MICROSTRATEGY INC
Form 10-Q
October 27, 2016
UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the Quarterly Period Ended September 30, 2016

OR

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

Commission File Number 000-24435

MICROSTRATEGY INCORPORATED

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of incorporation or organization)

51-0323571

(I.R.S. Employer

Identification Number)

1850 Towers Crescent Plaza, Tysons Corner, VA

(Address of Principal Executive Offices)

22182

(Zip Code)

(703) 848-8600

(Registrant’s telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

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

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

The number of shares of the registrant’s class A common stock and class B common stock outstanding on October 19, 2016 was 9,395,943 and 2,035,184, respectively.

MICROSTRATEGY INCORPORATED

FORM 10-Q

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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, 2016 (unaudited)	December 31, 2015
Assets		
Current assets:		
Cash and cash equivalents	$ 365,555	$ 292,341
Restricted cash	566	618
Short-term investments	213,347	193,320
Accounts receivable, net	58,052	68,154
Prepaid expenses and other current assets	11,597	10,881
Total current assets	649,117	565,314
Property and equipment, net	59,668	65,664
Capitalized software development costs, net	9,997	15,855
Deposits and other assets	5,624	2,072
Deferred tax assets, net	11,103	7,989
Total assets	$ 735,509	$ 656,894
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable and accrued expenses	$ 26,064	$ 31,840
Accrued compensation and employee benefits	41,417	40,067
Accrued restructuring costs	2	56
Deferred revenue and advance payments	115,626	100,695
Total current liabilities	183,109	172,658
Deferred revenue and advance payments	15,151	8,995
Other long-term liabilities	17,221	19,943
Deferred tax liabilities	127	17
Total liabilities	215,608	201,613
Commitments and Contingencies		
Stockholders' Equity		
Preferred stock undesignated, $0.001 par value; 5,000 shares authorized; no shares issued or outstanding	0	0
Class A common stock, $0.001 par value; 330,000 shares authorized; 15,801 shares issued and 9,396 shares outstanding, and 15,771 shares issued and 9,366 shares outstanding, respectively	16	16
Class B convertible common stock, $0.001 par value; 165,000 shares authorized;	2	2

2,035 shares issued and outstanding, and 2,035 shares issued and outstanding, respectively		
Additional paid-in capital	540,038	534,651
Treasury stock, at cost; 6,405 shares	(475,184)	(475,184)
Accumulated other comprehensive loss	(7,959)	(7,408)
Retained earnings	462,988	403,204
Total stockholders' equity	519,901	455,281
Total liabilities and stockholders' equity	$ 735,509	$ 656,894

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

MICROSTRATEGY INCORPORATED

CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share data)

	Three Months Ended September 30,	
	2016 (unaudited)	2015 (unaudited)
Revenues:		
Product licenses	$29,632	$27,511
Subscription services	7,639	6,546
Total product licenses and subscription services	37,271	34,057
Product support	72,460	71,392
Other services	20,165	24,087
Total revenues	129,896	129,536
Cost of revenues:		
Product licenses	2,370	2,680
Subscription services	3,219	3,075
Total product licenses and subscription services	5,589	5,755
Product support	3,959	3,174
Other services	13,387	15,755
Total cost of revenues	22,935	24,684
Gross profit	106,961	104,852
Operating expenses:		
Sales and marketing	39,169	36,403
Research and development	18,069	17,789
General and administrative	19,703	19,843
Restructuring costs	12	86
Total operating expenses	76,953	74,121
Income from operations	30,008	30,731
Interest income, net	507	116
Other (expense) income, net	(473)	766
Income before income taxes	30,042	31,613
Provision for income taxes	3,414	7,720
Net income	26,628	23,893
Basic earnings per share (1)	$2.33	$2.10
Weighted average shares outstanding used in computing basic earnings per share	11,431	11,365
Diluted earnings per share (1)	$2.31	$2.06
Weighted average shares outstanding used in computing diluted earnings per share	11,521	11,589

(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.

