MICROSTRATEGY INC
Form 10-Q
November 02, 2007
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the Quarterly Period Ended September 30, 2007

OR

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

Commission File Number 000-24435

MICROSTRATEGY INCORPORATED

(Exact name of registrant as specified in its charter)

Delaware

(State of incorporation)

1861 International Drive, McLean, VA

(Address of Principal Executive Offices)

22102

(Zip Code)

51-0323571

(I.R.S. Employer

Identification Number)

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

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

Indicate by check mark whether the registrant 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):

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 number of shares of the registrant s class A common stock and class B common stock outstanding on October 26, 2007 was 14,067,109 and 2,775,244, respectively.

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

MICROSTRATEGY INCORPORATED

CONSOLIDATED BALANCE SHEETS

(in thousands, except per share data)

	September 30, 2007 (unaudited)	December 31, 2006 (audited)
Assets		
Current assets:		
Cash and cash equivalents	$ 75,725	$ 78,980
Restricted cash and investments	2,875	3,799
Accounts receivable, net	52,782	54,468
Prepaid expenses and other current assets	9,366	8,649
Deferred tax assets, net	29,038	29,510
Total current assets	169,786	175,406
Property and equipment, net	10,136	11,102
Capitalized software development costs, net	2,903	1,903
Deposits and other assets	11,417	2,461
Deferred tax assets, net	35,795	57,944
Total Assets	$ 230,037	$ 248,816
Liabilities and Stockholders Equity		
Current liabilities:		
Accounts payable and accrued expenses	$ 20,947	$ 24,378
Accrued compensation and employee benefits	30,502	31,872
Deferred revenue and advance payments	65,045	56,578
Total current liabilities	116,494	112,828
Deferred revenue and advance payments	2,389	1,127
Other long-term liabilities	1,809	1,710
Total Liabilities	120,692	115,665
Commitments and Contingencies		
Stockholders Equity:		
Preferred stock undesignated, $0.001 par value; 5,000 shares authorized; no shares issued or outstanding		
Class A common stock, $0.001 par value; 330,000 shares authorized; 14,061 shares issued and 9,384 shares outstanding, and 13,972 shares issued and 9,918 shares outstanding, respectively	14	14
Class B common stock, $0.001 par value; 165,000 shares authorized; 2,775 issued and outstanding	3	3
Additional paid-in capital	445,678	440,768
Treasury stock, at cost, 4,676 and 4,054 shares, respectively	(331,410)	(268,776)
Accumulated other comprehensive income	2,777	3,123

Accumulated deficit		(7,717)		(41,981)
Total Stockholders Equity		109,345		133,151
Total Liabilities and Stockholders Equity	$	230,037	$	248,816

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

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MICROSTRATEGY INCORPORATED

CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share data)

(unaudited)

	Three Months Ended September 30, 2007	Three Months Ended September 30, 2006
Revenues:		
Product licenses	$ 30,210	$ 24,494
Product support, services and other revenues	65,634	53,171
Total revenues	95,844	77,665
Cost of Revenues:		
Product licenses	713	826
Product support, services and other revenues	15,294	10,883
Total cost of revenues	16,007	11,709
Gross Profit	79,837	65,956
Operating Expenses:		
Sales and marketing	28,843	21,518
Research and development	9,626	8,794
General and administrative	12,748	12,469
Amortization of intangible assets	18	18
Total operating expenses	51,235	42,799
Income from Operations	28,602	23,157
Financing and Other Income:		
Interest income, net	927	583
Gain on investments		14
Other expense, net	(809)	(208)
Total financing and other income	118	389
Income before income taxes	28,720	23,546
Provision for income taxes	9,385	6,574
Net Income	$ 19,335	$ 16,972
Basic earnings per share (1)	$ 1.57	$ 1.34
Basic weighted average shares outstanding	12,286	12,707
Diluted earnings per share (1)	$ 1.51	$ 1.27

Diluted weighted average shares outstanding	12,771	13,325

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

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

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MICROSTRATEGY INCORPORATED

CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share data)

(unaudited)

	Nine Months Ended September 30, 2007	Nine Months Ended September 30, 2006
Revenues:		
Product licenses	$ 68,608	$ 70,738
Product support, services and other revenues	184,470	150,531
Total revenues	253,078	221,269
Cost of Revenues:		
Product licenses	2,156	2,122
Product support, services and other revenues	44,284	29,752
Total cost of revenues	46,440	31,874
Gross Profit	206,638	189,395
Operating Expenses:		
Sales and marketing	80,050	61,800
Research and development	26,260	25,776
General and administrative	38,616	33,935
Amortization of intangible assets	54	53
Total operating expenses	144,980	121,564
Income from Operations	61,658	67,831
Financing and Other Income:		
Interest income, net	2,782	2,062
Gain (loss) on investments		14
Other expense, net	(804)	(876)
Total financing and other income	1,978	1,200
Income before income taxes	63,636	69,031
Provision for income taxes	22,843	20,508
Net Income	$ 40,793	$ 48,523
Basic earnings per share (1)	$ 3.29	$ 3.70
Basic weighted average shares outstanding	12,416	13,097
Diluted earnings per share (1)	$ 3.15	$ 3.52

Diluted weighted average shares outstanding	12,953	13,766

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

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

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MICROSTRATEGY INCORPORATED

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(unaudited)

