,956	114,793	79,873
Deferred revenue and advance payments, short-term	56,578	45,874	43,674	28,374	23,961
Deferred revenue and advance payments, long-term	1,127	1,554	1,681	2,750	1,381
Long-term liabilities, excluding deferred revenue and advance payments	1,710	2,815	5,063	5,987	51,106
Net liabilities of discontinued operations					1,151
Total stockholders' equity (deficit)	133,151	180,722	240,578	44,347	(34,509)

- (1) Share and per share amounts for all periods presented have been adjusted to reflect the one-for-ten reverse stock split which occurred in July 2002.
- (2) Basic and fully diluted earnings per share for Class A and Class B common stock are the same.
- (3) Net working capital (deficit) is equivalent to current assets less current liabilities, including net assets (liabilities) of discontinued operations, deferred revenue and advance payments and contingency from terminated contract.

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**ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

**Forward-Looking Information**

This discussion contains forward-looking statements within the meaning of Section 21E of 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 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**

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

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

We derive our revenues from product licenses and product support and other services. Product licenses revenues are derived from the sale of software licenses for our MicroStrategy 8 business intelligence platform and related products. We license our software to end users through our direct sales organization and through indirect sales channels, such as resellers, systems integrators and original equipment manufacturers, or OEMs. Our arrangements with customers typically include: (a) an end-user license fee paid for the use of our products in perpetuity or over a specified term; (b) an annual maintenance agreement that provides for software updates and upgrades and technical support for an annual fee; and (c) a services work order for implementation, consulting and training, generally for a fee determined on a time-and-materials basis or, in certain circumstances, a fixed-fee.

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We earned net income of \$70.9 million, \$64.7 million and \$168.3 million for the years ended December 31, 2006, 2005 and 2004, respectively. The following are some operating highlights for the years ended December 31, 2006, 2005 and 2004:

**Annual Performance Measures (in thousands)**

	Years Ended December 31,				
	2006	2005	2004	% Change in 2006	% Change in 2005
<b>Revenues:</b>					
Product licenses revenues	\$ 107,383	\$ 99,926	\$ 96,995	7.5%	3.0%
Product support revenues	142,136	115,851	91,070	22.7%	27.2%
Other services revenues	64,304	52,885	43,143	21.6%	22.6%
	\$ 313,823	\$ 268,662	\$ 231,208	16.8%	16.2%
Cost of revenues	44,386	36,451	32,871	21.8%	10.9%
Gross Profit	\$ 269,437	\$ 232,211	\$ 198,337	16.0%	17.1%
<b>Operating Expenses:</b>					
Sales and marketing	\$ 88,416	\$ 70,420	\$ 69,924	25.6%	0.7%
Research and development	34,133	31,471	24,915	8.5%	26.3%
General and administrative	47,028	36,382	34,977	29.3%	4.0%
Amortization of intangible assets	71	71	71	0.0%	0.0%
	\$ 169,648	\$ 138,344	\$ 129,887	22.6%	6.5%
Income from Operations	\$ 99,789	\$ 93,867	\$ 68,450	6.3%	37.1%

The business intelligence market is highly competitive and our results of operations depend on our ability to market and sell product offerings that provide customers with greater value than those offered by our competitors. Organizations recently have sought, and we expect will continue to seek, to standardize their various business intelligence applications around a single software platform. This trend presents both opportunities and risks for our business. It offers us the opportunity to increase the size of transactions with new customers and to expand the size of our business intelligence installations with existing customers. On the other hand, it presents the risk that we may not be able to penetrate accounts where a competitor currently is or may become the incumbent business intelligence application provider. In addition, companies with industry leading positions in certain software markets, such as Microsoft and Oracle, have begun incorporating certain business intelligence capabilities into their product suites. As a result, our products need to be sufficiently differentiated from these bundled software offerings to create customer demand for our platform and products.

To address these opportunities and challenges, we are implementing a number of initiatives, including:

focusing our research and development efforts on maintaining our position as a technology leader by continuing to innovate and lead in enterprise business intelligence, improving our products capability to efficiently handle the ever increasing data and user scalability



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needs of our current and future customers, and adding analytical and end user features to support the increasing levels of sophistication in our customers' business intelligence needs and applications, such as the incorporation of new dynamic enterprise dashboards to our interfaces; and

increasing our capacity to develop new business by significantly expanding our footprint in existing and new markets, strengthening our corporate infrastructure, expanding relationships with customers, and adding new leadership to our global team.