MICROSTRATEGY INCORPORATED

CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share data)

	Nine Months Ended September 30,	
	2016 (unaudited)	2015 (unaudited)
Revenues:		
Product licenses	$75,490	$77,634
Subscription services	22,775	20,285
Total product licenses and subscription services	98,265	97,919
Product support	212,408	211,444
Other services	61,380	76,984
Total revenues	372,053	386,347
Cost of revenues:		
Product licenses	6,828	5,895
Subscription services	9,667	9,800
Total product licenses and subscription services	16,495	15,695
Product support	10,919	9,734
Other services	42,445	52,265
Total cost of revenues	69,859	77,694
Gross profit	302,194	308,653
Operating expenses:		
Sales and marketing	113,448	109,142
Research and development	54,804	48,051
General and administrative	63,014	63,071
Restructuring costs	45	261
Total operating expenses	231,311	220,525
Income from operations	70,883	88,128
Interest income, net	1,449	129
Other (expense) income, net	(386)	2,601
Income before income taxes	71,946	90,858
Provision for income taxes	12,162	24,038
Net income	59,784	66,820
Basic earnings per share (1)	$5.23	$5.89
Weighted average shares outstanding used in computing basic earnings per share	11,422	11,345
Diluted earnings per share (1)	$5.20	$5.80
Weighted average shares outstanding used in computing diluted earnings per share	11,503	11,521

(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 COMPREHENSIVE INCOME

(in thousands)

	Three Months Ended September 30,	
	2016 (unaudited)	2015 (unaudited)
Net income	$ 26,628	$ 23,893
Other comprehensive income (loss), net of applicable taxes:		
Foreign currency translation adjustment	269	(597)
Less: reclassification adjustment for translation gain included in other income	0	280
Foreign currency translation adjustment, net	269	(317)
Unrealized gain (loss) on short-term investments	10	(21)
Total other comprehensive income (loss)	279	(338)
Comprehensive income	$ 26,907	$ 23,555

	Nine Months Ended September 30,	
	2016 (unaudited)	2015 (unaudited)
Net income	$ 59,784	$ 66,820
Other comprehensive loss, net of applicable taxes:		
Foreign currency translation adjustment	(567)	(1,649)
Less: reclassification adjustment for translation gain included in other income	0	280
Foreign currency translation adjustment, net	(567)	(1,369)
Unrealized gain (loss) on short-term investments	16	(35)
Total other comprehensive loss	(551)	(1,404)
Comprehensive income	$ 59,233	$ 65,416

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)

	Nine Months Ended September 30,	
	2016 (unaudited)	2015 (unaudited)
Operating activities:		
Net income	$59,784	$66,820
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	13,089	16,172
Bad debt expense	1,219	683
Unrealized net loss on foreign currency forward contracts	0	1,641
Non-cash restructuring costs and adjustments	0	(127)
Deferred taxes	(4,439)	11,015
Release of liabilities for unrecognized tax benefits	(394)	(61)
Share-based compensation expense	8,424	12,503
Excess tax benefits from share-based compensation arrangements	(1,208)	(963)
Reclassification of foreign currency translation adjustment from other comprehensive income	0	(280)
Changes in operating assets and liabilities:		
Accounts receivable	8,983	19,511
Prepaid expenses and other current assets	(657)	3,377
Deposits and other assets	(3,905)	1,562
Accounts payable and accrued expenses	(4,668)	(4,933)
Accrued compensation and employee benefits	717	(10,275)
Accrued restructuring costs	(56)	(1,940)
Deferred revenue and advance payments	19,435	11,153
Other long-term liabilities	(2,288)	(2,415)
Net cash provided by operating activities	94,036	123,443
Investing activities:		
Proceeds from redemption of short-term investments	273,520	316,000
Purchases of property and equipment	(1,560)	(3,352)
Purchases of short-term investments	(292,948)	(344,033)
Capitalized software development costs	0	(9,598)
Decrease in restricted cash	92	113
Net cash used in investing activities	(20,896)	(40,870)
Financing activities:		
Proceeds from sale of class A common stock under exercise of employee stock options	1,157	5,439
Payment of taxes relating to net exercise of employee stock options	(3,739)	0
Excess tax benefits from share-based compensation arrangements	1,208	963
Payments on capital lease obligations and other financing arrangements	(166)	(1,430)
Net cash (used in) provided by financing activities	(1,540)	4,972