	Nine Months Ended September 30, 2007	Nine Months Ended September 30, 2006
Operating activities:		
Net income	$ 40,793	$ 48,523
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	5,738	5,755
Bad debt provision	1,447	696
Deferred taxes	18,559	17,532
Stock-based compensation	428	1,086
Excess tax benefits from stock-based payment arrangements	(2,269)	(2,208)
Other, net	116	145
Changes in operating assets and liabilities:		
Accounts receivable	1,088	1,874
Prepaid expenses and other current assets	(486)	(1,401)
Deposits and other assets	(1,414)	(142)
Accounts payable and accrued expenses, compensation and employee benefits	(6,582)	(3,078)
Deferred revenue and advance payments	7,279	9,504
Other long-term liabilities	37	(482)
Net cash provided by operating activities	64,734	77,804
Investing activities:		
Proceeds from maturities of short-term investments		112,666
Purchases of short-term investments		(58,900)
Advance deposits on purchases of property and equipment	(7,500)	
Purchases of property and equipment, net	(2,868)	(2,671)
Capitalized software development costs	(2,650)	
Decrease in restricted cash and investments	997	1,308
Net cash (used in) provided by investing activities	(12,021)	52,403
Financing activities:		
Proceeds from sale of class A common stock under employee stock purchase plan and exercise of employee stock options	2,013	2,919
Excess tax benefits from stock-based payment arrangements	2,269	2,208
Purchases of treasury stock	(62,634)	(131,959)
Net cash used in financing activities	(58,352)	(126,832)
Effect of foreign exchange rate changes on cash and cash equivalents	2,384	2,135
Net (decrease) increase in cash and cash equivalents	(3,255)	5,510
Cash and cash equivalents, beginning of period	78,980	42,318
Cash and cash equivalents, end of period	$ 75,725	$ 47,828

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

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MICROSTRATEGY INCORPORATED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

(1) Basis of Presentation

Except for the consolidated balance sheet of MicroStrategy Incorporated (MicroStrategy or the Company) as of December 31, 2006, which is derived from audited financial statements, the accompanying consolidated financial statements are unaudited. In the opinion of management, all adjustments necessary for a fair statement of such financial position and results of operations have been included. All such adjustments are of a normal recurring nature. Interim results are not necessarily indicative of results for a full year.

The consolidated financial statements and notes are presented as required by Form 10-Q and do not contain certain information included in the Company s annual financial statements and notes. These financial statements should be read in conjunction with the Company s audited financial statements and the notes thereto filed with the Securities and Exchange Commission (SEC) in the Company s Annual Report on Form 10-K for the year ended December 31, 2006.

Certain prior year amounts in the consolidated financial statements have been reclassified to conform to the current year presentation.

(2) Recent Accounting Standards

In February 2007, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 159, The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No. 115 which is effective for fiscal years beginning after November 15, 2007. This statement permits an entity to choose to measure many financial instruments and certain other items at fair value at specified election dates. Subsequent unrealized gains and losses on items for which the fair value option has been elected will be reported in earnings. The Company is currently evaluating the potential impact of SFAS No. 159 on its consolidated results of operations and financial position.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements . SFAS No. 157 defines fair value, establishes a framework and gives guidance regarding the methods used for measuring fair value, and expands disclosures about fair value measurements. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The Company is currently evaluating the impact of SFAS No. 157 on its consolidated results of operations and financial position.

(3) Restricted Cash and Investments

On March 15, 2005, the Company entered into a security agreement with a bank under which the Company posted cash to secure existing letters of credit. These letters of credit are used as security deposits for office leases, including the office lease for the Company s corporate headquarters. The Company may invest the cash collateral under the security agreement in certain permitted investments. As of September 30, 2007 and December 31, 2006, the Company had $1.9 million and $2.9 million, respectively, in cash collateral posted under the security agreement, all invested in money market funds that are included in restricted cash and investments in the accompanying balance sheets. During July 2007, $1.0 million in cash collateral was released from the security agreement due to a scheduled reduction in the security deposit for the Company s corporate headquarters.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

(4) Accounts Receivable

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

	September 30, 2007	December 31, 2006
Billed and billable	$ 96,523	$ 112,080
Less: billed and unpaid deferred revenue	(40,948)	(55,722)
	55,575	56,358
Less: allowance for doubtful accounts	(2,793)	(1,890)
	$ 52,782	$ 54,468

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

(5) Deferred Revenue and Advance Payments

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

	September 30, 2007	December 31, 2006
Current:		
Deferred product licenses revenue	$ 2,386	$ 3,451
Deferred product support revenue	88,181	91,516
Deferred other services revenue	14,241	14,984
	104,808	109,951
Less: billed and unpaid deferred revenue	(39,763)	(53,373)
	$ 65,045	$ 56,578
Non-current:		
Deferred product licenses revenue	$ 369	$ 509
Deferred product support revenue	2,015	2,921
Deferred other services revenue	1,190	46
	3,574	3,476
Less: billed and unpaid deferred revenue	(1,185)	(2,349)
	$ 2,389	$ 1,127

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

(6) Litigation

The Company is involved in legal proceedings through the normal course of business. Although the outcomes of legal proceedings are inherently difficult to predict, management does 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.

(7) Commitments and Contingencies

On January 31, 2007, the Company entered into an agreement to purchase a corporate aircraft for delivery in mid-2009, which it expects to begin operating during the 2009 calendar year. The aggregate purchase price for the aircraft is $46.0 million, payable in installments on various dates related to the completion of

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(unaudited)

manufacturing of the aircraft and the delivery of the aircraft. The Company has the option to accelerate the delivery date under certain circumstances if the manufacturer is able to offer the aircraft prior to the scheduled delivery date. The Company expects to meet its payment obligations under this purchase commitment using funds from operations, but may consider using conventional aircraft financing or other borrowing arrangements.

The Company made deposits of $5 million and $2.5 million with regards to this aircraft in January 2007 and September 2007, respectively, and recorded the amount of the deposits in deposits and other assets.