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 in

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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.

### **Critical Accounting Estimates**

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, valuation of net deferred tax assets, and litigation and contingencies, have a material impact on our financial statements and are discussed in detail throughout our analysis of the results of operations discussed below.

In addition to evaluating estimates relating to the items discussed above, we also consider other estimates and judgments, including, but not limited to, those related to allowance for doubtful accounts, software development costs, intangible assets, provision for income taxes, and other contingent liabilities, including liabilities that we deem not probable of assertion. We base our estimates on historical experience and various other assumptions that we believe are reasonable under the circumstances, the results of which form the basis for making judgments about the carrying value of assets, liabilities and equity that are not readily apparent from other sources. Actual results and outcomes could differ from these estimates and assumptions.

MicroStrategy does not have any material ownership interest in any special purpose or other entities that are not wholly-owned and/or consolidated into our consolidated financial statements. Additionally, MicroStrategy does not have any material related party transactions as defined under Statement of Financial Accounting Standards ( SFAS ) No. 57, Related Party Disclosures.

**Revenue Recognition.** MicroStrategy's software revenue recognition policies are in accordance with the American Institute of Certified Public Accountants' Statement of Position ( SOP ) 97-2, Software Revenue Recognition, as amended. In the case of software arrangements that require significant production, modification or customization of software, we follow the guidance in SOP 81-1, Accounting for Performance of Construction-Type and Certain Production-Type Contracts. We also follow the guidance provided by SEC Staff Accounting Bulletin ( SAB ) No. 101, Revenue Recognition in Financial Statements, and SAB No. 104, Revenue Recognition where applicable.

We recognize revenue from sales of software licenses to end users or resellers upon:

- 1) persuasive evidence of an arrangement, as provided by agreements, contracts, purchase orders or other arrangements, generally executed by both parties (other than certain customer specific instances in which we have a customary and historical business practice of accepting orders without signed agreements);

- 2) delivery of the software; and
- 3) determination that collection of a fixed or determinable fee is reasonably assured.

When the fees for software upgrades and enhancements, technical support, consulting and education are bundled with the license fee, they are unbundled for revenue recognition purposes using vendor specific objective evidence of the fair value ( VSOE ) of the elements.

Product support or post contract support ( PCS ) revenue is derived from providing technical software support and software updates and upgrades to customers. PCS revenue is recognized ratably over the term of the

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contract, which in most cases is one year. Our VSOE for PCS, which includes updates, upgrades, and enhancements, is determined based upon the optional stated renewal fee for PCS in the contract, which is the price the customer is required to pay when PCS is renewed. Additionally, the optional stated renewal fee used to establish VSOE for PCS in a software transaction must be above our minimum VSOE rate for PCS. If a stated renewal rate is non-substantive, VSOE of PCS has not been established and we recognize all revenue under the arrangement ratably over the PCS period. A substantive minimum VSOE rate is determined based upon an analysis of historical sales of PCS. For a renewal rate to be non-substantive, we believe it must be significantly lower than our minimum VSOE rate.

Revenue from consulting, education and other services is recognized as the services are performed. Our VSOE for services other than PCS is determined based upon an analysis of our historical sales of each element when sold separately from software. We sell various levels of consulting services such as associate, consultant, senior consultant, manager, and senior manager.

In accordance with SOP 97-2, for new offerings of services other than PCS or service offerings that have not had a sufficient history of sales activity, we initially establish VSOE based on the list price as determined by management with the relevant authority. Each service offering has a single list price in each country where sold.

If VSOE exists for all undelivered elements and there is no such evidence of fair value established for delivered elements, the arrangement fee is first allocated to the elements where evidence of fair value has been established and the residual amount is allocated to the delivered elements. If evidence of fair value for any undelivered element of an arrangement does not exist, all revenue from the arrangement is deferred until such time that evidence of fair value exists for undelivered elements or until all elements of the arrangement are delivered, subject to certain limited exceptions set forth in SOP 97-2.