Effect of foreign exchange rate changes on cash and cash equivalents	1,614	(4,276)
Net increase in cash and cash equivalents	73,214	83,269
Cash and cash equivalents, beginning of period	292,341	146,919
Cash and cash equivalents, end of period	$365,555	$230,188
Supplemental disclosure of noncash investing and financing activities:		
Assets acquired under capital lease obligations and other financing arrangements	$0	$14

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

MICROSTRATEGY INCORPORATED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

(1) Summary of Significant Accounting Policies

(a) Basis of Presentation

Except for the Consolidated Balance Sheet of MicroStrategy Incorporated ("MicroStrategy" or the "Company") as of December 31, 2015, which was derived from audited financial statements, the accompanying Consolidated Financial Statements are unaudited. In the opinion of management, all adjustments necessary for a fair statement of such financial position and results of operations have been included. All such adjustments are of a normal recurring nature, unless otherwise disclosed. Interim results are not necessarily indicative of results for a full year.

The Consolidated Financial Statements and Notes to Consolidated Financial Statements are presented as required by the United States Securities and Exchange Commission ("SEC") and do not contain certain information included in the Company's annual financial statements and notes. These financial statements should be read in conjunction with the Company's audited financial statements and the notes thereto filed with the SEC in the Company's Annual Report on Form 10-K for the year ended December 31, 2015. There have been no significant changes in the Company's accounting policies since December 31, 2015.

The accompanying Consolidated Financial Statements include the accounts of the Company and its subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation. The Company is not aware of any subsequent event which would require recognition or disclosure.

(2) Recent Accounting Standards

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update No. 2014-09, Revenue from Contracts with Customers (Topic 606) ("ASU 2014-09"), which supersedes nearly all existing revenue recognition guidance. The standard's core principle is that an entity should recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The standard creates a five-step model to achieve its core principle: (i) identify the contract(s) with a customer; (ii) identify the performance obligations in the contract; (iii) determine the transaction price; (iv) allocate the transaction price to the separate performance obligations in the contract; and (v) recognize revenue when (or as) the entity satisfies a performance obligation. In addition, entities must disclose sufficient information to enable users of financial statements to understand the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. Qualitative and quantitative disclosures are required about: (i) the entity's contracts with customers; (ii) the significant judgments, and changes in judgments, made in applying the guidance to those contracts; and (iii) any assets recognized from the costs to obtain or fulfill a contract with a customer. In August 2015, the FASB issued ASU 2015-14, Revenue from Contracts with Customers (Topic 606) – Deferral of the Effective Date, which defers the effective date of ASU 2014-09 to interim and annual periods beginning January 1, 2018. The standard allows entities to apply the standard retrospectively to each prior reporting period presented ("full retrospective adoption") or retrospectively with the cumulative effect of initially applying the standard recognized at the date of initial application ("modified retrospective adoption"). The Company is currently

evaluating the impact of this guidance on its consolidated financial position, results of operations, and cash flows.

In February 2016, the FASB issued Accounting Standards Update No. 2016-02, Leases (Topic 842) (“ASU 2016-02”), which requires lease assets and lease liabilities be recognized for all leases, in addition to the disclosure of key information to enable users of financial statements to assess the amount, timing, and uncertainty of cash flows arising from an entity’s leasing arrangements. ASU 2016-02 defines a lease as a contract, or part of a contract, that conveys both (i) the right to obtain economic benefits from and (ii) direct the use of an identified asset for a period of time in exchange for consideration. Under ASU 2016-02, leases are classified as either finance or operating leases. For finance leases, a lessee shall recognize in profit or loss the amortization of the lease asset and interest on the lease liability. For operating leases, a lessee shall recognize in profit or loss a single lease cost, calculated so that the remaining cost of the lease is allocated over the remaining lease term, generally on a straight-line basis. ASU 2016-02 requires the recognition and measurement of leases at the beginning of the earliest period presented using a modified retrospective approach and is effective for interim and annual periods beginning January 1, 2019. Early adoption is permitted. The Company is currently evaluating the impact of this guidance on its consolidated financial position, results of operations, and cash flows.