From time to time, the Company enters into certain types of contracts that require it to indemnify parties against third party claims. These contracts primarily relate to agreements under which the Company has agreed to indemnify customers and partners for claims arising from intellectual property infringement. The conditions of these obligations vary and generally a maximum obligation is explicitly stated. Because the conditions of these obligations vary and the maximum is not always explicitly stated, the overall maximum amount of the Company s indemnification obligations cannot be reasonably estimated. Historically, the Company has not been obligated to make significant payments for these obligations, and as such has not recorded an indemnification liability on its balance sheets as of September 30, 2007 or December 31, 2006. The Company carries coverage under certain insurance policies for certain of these liabilities; however, this coverage may not be sufficient.

(8) Treasury Stock

On July 28, 2005, the Company announced that its Board of Directors had authorized the Company s repurchase of up to an aggregate of $300.0 million of its class A common stock from time-to-time on the open market (the 2005 Share Repurchase Program). The timing and amount of any shares repurchased will be determined by the Company s management based on its evaluation of market conditions and other factors. The 2005 Share Repurchase Program has a five-year term, but may be suspended or discontinued by the Company at any time. The 2005 Share Repurchase Program may be funded using the Company s working capital, as well as proceeds from any credit facilities and other borrowing arrangements which the Company may enter into in the future. During the three months ended September 30, 2007, the Company repurchased an aggregate of 264,157 shares of its class A common stock at an average price per share of $67.74 and an aggregate cost of $17.9 million pursuant to the 2005 Share Repurchase Program. During the nine months ended September 30, 2007, the Company repurchased an aggregate of 621,931 shares of its class A common stock at an average price of $100.71 and an aggregate cost of $62.6 million pursuant to the 2005 Share Repurchase Program. As of September 30, 2007, the Company had repurchased an aggregate of 2,098,390 shares of its class A common stock at an average price of $96.03 and an aggregate cost of $201.5 million pursuant to the 2005 Share Repurchase Program.

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

(9) Income Taxes

The Company adopted the provisions of FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes (FIN 48), on January 1, 2007. As a result of the implementation of FIN 48, the Company recognized a $6.5 million increase in U.S. and foreign income tax liabilities for unrecognized tax benefits, which was accounted for as a reduction to the January 1, 2007 balance of retained earnings. Reserves for unrecognized tax benefits had not been established prior to the implementation of FIN 48; therefore, as of January 1, 2007, the total amount of unrecognized tax benefits was $6.5 million.

The Company and its subsidiaries conduct business in the U.S. and various foreign countries and are subject to tax in numerous domestic and foreign jurisdictions. As a result of its business activities, the Company files tax returns that are subject to examination by various federal, state, local, and foreign tax

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(unaudited)

authorities. With few exceptions, the Company is no longer subject to U.S. federal, state and local, or foreign income tax examination by tax authorities for years before 2000; however, due to its federal and state net operating loss (NOL) carryovers, the federal and state tax authorities may attempt to reduce or fully offset the amount of NOL or tax credit carryovers from tax years ending in 1999 forward that were used in later tax years. The Company is currently under tax audits in Germany and Japan; however, no adjustments have been proposed to date. A French tax audit relating to tax years 2003 through 2005 was settled during the second quarter of 2007 with no adjustments to previously filed tax returns. Accordingly, the FIN 48 tax accrual of $0.2 million relating to this audit was reversed.

The Company recognizes accrued interest related to unrecognized tax benefits in the tax expense account. Penalties, if incurred, would also be recognized as a component of income tax expense. As of January 1, 2007, the amount of accrued interest expense on unrecognized tax benefits was not material.

As of September 30, 2007, if recognized, $7.4 million of unrecognized tax benefits would impact the effective tax rate. Unrecognized tax benefits related to cross border transactions are expected to increase by $0.4 million by the end of 2007. During the nine months ended September 30, 2007, the Company recognized an additional $1.1 million of tax expense related to post-2006 uncertain tax positions. During the same time period, the Company recognized a $0.2 million benefit related to the settlement of a tax audit in France.

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

	September 30, 2007	December 31, 2006
Deferred tax assets, net of deferred tax liabilities	$ 74,323	$ 95,182
Valuation allowance	(9,490)	(7,728)
Deferred tax assets, net of valuation allowance	$ 64,833	$ 87,454
Short-term deferred tax assets, net	$ 29,038	$ 29,510
Long-term deferred tax assets, net	35,795	57,944
Total deferred tax assets, net	$ 64,833	$ 87,454

The valuation allowance as of each of September 30, 2007 and December 31, 2006 relates to domestic capital loss carryforwards and certain foreign net operating loss carryforwards that the Company expects will expire unused.

The Company has estimated its annual effective tax rate for the full fiscal year 2007 and applied that rate to its income before income taxes in determining its provision for income taxes for the nine months ended September 30, 2007. For the nine months ended September 30, 2007 and 2006, the Company s consolidated annualized effective tax rate was 35.9% and 29.7%, respectively. The Company s effective tax rate increased during the nine months ended September 30, 2007, as compared to the nine months ended September 30, 2006, primarily as a result of foreign pretax losses in certain foreign jurisdictions with no related income tax benefit, as the Company currently lacks evidence that the loss carryforwards in those jurisdictions will be able to be used prior to their expiration.

The Company intends to indefinitely reinvest the undistributed 2007 earnings of certain foreign subsidiaries. Previously taxed income related to prior Subpart F deemed dividends is distributed currently; however, no additional tax is incurred on the distribution. Accordingly, the annualized effective tax rate applied to the Company s pre-tax income for the nine months ended September 30, 2007 did not include any provision for U.S. federal and state income taxes on the projected amount of these undistributed 2007 foreign earnings. The Company accrues applicable U.S. federal and state income taxes (net of foreign tax credits) on projected undistributed foreign subsidiary earnings that it intends to repatriate.