When a software license arrangement requires us to provide significant production, customization or modification of the software, or when the customer considers these services essential to the functionality of the software product, both the product licenses revenue and consulting services revenue are recognized using the percentage of completion method. Under percentage of completion accounting, both product licenses and consulting services revenue are recognized as work progresses based upon labor hours incurred. Any expected losses on contracts in progress are expensed in the period in which the losses become probable and reasonably estimable. Contracts accounted for under the percentage of completion method were not material for the years ended December 31, 2006, 2005 and 2004.

If an arrangement includes acceptance criteria, revenue is not recognized until we can objectively demonstrate that the software or service can meet the acceptance criteria or the acceptance period lapses, whichever occurs earlier. If a software license arrangement obligates us to deliver specified future products or upgrades, revenue is recognized when the specified future product or upgrades are delivered or when the obligation to deliver specified future products expires, whichever occurs earlier. If a software license arrangement obligates us to deliver unspecified future products, then revenue is recognized on the subscription basis, ratably over the term of the contract.

License revenue derived from sales to resellers or OEMs who purchase our products for resale is recognized upon sufficient evidence that the products have been sold to the ultimate end users provided all other revenue recognition criteria have been met. Our standard software license and reseller agreements do not include any return rights other than the right to return non-conforming products for repair or replacement under our standard product warranties, which we account for in accordance with SFAS No. 5. During the last three fiscal years, we have not experienced any product returns related to warranty claims.

Our standard software license agreements do not include any price protection or similar rights. With respect to software arrangements with resellers, our business practice is to require end-user sell-through evidence or representation at the time a reseller order is placed.



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We offer price protection to certain government agencies as required by applicable laws and regulations. For example, transactions under our General Services Administration Federal Supply Schedule contract must comply with the Price Reductions clause. In addition, certain government agencies have the right to cancel contracts for convenience. During the last three fiscal years, contracts cancelled for convenience were not significant.

During the last three fiscal years, we have not paid any significant amounts with regards to a return, price protection or similar rights clause. Therefore no allowance for returns, price protection or similar rights has been recorded in our financial statements for the last three fiscal years.

Amounts collected prior to satisfying the above revenue recognition criteria are included in deferred revenue and advance payments in the accompanying consolidated balance sheets.

The application of SOP 97-2, as amended, requires judgment, including a determination that collectibility is reasonably assured, the fee is fixed and determinable, whether a software arrangement includes multiple elements, and if so, whether VSOE of fair value exists for those elements. Judgment is also required to assess whether future releases of certain software represent new products or upgrades and enhancements to existing products.

***Litigation and Contingencies.*** We are subject to various loss contingencies arising in the ordinary course of business. We consider the likelihood of loss or impairment of an asset or the incurrence of a liability, as well as our ability to reasonably estimate the amount of loss in determining loss contingencies. An estimated loss contingency is accrued when it is probable that an asset has been impaired or a liability has been incurred and the amount of loss can be reasonably estimated. We regularly evaluate current information available to us to determine whether such accruals should be adjusted. For example, in October 2006, the Company's subsidiary in Spain received notice of an adverse judgment from a commercial court in Spain, requiring it to pay \$1.1 million, plus interest and certain costs of the proceeding, in connection with a commercial dispute and resulting in the Company recording a liability of \$1.1 million in the third quarter of 2006. No accrual had previously been recorded in connection with such dispute because, prior to receipt of the court judgment, management believed that the risk of loss was not probable and the amount of loss could not be reasonably estimated.

We have 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, we may be required to record significant expenses and liabilities in the period in which these liabilities are asserted or become probable of assertion.

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

***Income Taxes.*** In determining our net deferred tax assets 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 methodologies and prudent and feasible tax planning strategies. During 2004, we recognized a tax benefit of \$107.4 million related to the release of a valuation allowance on certain domestic and foreign net operating loss deferred tax assets. Since 2004, we have not materially changed the amount of our valuation allowance on our domestic and foreign net operating loss deferred tax assets. However, judgments and estimates related to our projections and assumptions are inherently uncertain; therefore, actual results could differ materially from our projections, which could impact the carrying value of our net deferred tax assets in future periods.