MICROSTRATEGY INCORPORATED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

In March 2016, the FASB issued Accounting Standards Update No. 2016-09, Compensation – Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting ("ASU 2016-09"), to simplify certain aspects of accounting for share-based payment transactions. Under ASU 2016-09, all excess tax benefits should be recognized as income tax expense or benefit in the income statement, regardless of whether the benefit reduces taxes payable in the current period. The excess tax benefits will be combined with other income tax cash flows within operating activities in the statement of cash flows. In addition, excess tax benefits or tax deficiencies will no longer be included in the calculation of assumed proceeds under the treasury stock method of computing diluted earnings per share. ASU 2016-09 also allows companies to make an accounting policy election to either estimate the number of awards expected to vest or to account for forfeitures as they occur, when accruing share-based compensation expense. Lastly, ASU 2016-09 permits employers to withhold up to the employee's maximum statutory tax rate in applicable jurisdictions and still qualify for the exception to liability classification. Cash paid by an employer when directly withholding shares for tax-withholding purposes should be classified as a financing activity in the statement of cash flows. ASU 2016-09 is effective for interim and annual periods beginning January 1, 2017. Early adoption is permitted, however an entity that elects early adoption must adopt all of the amendments in the same period. The Company expects to adopt this guidance on January 1, 2017, and is currently evaluating the impact of this guidance and its various transition methods on its consolidated financial position, results of operations, and cash flows.

(3) Fair Value Measurements

The Company measures certain assets and liabilities at fair value on a recurring basis. Fair value is defined as the price that is expected to be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The Company uses a three-level hierarchy that prioritizes fair value measurements based on the types of inputs used for the various valuation techniques. The three levels of the fair value hierarchy are described below:

Level 1:	Quoted (unadjusted) prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities.
Level 2:	Inputs other than quoted prices that are either directly or indirectly observable, such as quoted prices in active markets for similar assets or liabilities, quoted prices for identical or similar assets or liabilities in inactive markets, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.
Level 3:	Inputs that are generally unobservable, supported by little or no market activity, and typically reflect management's estimates of assumptions that market participants would use in pricing the asset or liability.

The categorization of an asset or liability within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement. The valuation techniques used by the Company when measuring fair value maximize the use of observable inputs and minimize the use of unobservable inputs.

The Company is exposed to certain risks related to its ongoing business operations, including the effect of changes in foreign exchange rates on the Company's monetary assets and liabilities denominated in foreign currency. The

Company may use foreign currency forward contracts as part of its strategy to manage these risks, but does not hold or issue derivative instruments for trading purposes or speculation. The Company executes these instruments with financial institutions that hold an investment grade credit rating. These foreign currency forward contracts do not meet the requirements for hedge accounting and are recorded on the balance sheet as either an asset or liability measured at their fair value as of the reporting date. Changes in the fair value of derivative instruments, as measured using the three-level hierarchy described above, are recognized in "Other (expense) income, net" in the Company's Consolidated Statements of Operations.

As of September 30, 2016 and December 31, 2015, there were no financial assets or liabilities measured at fair value on a recurring basis.

The fair value of our foreign currency forward contracts is determined using Level 2 observable market inputs to extrapolate forward points to be added to or subtracted from the closing market spot rate on the reporting date, and then discounted to present value.

MICROSTRATEGY INCORPORATED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

Changes in the fair value of our foreign currency forward contracts (in thousands) for the three and nine months ended September 30, 2016 and 2015 were as follows:

		(Loss) Gain on Derivative Instruments Recognized in Income			
		Three Months Ended September 30,		Nine Months Ended September 30,	
	Location	2016	2015	2016	2015
Non-hedging derivative instruments:					
Unrealized loss on foreign currency forward contracts	Other (expense) income, net	$ 0	$ 0	$ 0	$ (1,641)
Realized gain on foreign currency forward contracts	Other (expense) income, net	$ 0	$ 0	$ 0	$ 2,129

The “Unrealized loss on foreign currency forward contracts” line item in the above table includes both the unrealized fair value gains and losses on outstanding foreign currency forward contracts and the reversal of previous period unrealized gains and losses upon the settlement of foreign currency forward contracts. There were no foreign currency forward contracts outstanding as of September 30, 2016. There were no transfers among the levels within the fair value hierarchy during each of the three and nine months ended September 30, 2016 and 2015. As of September 30, 2016 and December 31, 2015, the Company had no assets or liabilities that were required to be measured at fair value on a non-recurring basis.