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(unaudited)

In determining the Company s provision for income taxes, net deferred tax assets, liabilities, valuation allowances, and uncertain tax positions, management is required to make judgments and estimates related to projections of domestic and foreign profitability, the timing and extent of the utilization of both net operating loss carryforwards and capital loss carryforwards, applicable tax rates, transfer pricing methods, expected tax authority positions on audit, and prudent and feasible tax planning strategies. As a multinational company, the Company is required to calculate and provide for estimated income tax liabilities in each of the tax jurisdictions in which it operates. This process involves estimating current tax obligations and exposures in each jurisdiction as well as making judgments regarding the future recoverability of deferred tax assets. Changes in the estimated level of annual pre-tax income, changes in tax laws particularly related to the utilization of net operating losses in various jurisdictions, and changes resulting from tax audits can all affect the overall effective income tax rate which, in turn, impacts the overall level of income tax expense and net income.

Judgments and estimates related to the Company s projections and assumptions are inherently uncertain; therefore, actual results could differ materially from projections. The timing and manner in which the Company will use the net operating loss carryforwards, research and development tax credit carryforwards, alternative minimum tax credit carryforwards, and foreign tax credit carryforwards in any year, or in total, may be limited by provisions of the Internal Revenue Code regarding changes in the Company s ownership. Currently, the Company expects to use the tax assets subject to Internal Revenue Code limitations within the carryforward periods. Valuation allowances have been established where the Company expects deferred tax assets to expire unused.

(10) Share-Based Compensation

The Company has share-based compensation plans under which directors, officers, employees and other eligible participants have previously received stock option awards. All stock options granted under the Company s stock plans have terms of five to ten years and generally vest ratably over 5 years. Upon exercise, the Company generally issues new shares in the amount of the award exercised. The Company had 2.3 million shares of class A common stock authorized for option grants as of September 30, 2007. The Company has not issued any material stock option or other share-based compensation awards since the first quarter of 2004, and does not have any current plans to issue additional stock option awards on its equity.

In addition, a subsidiary of the Company maintains a share-based compensation plan for its employees that is based upon the equity of the subsidiary. The share-based awards and related expense for this subsidiary have not been significant through September 30, 2007.

The Company recognized share-based compensation expense of $0.1 million and $0.3 million for the three months ended September 30, 2007 and 2006, respectively. The Company recognized share-based compensation expense of $0.4 million and $1.1 million for the nine months ended September 30, 2007 and 2006, respectively.

(11) Comprehensive Income

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

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MICROSTRATEGY INCORPORATED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2007	**2006**	**2007**	**2006**
Net income	$ 19,335	$ 16,972	$ 40,793	$ 48,523
Foreign currency translation adjustment	156	(622)	(337)	(224)
Unrealized gain on short-term investments, net of applicable taxes	(4)	(7)	(9)	(20)
Comprehensive income	$ 19,487	$ 16,343	$ 40,447	$ 48,279

(12) Common Equity and Earnings per Share

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

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

(13) Accumulated Deficit

The accumulated deficit balance (in thousands) changed as follows during the nine months ended September 30, 2007:

Balance, December 31, 2006	$ (41,981)
Net Income for the nine months ended September 30, 2007	40,793
Adoption of FIN 48	(6,529)
Balance, September 30, 2007	$ (7,717)

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MICROSTRATEGY INCORPORATED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

(14) Segment Information

The Company operates in two business segments business intelligence software and services and other . The business segment other consists of the Company s Alarm.com and Angel.com businesses. The following summary discloses total revenues and long-lived assets, excluding long-term investments and long-term deferred tax assets, according to geographic region (in thousands):

	Business Intelligence Software and Services			Other	
	Domestic	EMEA	Other Regions	Domestic	Consolidated
Geographic regions:					
Three months ended September 30, 2007					
Total revenues	$ 55,482	$ 28,152	$ 5,772	$ 6,438	$ 95,844
Long-lived assets	19,052	3,596	1,727	81	$ 24,456
Three months ended September 30, 2006					
Total revenues	$ 47,071	$ 22,715	$ 5,824	$ 2,055	$ 77,665
Long-lived assets	11,496	2,441	1,134	68	$ 15,139
Nine months ended September 30, 2007					
Total revenues	$ 146,520	$ 72,102	$ 16,607	$ 17,849	$ 253,078
Long-lived assets	19,052	3,596	1,727	81	$ 24,456
Nine months ended September 30, 2006					
Total revenues	$ 134,299	$ 64,227	$ 16,994	$ 5,749	$ 221,269
Long-lived assets	11,496	2,441	1,134	68	$ 15,139

The domestic region consists of the United States and Canada. The EMEA region includes operations in Europe, the Middle East and Africa. The other regions include all other foreign countries, generally comprising Latin America and the Asia Pacific region. For each of the three and nine months ended September 30, 2007 and 2006, no individual country outside the United States accounted for 10% or more of total consolidated revenues.

As of each of September 30, 2007 and December 31, 2006, no individual country outside the United States accounted for 10% or more of consolidated assets. For each of the three and nine months ended September 30, 2007 and 2006, no individual customer accounted for 10% or more of the Company s total consolidated revenues.

Domestic intercompany software fee charges to international operations of $9.3 million and $12.5 million for the three months ended September 30, 2007 and 2006, respectively, and $30.2 million and $32.9 million for the nine months ended September 30, 2007 and 2006, respectively, have been excluded from the above tables and eliminated in the consolidated financial statements.