As a global company with subsidiaries in many countries, we are required to calculate and provide for estimated income tax liabilities for each of the tax jurisdictions in which we operate. This process involves

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estimating current tax obligations and exposures in each jurisdiction as well as making judgments regarding the future recoverability of deferred tax assets. Changes in the estimated level of annual pre-tax income, changes in tax laws particularly related to the utilization of net operating losses in various jurisdictions, and changes resulting from tax audits can all affect the overall effective income tax rate which, in turn, impacts the overall level of income tax expense and net income. We record a valuation allowance to reduce our deferred tax assets to the amount that is more likely than not to be realized. We consider future taxable income and ongoing tax planning strategies in assessing the need for a valuation allowance. Should we determine that we would not be able to realize all or part of net deferred tax assets in the future, an adjustment to deferred tax assets would reduce income in the period that such determination was made.

We will adopt FASB Interpretation No. 48 ( FIN 48 ), Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109 , effective January 1, 2007. FIN 48 clarifies the accounting for uncertain income tax positions recognized in an enterprise's financial statements in accordance with Statement SFAS No. 109, Accounting for Income Taxes . It provides that a company should use a more-likely-than-not recognition threshold based on the technical merits of the income tax position taken. Income tax positions that meet the more-likely-than-not recognition threshold should be measured in order to determine the tax benefit to be recognized in the financial statements. We are currently evaluating the impact of FIN 48 on our consolidated results of operations and financial condition.

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

We conduct a significant portion of our business in currencies other than the US dollar, the currency in which we report our consolidated financial statements. Historically, we have generated a significant portion of our revenues and incurred a significant portion of our expenses in euro and British pound sterling. As currency rates change from quarter to quarter and year over year, our results of operation may be impacted. The table below summarizes the impact of fluctuations in foreign currency exchange rates on certain components of our consolidated statements of operations by showing the increase (decrease) to the percentage change in revenues or expenses, as applicable, from the prior year.

For example, if there had been no change to the foreign currency exchange rates from 2005 to 2006, the percentage change in international product licenses revenues for the year ended December 31, 2006 would have been -2.8%, rather than the -1.5% reported in our consolidated statements of operations. If there had been no change to the foreign currency exchange rates from 2005 to 2006, the percentage change in cost of product support revenues for the year ended December 31, 2006 would have been 9.6%, rather than the 10.1% reported in our consolidated statements of operations.

	Years Ended December 31,		
	2006	2005	2004
International product licenses revenues	1.3%	0.7%	16.0%
International product support revenues	1.9%	1.3%	14.0%
International other services revenues	0.4%	1.7%	10.1%
Cost of product support revenues	0.5%	0.2%	2.4%
Cost of other services revenues	4.3%	(0.2%)	4.2%
Sales and marketing expenses	0.8%	0.5%	3.9%
General and administrative expenses	0.5%	0.5%	2.1%

Foreign currency exchange rate fluctuations from 2005 to 2006 remained relatively flat. During 2004, the favorable effect of foreign currency exchange rate fluctuations was primarily a result of the 57.5% increase in international revenues. During 2006 and 2005, international revenues increased 10.6% and 9.5%, respectively.





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

	<u>Years Ended December 31,</u>			<u>% Change</u>	<u>% Change</u>
	<u>2006</u>	<u>2005</u>	<u>2004</u>	<u>in 2006</u>	<u>in 2005</u>
Product Licenses Revenues:					
Domestic (U.S. and Canada)	\$ 69,816	\$ 61,768	\$ 53,848	13.0%	14.7%
International	37,567	38,158	43,147	-1.5%	-11.6%
Total product licenses revenues	<u>\$ 107,383</u>	<u>\$ 99,926</u>	<u>\$ 96,995</u>	<u>7.5%</u>	<u>3.0%</u>