The Company also estimates the fair value of cash and cash equivalents, restricted cash, accounts receivable, accounts payable and accrued expenses, accrued compensation and employee benefits, and accrued restructuring costs. The Company considers the carrying value of these instruments in the financial statements to approximate fair value due to their short maturities.

(4) Short-term Investments

The Company periodically invests a portion of its excess cash in short-term investment instruments. Substantially all of the Company’s short-term investments are in U.S. Treasury securities and certificates of deposit, and the Company has the ability and intent to hold these investments to maturity. The stated maturity dates of these investments are between three months and one year from the purchase date. These held-to-maturity investments are recorded at amortized cost and included within “Short-term investments” on the accompanying Consolidated Balance Sheets. The fair value of held-to-maturity investments in U.S. Treasury securities and certificates of deposit is determined based

on quoted market prices in active markets for identical securities (Level 1 inputs).

The amortized cost, carrying value, and fair value of held-to-maturity investments at September 30, 2016 were $213.3 million, $213.3 million, and $213.3 million, respectively. The amortized cost, carrying value, and fair value of held-to-maturity investments at December 31, 2015 were $193.3 million, $193.3 million, and $193.2 million, respectively. The gross unrecognized holding gains and losses were not material for each of the three and nine months ended September 30, 2016 and 2015. No other-than-temporary impairments related to these investments have been recognized in accumulated other comprehensive loss as of September 30, 2016 and December 31, 2015. As of September 30, 2016 and December 31, 2015, the Company's available-for-sale investments were not material.

(5) Accounts Receivable

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

	September 30, 2016	December 31, 2015
Billed and billable	$ 124,392	$ 175,382
Less: unpaid deferred revenue	(61,932)	(103,403)
Accounts receivable, gross	62,460	71,979
Less: allowance for doubtful accounts	(4,408)	(3,825)
Accounts receivable, net	$ 58,052	$ 68,154

MICROSTRATEGY INCORPORATED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

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

The Company maintains an allowance for doubtful accounts which represents its best estimate of probable losses inherent in the accounts receivable balances. The Company evaluates specific accounts when it becomes aware that a customer may not be able to meet its financial obligations due to deterioration of its liquidity or financial viability, credit ratings, or bankruptcy. In addition, the Company periodically adjusts this allowance based on its review and assessment of the aging of receivables.

(6) Deferred Revenue and Advance Payments

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

	September 30, 2016	December 31, 2015
Current:		
Deferred product licenses revenue	$ 11,401	$ 13,506
Deferred subscription services revenue	12,820	15,763
Deferred product support revenue	140,593	158,738
Deferred other services revenue	9,226	9,149
Gross current deferred revenue and advance payments	174,040	197,156
Less: unpaid deferred revenue	(58,414)	(96,461)
Net current deferred revenue and advance payments	$ 115,626	$ 100,695
Non-current:		
Deferred product licenses revenue	$ 9,918	$ 5,397
Deferred subscription services revenue	1,594	2,138
Deferred product support revenue	6,394	7,607
Deferred other services revenue	763	795
Gross non-current deferred revenue and advance payments	18,669	15,937
Less: unpaid deferred revenue	(3,518)	(6,942)
Net non-current deferred revenue and advance payments	$ 15,151	$ 8,995

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

(7) Commitments and Contingencies

(a) Commitments

From time to time, the Company enters into certain types of contracts that require it to indemnify parties against third-party claims. These contracts primarily relate to agreements under which the Company assumes indemnity obligations for intellectual property infringement, as well as other obligations from time to time depending on arrangements negotiated with customers and other third parties. The conditions of these obligations vary. Thus, the overall maximum amount of the Company's indemnification obligations cannot be reasonably estimated. Historically, the Company has not been obligated to make significant payments for these obligations and does not currently expect to incur any material obligations in the future. Accordingly, the Company has not recorded an indemnification liability on its balance sheets as of September 30, 2016 or December 31, 2015.