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

FORWARD-LOOKING INFORMATION

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

Overview

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

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

Our core business intelligence (BI) business derives its revenues from product licenses and product support and other services. Product licenses revenues are derived from the sale of software licenses for our MicroStrategy 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.

We also have two other businesses, Alarm.com and Angel.com, that focus outside of the BI software and services market. Alarm.com is a provider of web-enabled residential and commercial security and activity monitoring technology, and Angel.com is a provider of interactive voice response telephony systems. We are considering various strategic alternatives relating to these two businesses.

The following table sets forth certain operating highlights for the three and nine months ended September 30, 2007 and 2006 (in thousands):

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Performance Measures (in thousands)

	Core BI Business		Alarm.com		Angel.com		Consolidated	
	Three Months Ended September 30,		Three Months Ended September 30,		Three Months Ended September 30,		Three Months Ended September 30,	
	2007	2006	2007	2006	2007	2006	2007	2006
Revenues								
Product licenses	$ 30,210	$ 24,494	$	$	$	$	$ 30,210	$ 24,494
Product support and services revenues	59,196	51,115					59,196	51,115
Alarm.com hardware and services			4,613	850			4,613	850
Angel.com telephony services					1,825	1,206	1,825	1,206
Total revenues	**89,406**	**75,609**	**4,613**	**850**	**1,825**	**1,206**	**95,844**	**77,665**
Cost of Revenues								
Product licenses	713	830				(4)	713	826
Product support and other services	11,276	9,901					11,276	9,901
Alarm.com hardware and services			3,511	701			3,511	701
Angel.com telephony services					507	281	507	281
Total cost of revenues	**11,989**	**10,731**	**3,511**	**701**	**507**	**277**	**16,007**	**11,709**
Gross profit	**77,417**	**64,878**	**1,102**	**149**	**1,318**	**929**	**79,837**	**65,956**
Operating Expenses								
Sales and marketing	26,931	20,042	300	311	1,612	1,165	28,843	21,518
Research and development	8,615	7,963	347	280	664	551	9,626	8,794
General and administrative	12,147	12,060	594	409	7		12,748	12,469
Amortization of intangible assets	18	18					18	18
Total operating expenses	**47,711**	**40,083**	**1,241**	**1,000**	**2,283**	**1,716**	**51,235**	**42,799**
Income (loss) from operations	**$ 29,706**	**$ 24,795**	**$ (139)**	**$ (851)**	**$ (965)**	**$ (787)**	**$ 28,602**	**$ 23,157**

	Core BI Business		Alarm.com		Angel.com		Consolidated	
	Nine Months Ended September 30,		Nine Months Ended September 30,		Nine Months Ended September 30,		Nine Months Ended September 30,	
	2007	2006	2007	2006	2007	2006	2007	2006
Revenues								
Product licenses	$ 68,608	$ 70,738	$	$	$	$	$ 68,608	$ 70,738
Product support and services revenues	166,621	144,781					166,621	144,781
Alarm.com hardware and services			12,932	2,308			12,932	2,308
Angel.com telephony services					4,917	3,442	4,917	3,442
Total revenues	**235,229**	**215,519**	**12,932**	**2,308**	**4,917**	**3,442**	**253,078**	**221,269**
Cost of Revenues								
Product licenses	2,156	2,122					2,156	2,122
Product support and services revenues	33,481	27,132					33,481	27,132
Alarm.com hardware and services			9,360	1,874			9,360	1,874
Angel.com telephony services					1,443	746	1,443	746

Total cost of revenues	**35,637**	**29,254**	**9,360**	**1,874**	**1,443**	**746**	**46,440**	**31,874**
Gross profit	**199,592**	**186,265**	**3,572**	**434**	**3,474**	**2,696**	**206,638**	**189,395**
Operating Expenses								
Sales and marketing	74,683	58,097	828	681	4,539	3,022	80,050	61,800
Research and development	23,048	23,721	1,134	774	2,078	1,281	26,260	25,776
General and administrative	37,117	33,032	1,492	903	7		38,616	33,935
Amortization of intangible assets	54	53					54	53
Total operating expenses	134,902	114,903	3,454	2,358	6,624	4,303	144,980	121,564
Income (loss) from operations	**$ 64,690**	**$ 71,362**	**$ 118**	**$ (1,924)**	**$ (3,150)**	**$ (1,607)**	**$ 61,658**	**$ 67,831**

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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, Oracle and SAP, 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 continue to focus on certain initiatives, including:

- concentrating our research and development efforts on maintaining our position as a technology leader by continuing to innovate and lead in enterprise business intelligence, improving the capability of our products to efficiently handle the ever increasing volume of data and user scalability 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 dynamic enterprise dashboards to our interfaces; and

- enhancing our global sales and services organizations, which we have grown substantially over the last eighteen months. During the three months ended September 30, 2007, we continued to slow the pace of headcount growth in these organizations to focus on integrating and leveraging the additional sales and services capacity we now have in place.

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 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 Policies

Our discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States.

The preparation of our consolidated financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities and equity and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. These estimates, particularly estimates relating to revenue recognition, valuation of net deferred tax assets, 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. 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.

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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.

For a more detailed explanation of the judgments made in these areas and a discussion of our accounting estimates and policies, refer to Critical Accounting Estimates included in Item 7 and Summary of Significant Accounting Policies (Note 2) included in Item 15 of our Annual Report on Form 10-K for the year ended December 31, 2006. As discussed in Note 9 to the Consolidated Financial Statements, we have adopted FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes (FIN 48) and otherwise there have been no significant changes to our critical accounting estimates and policies during the three months ended September 30, 2007.