	<u>Years Ended December 31,</u>		
	<u>2006</u>	<u>2005</u>	<u>2004</u>
Product License Transactions with Revenue Recognized in the Applicable Period:			
At least \$1.0 million of licenses revenue recognized	17	10	8
Between \$500,000 and \$1.0 million of licenses revenue recognized	22	24	22
Total	<u>39</u>	<u>34</u>	<u>30</u>
Domestic:			
At least \$1.0 million of licenses revenue recognized	12	8	4
Between \$500,000 and \$1.0 million of licenses revenue recognized	18	18	16
Total	<u>30</u>	<u>26</u>	<u>20</u>
International:			
At least \$1.0 million of licenses revenue recognized	5	2	4
Between \$500,000 and \$1.0 million of licenses revenue recognized	4	6	6
Total	<u>9</u>	<u>8</u>	<u>10</u>

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For the years ended December 31, 2006, 2005 and 2004, product license transactions with greater than \$500,000 in recognized revenue represented 42.1%, 31.6%, and 36.5%, respectively, of our product licenses revenues. During 2006, our top three product license transactions, including one transaction with \$4.3 million in revenue recognized, totaled approximately \$10.2 million in revenue recognized, compared with \$5.5 million for the top three product license transactions in 2005 or 9.5% and 5.5% of total product licenses revenues in the years ended December 31, 2006 and 2005, respectively.

Product licenses revenues increased during 2006, as compared to 2005, due to increases in both the number and the average deal size of product license transactions with at least \$1.0 million in recognized revenue.

Product licenses revenues increased during 2005, as compared to 2004, due to an increase in the total number of recognized product license transactions. The increase was partially attributable to new product launches during 2005.

***Domestic product licenses revenues.*** Domestic product licenses revenues increased during 2006, as compared to 2005, due to increases in both the number and the average deal size of product license transactions with at least \$1.0 million in recognized revenue.

Domestic product licenses revenues increased during 2005, as compared to 2004, due to an increase in the total number of recognized product license transactions. The increase was partially attributable to new product launches during 2005.

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**International product licenses revenues.** International product licenses revenues remained relatively flat during 2006, as compared to 2005, due to a decrease in the average deal size of product license transactions with less than \$500,000 in recognized revenue, partially offset by an increase in the number of product license transactions with at least \$1.0 million in recognized revenue.

International product licenses revenues decreased during 2005, as compared to 2004, due to decreases in both the number and the average deal size of product license transactions with at least \$1.0 million in recognized revenue. During 2005, we recognized revenue from two transactions, each in excess of \$1.0 million, that together comprised \$3.1 million of international product licenses revenues. During 2004, we recognized revenue from four transactions, each in excess of \$1.0 million, that together comprised \$12.4 million of international product licenses revenues. This decrease in revenue recognized from high-dollar transactions was partially offset by an increase in the total number of recognized international product license transactions in 2005.

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

	Years Ended December 31,			% Change	% Change
	2006	2005	2004	in 2006	in 2005
Product Support Revenues:					
Domestic (U.S. and Canada)	\$ 84,619	\$ 70,021	\$ 55,861	20.8%	25.3%
International	57,517	45,830	35,209	25.5%	30.2%
Total product support revenues	\$ 142,136	\$ 115,851	\$ 91,070	22.7%	27.2%

Product support revenues are derived from providing technical software support and software updates and upgrades to customers. Product support revenues are recognized ratably over the term of the contract, which in most cases is one year.

Both domestic and international product support revenues increased during each of 2006 and 2005, as compared to the prior year. Contributing to the increase in 2006 was a 23.2% growth in our installed base of technical support contracts, which includes a high percentage of maintenance renewals from existing contracts. Contributing to the increase in 2005 was growth in our installed base of technical support contracts, which includes a high percentage of maintenance renewals from existing contracts.

Although our international product licenses revenues remained relatively flat from 2005 to 2006 and decreased from 2004 to 2005, international product support revenues increased by 25.5% and 30.2% during these time periods. The increases are attributable to the following: (1) an increase in product support pricing, (2) a conversion of distributors providing product support services to our providing the support directly to the customer, and (3) the difference in timing between the recognition of product licenses revenues and related product support revenues.

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

	Years Ended December 31,			% Change	% Change
	2006	2005	2004	in 2006	in 2005
Other Services Revenues:					
Consulting	\$ 42,648	\$ 36,629	\$ 31,501	16.4%	16.3%
Education	13,134	12,340	10,307		