The Company leases office space and computer and other equipment under operating lease agreements. It also leases certain computer and other equipment under capital lease agreements and licenses certain software under other financing arrangements. Under the lease agreements, in addition to base rent, the Company is generally responsible for certain taxes, utilities and maintenance costs, and other fees; and several leases include options for renewal or purchase. The Company leases approximately 214,000 square feet of office space at a location in Northern Virginia that began serving as its corporate headquarters in October 2010. The term of the lease expires in December 2020.

MICROSTRATEGY INCORPORATED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

At September 30, 2016 and December 31, 2015, deferred rent of $13.2 million and $15.7 million, respectively, was included in other long-term liabilities, and $3.5 million and $3.3 million, respectively, was included in current accrued expenses.

In January 2016, the Board of Directors implemented a reorganization of the Company's executive management team to further streamline the Company's business. The reorganization enabled the Company to eliminate a layer of management by eliminating a separate Office of the President and was designed to better position the Company's business for profitable growth. This streamlining resulted in the departures of our former President, Paul N. Zolfaghari, and our former President & Chief Legal Officer, Jonathan F. Klein. As of September 30, 2016, the Company's balance sheet included an accrual of approximately $3.4 million taken in the first quarter of 2016 for potential future payments in connection with their departures from the Company.

(b) Contingencies

In December 2011, DataTern, Inc. ("DataTern") filed a complaint for patent infringement against the Company in the United States District Court for the District of Massachusetts (the "District Court"). The complaint alleged that the Company infringes U.S. Patent No. 6,101,502 (the "'502 Patent"), allegedly owned by DataTern, by making, selling, or offering for sale several of the Company's products and services including MicroStrategy 9™, MicroStrategy Intelligence Server™, MicroStrategy Business Intelligence Platform™, MicroStrategy Cloud Personal, and other MicroStrategy applications for creating or using data mining, dashboards, business analytics, data storage and warehousing, and Web hosting support. The complaint accused the Company of willful infringement and sought an unspecified amount of damages, an award of attorneys' fees, and preliminary and permanent injunctive relief. In light of a judgment in a separate action involving DataTern in another jurisdiction, in February 2013, MicroStrategy and DataTern filed motions for summary judgment of non-infringement and the District Court entered summary judgment against DataTern. In March 2013, DataTern filed a notice of appeal with the United States Court of Appeals for the Federal Circuit (the "Federal Circuit"). In December 2014, the Federal Circuit issued an opinion vacating the District Court's summary judgment, stating that the claim construction on which the summary judgment was based was incorrect. A claim construction hearing was held in September 2016, the outcome of which is still pending. The Company has received indemnification requests from certain of its channel partners and customers who were sued by DataTern in the District Court in lawsuits alleging infringement of the '502 Patent. The proceedings against these channel partners and customers have been stayed pending the resolution of DataTern's lawsuit against the Company. The outcome of these matters is not presently determinable, and the Company cannot make a reasonable estimate of the possible loss or range of loss with respect to these matters at this time. Accordingly, no estimated liability for these matters has been accrued in the accompanying Consolidated Financial Statements.

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

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

assertion.

(8) Treasury Stock

The Board of Directors has authorized the Company's repurchase of up to an aggregate of $800.0 million of its class A common stock from time to time on the open market through April 29, 2018 (the "2005 Share Repurchase Program"), although the program may be suspended or discontinued by the Company at any time. The timing and amount of any shares repurchased will be determined by the Company's management based on its evaluation of market conditions and other factors. The 2005 Share Repurchase Program may be funded using the Company's working capital, as well as proceeds from any other funding arrangements that the Company may enter into in the future. During the three and nine months ended September 30, 2016 and 2015, the Company did not repurchase any shares of its class A common stock pursuant to the 2005 Share Repurchase Program. As of September 30, 2016, the Company had repurchased an aggregate of 3,826,947 shares of its class A common stock at an average price per share of $90.23 and an aggregate cost of $345.3 million. The average price per share and aggregate cost amounts disclosed above include broker commissions.