Impact of Foreign Currency Exchange Rate Fluctuations on Results of Operations

We conduct a significant portion of our business in currencies other than the U.S. dollar, the currency in which we report our consolidated financial statements. 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 (in thousands) of fluctuations in foreign currency exchange rates on certain components of our consolidated statements of operations by showing the increase (decrease) in revenues or expenses, as applicable, from the prior year.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2007	**2006**	**2007**	**2006**
International product licenses revenues	$ 604	$ 368	$ 1,596	$ (327)
International product support revenues	1,176	537	3,351	(222)
International other services revenues	384	164	985	(115)
Cost of product support revenues	45	23	128	(8)
Cost of other services revenues	197	101	614	(35)
Sales and marketing expenses	740	272	2,057	(210)
General and administrative expenses	98	137	474	34

For example, if there had been no change to foreign currency exchange rates from 2006 to 2007, international product licenses revenues would have been $10.0 million rather than $10.6 million and $23.6 million rather than $25.2 million for the three and nine months ended September 30, 2007, respectively. If there had been no change to foreign currency exchange rates from 2006 to 2007, sales and marketing expenses would have been $28.1 million rather than $28.8 million and $78.0 million rather than $80.1 million for the three and nine months ended September 30, 2007, respectively.

The change in the impact of fluctuations in foreign currency exchange rates from the three and nine months ended September 30, 2007 to the three and nine months ended September 30, 2006 is primarily due to the weakening of the U.S. dollar as compared to the principal currencies in which the Company s foreign subsidiaries operate. During the nine months ended September 30, 2006, the U.S. dollar generally strengthened.

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Results of Operations

Comparison of the three and nine months ended September 30, 2007 and 2006

Revenues

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

	Three Months Ended September 30, 2007	Three Months Ended September 30, 2006	% Change	Nine Months Ended September 30, 2007	Nine Months Ended September 30, 2006	% Change
Product Licenses Revenues:						
Domestic (U.S. and Canada)	$ 19,574	$ 15,611	25.4%	$ 43,414	$ 45,095	-3.7%
International	10,636	8,883	19.7%	25,194	25,643	-1.8%
Total product licenses revenues	$ 30,210	$ 24,494	23.3%	$ 68,608	$ 70,738	-3.0%

	Three Months Ended September 30, 2007	Three Months Ended September 30, 2006	Nine Months Ended September 30, 2007	Nine Months Ended September 30, 2006
Product Licenses Transactions with Recognized Licenses Revenue in the Applicable Period:				
At least $1.0 million of licenses revenue recognized	6	5	10	12
Between $500,000 and $1.0 million of licenses revenue recognized	7	3	18	12
Total	13	8	28	24
Domestic:				
At least $1.0 million of licenses revenue recognized	4	3	7	8
Between $500,000 and $1.0 million of licenses revenue recognized	4	3	14	9
Total	8	6	21	17
International:				
At least $1.0 million of licenses revenue recognized	2	2	3	4
Between $500,000 and $1.0 million of licenses revenue recognized	3	0	4	3
Total	5	2	7	7

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The following table sets forth the recognized revenue attributable to product licenses transaction, grouped by size, during the periods indicated:

	Three Months Ended September 30, 2007	Three Months Ended September 30, 2006	% Change	Nine Months Ended September 30, 2007	Nine Months Ended September 30, 2006	% Change
Product Licenses Revenue Recognized in the Applicable Period (in thousands):						
At least $1.0 million of licenses revenue recognized	$ 9,355	$ 8,695	7.6%	$ 14,180	$ 18,509	-23.4%
From $500,000 to $1.0 million of licenses revenue recognized	4,820	2,292	110.3%	11,879	8,261	43.8%
Below $500,000 of licenses revenue recognized	16,035	13,507	18.7%	42,549	43,968	-3.2%
Total	30,210	24,494	23.3%	68,608	70,738	-3.0%
Domestic:						
At least $1.0 million of licenses revenue recognized	6,905	5,981	15.4%	10,706	13,247	-19.2%
From $500,000 to $1.0 million of licenses revenue recognized	2,955	2,292	28.9%	9,472	6,225	52.2%
Below $500,000 of licenses revenue recognized	9,714	7,338	32.4%	23,236	25,623	-9.3%
Total	19,574	15,611	25.4%	43,414	45,095	-3.7%
International:						
At least $1.0 million of licenses revenue recognized	2,450	2,714	-9.7%	3,474	5,262	-34.0%
From $500,000 to $1.0 million of licenses revenue recognized	1,865			2,407	2,036	18.2%
Below $500,000 of licenses revenue recognized	6,321	6,169	2.5%	19,313	18,345	5.3%
Total	$ 10,636	$ 8,883	19.7%	$ 25,194	$ 25,643	-1.8%

Domestic product licenses revenues increased during the three months ended September 30, 2007, as compared to the same period in the prior year, primarily due to an increase in the average size of domestic transactions with less than $500,000 of recognized revenue as well as to an increase in the number of domestic transactions with at least $500,000 of recognized revenue. International product licenses revenues increased during the three months ended September 30, 2007, as compared to the same period in the prior year, primarily due to an increase in the number of international transactions with greater than $500,000 but less than $1.0 million of recognized revenue.

Domestic product licenses revenues decreased during the nine months ended September 30, 2007, as compared to the same period in the prior year, primarily due to a decrease in the number and average size of domestic transactions with at least $1 million of recognized revenue. This decrease in domestic product licenses revenues was partially offset by an increase in the number of domestic transactions with greater than $500,000 but less than $1.0 million of recognized revenue. International product licenses revenues decreased during the nine months ended September 30, 2007, as compared to the same period in the prior year, primarily due to a decrease in the number and average size of international transactions with at least $1 million of recognized revenue.

Product support and services revenues. The following table sets forth product support revenues (in thousands) and percentage changes for our core BI business for the periods indicated:

	Three Months Ended September 30, 2007	Three Months Ended September 30, 2006	% Change	Nine Months Ended September 30, 2007	Nine Months Ended September 30, 2006	% Change
Product Support and Services Revenues:						
Domestic (U.S. and Canada)	$ 24,997	$ 21,727	15.1%	$ 72,373	$ 61,824	17.1%
International	17,676	15,189	16.4%	49,191	41,578	18.3%

Total product support revenues	42,673	36,916	15.6%	121,564	103,402	17.6%
Consulting	13,073	10,944	19.5%	34,500	31,695	8.8%
Education	3,450	3,255	6.0%	10,557	9,684	9.0%
Total product support and services revenues	$ 59,196	$ 51,115	15.8%	$ 166,621	$ 144,781	15.1%

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Product support revenues. 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 the three months ended September 30, 2007, as compared to the same period in the prior year. Contributing to this increase was an 11.8% growth in the number of technical support contracts, which includes a high percentage of maintenance renewals from existing contracts.

Both domestic and international product support revenues increased during the nine months ended September 30, 2007, as compared to the same period in the prior year, primarily due to a 16.1% growth in the number of technical support contracts, which includes a high percentage of maintenance renewals from existing contracts.

Consulting revenues. Consulting revenues are derived from helping customers plan and execute the deployment of our software. Consulting revenues increased during the three months ended September 30, 2007, as compared to the same period in the prior year, primarily due to an 11.1% increase in total billable hours resulting from enhancements to internal business processes which are driving an increase in consultant utilization.

Consulting revenues increased during the nine months ended September 30, 2007, as compared to the same period in the prior year, primarily due to a 21.4% increase in the number of domestic billable hours resulting from enhancements to internal business processes which are driving an increase in consultant utilization, partially offset by a 21.9% decrease in international billable hours.

Education revenues. Education revenues are derived from the education and training that we provide to our customers to enhance their ability to fully utilize the features and functionality of our software. Education revenues increased during the three and nine months ended September 30, 2007, as compared to the same periods in the prior year, primarily due to growth in the number of students trained resulting from the increase in public classes, on-site training and new education and training offerings.

Alarm.com and Angel.com revenues. The following table sets forth Alarm.com and Angel.com revenues (in thousands) and percentage changes for the periods indicated:

	Three Months Ended			**Nine Months Ended**		
	September 30,		**%**	**September 30,**		**%**
	2007	**2006**	**Change**	**2007**	**2006**	**Change**
Alarm.com						
Alarm.com hardware	$ 3,764	$ 620	507.1%	$ 11,388	$ 1,747	551.9%
Alarm.com services	849	230	269.1%	1,544	561	175.2%
Total Alarm.com revenues	4,613	850	442.7%	12,932	2,308	460.3%
Angel.com telephony services	1,825	1,206	51.3%	4,917	3,442	42.9%
Total other services revenues	$ 6,438	$ 2,056	213.1%	$ 17,849	$ 5,750	210.4%

Alarm.com hardware revenues increased during the three and nine months ended September 30, 2007, as compared to the same periods in the prior year, primarily as a result of Alarm.com recognizing $3.6 million and $7.7 million of revenue from sales to two Alarm.com distributors during the three and nine months ended September 30, 2007, respectively,.

Alarm.com services revenues increased during the three and nine months ended September 30, 2007, as compared to the same periods in the prior year, primarily due to an increase in the number of customers.

Angel.com telephony services revenues increased during the three and nine months ended September 30, 2007, as compared to the same periods in the prior year, primarily due to an increase in the number of higher-value contracts.

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Costs and Expenses

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

	Three Months Ended			Nine Months Ended		
	September 30,		%	September 30,		%
	2007	2006	Change	2007	2006	Change
Cost of Revenues:						
Product licenses	$ 713	$ 826	-13.7%	$ 2,156	$ 2,122	1.6%
Product support	2,742	2,325	17.9%	7,886	6,638	18.8%
Consulting	6,862	6,240	10.0%	20,673	16,620	24.4%
Education	1,672	1,336	25.1%	4,922	3,874	27.1%
Alarm.com hardware and services	3,511	701	400.9%	9,360	1,874	399.5%
Angel.com telephony services	507	281	80.4%	1,443	746	93.4%
Total cost of revenues	$ 16,007	$ 11,709	36.7%	$ 46,440	$ 31,874	45.7%

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

Cost of product licenses revenues decreased during the three months ended September 30, 2007, as compared to the same period in the prior year, primarily due to a decrease in royalties and referral fees paid.

Cost of product licenses revenues remained relatively flat during the nine months ended September 30, 2007, as compared to the same period in the prior year.

Cost of product support revenues. Cost of product support revenues consists of product support personnel and related overhead costs.

The increase in cost of product support revenues during the three and nine months ended September 30, 2007, as compared to the same periods in the prior year, was primarily attributable to the expenses related to an increase in product support staffing levels to support our growing customer base. Product support headcount increased 24.1% to 108 at September 30, 2007 from 87 at September 30, 2006.

Cost of consulting revenues. Cost of consulting revenues consists of personnel and related overhead costs. The increase in cost of consulting revenues during the three and nine months ended September 30, 2007, as compared to the same periods in the prior year, was primarily attributable to the expenses related to increases in staffing levels to support our growing customer base. Consulting headcount increased 7.4% to 218 at September 30, 2007 from 203 at September 30, 2006.

Cost of education revenues. Cost of education revenues consists of personnel and related overhead costs. The increase in cost of education revenues during the three and nine months ended September 30, 2007, as compared to the same periods in the prior year, was primarily attributable to the expenses related to an increase in staffing levels to support our growing customer base. Education headcount increased 24.3% to 46 at September 30, 2007 from 37 at September 30, 2006.