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(9) Income Taxes

The Company and its subsidiaries conduct business in the United States and various foreign countries and are subject to taxation in numerous domestic and foreign jurisdictions. As a result of its business activities, the Company files tax returns that are subject to examination by various federal, state and local, and foreign tax authorities. With few exceptions, the Company is no longer subject to U.S. federal, state and local, or foreign income tax examination by tax authorities for years before 2013. However, due to its use of state net operating loss ("NOL") and federal tax credit carryovers in the United States, U.S. tax authorities may attempt to reduce or fully offset the amount of state NOL or federal tax credit carryovers from tax years ended in 2006 and forward that were used in later tax years. The Company's major foreign tax jurisdictions and tax years that remain subject to potential examination are Germany for tax years 2013 and forward, Poland and China for tax years 2011 and forward, Spain for tax years 2012 and forward, and the United Kingdom for tax years 2014 and forward. The Company settled the tax examination in the United States for tax years 2011 and 2012 without any material audit assessments. To date there have been no material audit assessments related to audits in any of the applicable foreign jurisdictions.

As of September 30, 2016, the Company had unrecognized tax benefits of $3.4 million, which are recorded in other long-term liabilities. If recognized, $2.7 million of these unrecognized tax benefits would impact the effective tax rate. The Company recognizes estimated accrued interest related to unrecognized income tax benefits in the provision for income tax accounts. Penalties relating to income taxes, if incurred, would also be recognized as a component of the Company's provision for income taxes. Over the next 12 months, the amount of the Company's liability for unrecognized tax benefits is not expected to change by a material amount. As of September 30, 2016, the amount of cumulative accrued interest expense on unrecognized income tax benefits was approximately $0.4 million.

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

	September 30, 2016	December 31, 2015
Deferred tax assets, net of deferred tax liabilities	$ 11,985	$ 9,956
Valuation allowance	(1,009)	(1,984)
Deferred tax assets, net of deferred tax liabilities and valuation allowance	$ 10,976	$ 7,972

The valuation allowance as of September 30, 2016 and December 31, 2015 primarily related to certain foreign tax credit carryforwards that, in our present estimation, more likely than not will not be realized.

The Company has estimated its annual effective tax rate for the full fiscal year 2016 and applied that rate to its income before income taxes in determining its provision for income taxes for the nine months ended September 30, 2016. The Company also records discrete items in each respective period as appropriate. The estimated effective tax rate is

subject to fluctuation based on the level and mix of earnings and losses by tax jurisdiction, foreign tax rate differentials, and the relative impact of permanent book to tax differences (e.g., non-deductible expenses). Each quarter, a cumulative adjustment is recorded for any fluctuations in the estimated annual effective tax rate as compared to the prior quarter. As a result of these factors, and due to potential changes in the Company's period-to-period results, fluctuations in the Company's effective tax rate and respective tax provisions or benefits may occur.

For the nine months ended September 30, 2016, the Company recorded a provision for income taxes of $12.2 million that resulted in an effective tax rate of 16.9%, as compared to a provision for income taxes of $24.0 million that resulted in an effective tax rate of 26.5% for the nine months ended September 30, 2015. The change in the effective tax rate in 2016 is mainly due to the change in the expected proportion of U.S. versus foreign income and certain discrete tax benefits recorded in the third quarter of 2016. The discrete tax benefits are comprised of a release of the valuation allowance against certain foreign tax credit deferred tax assets, the release of the liability for unrecognized tax benefits upon the settlement of the tax examination in the United States for tax years 2011 and 2012, and the change in an estimated amount of a provision as a result of additional analysis of certain foreign tax laws.

Except as discussed below, the Company intends to indefinitely reinvest its undistributed earnings of all of its foreign subsidiaries. Therefore, the annualized effective tax rate applied to the Company's pre-tax income does not include any provision for U.S. federal and state income taxes on the amount of the undistributed foreign earnings. U.S. federal tax laws, however, require the Company to include in its U.S. taxable income certain investment income earned outside of the United States in excess of certain limits ("Subpart F

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deemed dividends"). Because Subpart F deemed dividends are already required to be recognized in the Company's U.S. federal income tax return, the Company regularly repatriates Subpart F deemed dividends to the United States and no additional tax is incurred on the distribution. As of September 30, 2016 and December 31, 2015, the amount of cash and cash equivalents and short-term investments held by U.S. entities was $261.0 million and $219.3 million, respectively, and by non-U.S. entities was $317.9 million and $266.4 million, respectively. If the cash and cash equivalents and short-term investments held by non-U.S. entities were to be repatriated to the United States, the Company would generate U.S. taxable income to the extent of the Company's undistributed foreign earnings, which amounted to $252.9 million at December 31, 2015. Although the tax impact of repatriating these earnings is difficult to determine, the Company would not expect the maximum effective tax rate that would be applicable to such repatriation to exceed the U.S. statutory rate of 35.0%, after considering applicable foreign tax credits.