Cost of Alarm.com and Angel.com revenues. Cost of Alarm.com and Angel.com revenues includes hardware and telephony costs, respectively.

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The increase in cost of Alarm.com hardware and services revenues during the three and nine months ended September 30, 2007, as compared to the same periods in the prior year, was primarily attributable to increased hardware costs as a result of increased sales to two Alarm.com distributors during 2007.

The increase in cost of Angel.com telephony services revenues during the three and nine months ended September 30, 2007, as compared to the same periods in the prior year, was the result of the increase in customer demand, which requires us to purchase additional telecommunications capacity.

Sales and marketing, general and administrative, and other operating expenses for core BI business. The following table sets forth (in thousands) sales and marketing, general and administrative and other operating expenses for our core BI business and percentage changes for the periods indicated:

	Three Months Ended September 30,		%	Nine Months Ended September 30,		%
	2007	2006	Change	2007	2006	Change
Sales and marketing	$ 26,931	$ 20,042	34.4%	$ 74,683	$ 58,097	28.5%
General and administrative	12,147	12,060	0.7%	37,117	33,032	12.4%
Other operating expenses	18	18	0.0%	54	53	1.9%
Total	$ 39,096	$ 32,120	21.7%	$ 111,854	$ 91,182	22.7%

Sales and marketing expenses for core BI business. Sales and marketing expenses for our core BI business consists of personnel costs, commissions, office facilities, travel, advertising, public relations programs and promotional events, such as trade shows, seminars and technical conferences.

Sales and marketing expenses increased during the three months ended September 30, 2007, as compared to the same period in the prior year, with 84.7% of the increase attributable to an increase in expenses related to an increase in staffing levels and 6.4% of the increase due to increases in facility and other related support costs. The remainder of the increase was primarily attributable to increases in travel expenses and entertainment costs. Sales and marketing headcount increased 32.2% to 567 at September 30, 2007 from 429 at September 30, 2006.

Sales and marketing expenses increased during the nine months ended September 30, 2007, as compared to the same period in the prior year, with 80.4% of the increase attributable to an increase in expenses related to an increase in staffing levels, 10.2% of the increase attributable to increases in facility and other related support costs, and 11.1% of the increase attributable to increases in travel and entertainment costs.

General and administrative expenses for our core BI business. General and administrative expenses for core BI business consists of personnel and other costs of our executive, finance, human resources, information systems and administrative departments, as well as third-party consulting, legal and other professional fees.

General and administrative expenses increased slightly during the three months ended September 30, 2007, as compared to the same period in the prior year, with a $1.4 million increase due to an increase in expenses related to an increase in staffing levels and a $0.4 million increase in recruiting costs partially offset by a decrease of $0.7 million related to a decrease in withholding taxes resulting from a change in tax law related to our subsidiary in Brazil. Additionally, in the three months ended September 30, 2006, general and administrative expenses included a non-recurring expense of $1.1 million associated with litigation relating to a commercial dispute involving our subsidiary in Spain. General and administrative headcount increased 37.8% to 299 at September 30, 2007 from 217 at September 30, 2006.

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General and administrative expenses increased during the nine months ended September 30, 2007, as compared to the same period in the prior year, with a $3.3 million increase due to an increase in expenses related to an increase in staffing levels, $1.8 million increase in third-party consulting costs and $1.2 million increase in recruiting costs partially offset by a decrease of $0.7 million related to a decrease in withholding taxes resulting from a change in tax law related to our subsidiary in Brazil and a decrease in domestic legal costs as a result of a settlement and reduction in the accrual for legal services of $0.8 million. The increase in third-party consulting costs was primarily the result of increased tax, audit, legal and administrative costs associated with our activity in and expansion into foreign markets. Additionally, increased third-party consulting costs were incurred to upgrade our enterprise resource planning software. Additionally, in the nine months ended September 30, 2006, general and administrative expenses included a non-recurring expense of $1.1 million associated with litigation relating to a commercial dispute involving our subsidiary in Spain.

Alarm.com and Angel.com sales and marketing and general and administrative expenses. The following table sets forth sales and marketing and general and administrative expenses (in thousands) for our Alarm.com and Angel.com businesses, in the aggregate, and percentage changes for these expenses for the periods indicated:

	Three Months Ended			Nine Months Ended		
	September 30,		%	September 30,		%
	2007	2006	Change	2007	2006	Change
Sales and marketing	$ 1,912	$ 1,476	29.5%	$ 5,367	$ 3,703	44.9%
General and administrative	601	409	46.9%	1,499	903	66.0%
Total	$ 2,513	$ 1,885	33.3%	$ 6,866	$ 4,606	49.1%

The increase in sales and marketing and general and administrative expenses during the three and nine months ended September 30, 2007, as compared to the same periods in the prior year, were primarily attributable to expenses related to increases in staffing levels to support the growing revenue streams of those businesses. Our core BI business provides general and administrative services to Angel.com. The amount of expenses attributable to these services was not significant for each of the three and nine months ended September 30, 2007 and 2006.

Research and development expenses. Research and development expenses consists of the personnel costs for our software engineering personnel, depreciation of equipment and other related costs.

The following table summarizes research and development expenses and amortization of capitalized software development costs (in thousands) and percentage changes in those costs for the periods indicated:

	Three Months Ended			Nine Months Ended		
	September 30,		%	September 30,		%
	2007	2006	Change	2007	2006	Change
Gross research and development expenses:						
Core research and development activities	$ 8,846	$ 7,962	11.1%	$ 25,698	$ 23,721	8.3%
Alarm.com and Angel.com research and development activities	1,011	832	21.5			