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

Judgments and estimates related to the Company's projections and assumptions are inherently uncertain. Therefore, actual results could differ materially from projections. The timing and manner in which the Company will use research and development tax credit carryforward tax assets, alternative minimum tax credit carryforward tax assets, and foreign tax credit carryforward tax assets in any year, or in total, may be limited by provisions of the Internal Revenue Code regarding changes in the Company's ownership. Currently, the Company expects to use the tax assets, subject to Internal Revenue Code limitations, within the carryforward periods. Valuation allowances have been established where the Company has concluded that it is more likely than not that such deferred tax assets are not realizable. If the Company is unable to sustain profitability in future periods, it may be required to increase the valuation allowance against the deferred tax assets, which could result in a charge that would materially adversely affect net income in the period in which the charge is incurred.

(10) Share-based Compensation

The Company's 2013 Stock Incentive Plan (as amended, the "2013 Equity Plan") authorizes the issuance of various types of share-based awards to the Company's employees, officers, directors, and other eligible participants. As of September 30, 2016, the total number of shares of the Company's class A common stock authorized for issuance under the 2013 Equity Plan was 1,700,000 shares.

During the third quarter of 2016, no stock option awards were granted pursuant to the 2013 Equity Plan. As of September 30, 2016, there were options to purchase 915,000 shares of class A common stock outstanding under the 2013 Equity Plan. As of September 30, 2016, there were 577,500 remaining shares of class A common stock authorized for future issuance under the 2013 Equity Plan.

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The following table summarizes the Company's stock option activity (in thousands, except per share data and years) for the three months ended September 30, 2016:

	Stock Options Outstanding			
	Shares	Weighted Average Exercise Price Per Share	Aggregate Intrinsic Value	Weighted Average Remaining Contractual Term (Years)
Balance as of July 1, 2016	935	$ 146.31		
Granted	0	0.00		
Exercised	0	0.00	$ 0	
Forfeited/Expired	(20)	201.25		
Balance as of September 30, 2016	915	$ 145.11		
Exercisable as of September 30, 2016	340	$ 134.33	$ 12,285	7.8
Expected to vest as of September 30, 2016	575	$ 151.48	13,324	8.2
Total	915	$ 145.11	$ 25,609	8.0

Stock options outstanding as of September 30, 2016 are comprised of the following range of exercise prices per share (in thousands, except per share data and years):

	Stock Options Outstanding at September 30, 2016		
Range of Exercise Prices per Share	Shares	Weighted Average Exercise Price Per Share	Weighted Average Remaining Contractual Term (Years)
$117.85 - $120.00	30	$ 118.63	7.6
$120.01 - $150.00	514	$ 121.43	7.6
$150.01 - $180.00	216	$ 167.21	8.4
$180.01 - $201.25	155	$ 197.87	9.2
Total	915	$ 145.11	8.0

An aggregate of 27,500 stock options with an aggregate fair value of $2.3 million vested during the three months ended September 30, 2016. The Company expects all unvested options at September 30, 2016 to fully vest in future years in accordance with their vesting schedules. Therefore, share-based compensation expense has not been adjusted for any expected forfeitures. No stock option awards were granted during the three months ended September 30, 2016. The weighted average grant date fair value of stock option awards using the Black-Scholes pricing model was $82.89 for each share subject to a stock option granted during the three months ended September 30, 2015, based on the following assumptions:

	Three months ended September 30, 2015
Expected term of options in years	6.3
Expected volatility	39.0%
Risk-free interest rate	1.9%
Expected dividend yield	0.0%

For the three and nine months ended September 30, 2016, the Company recognized approximately $3.3 million and $8.4 million, respectively, in share-based compensation expense from stock options granted under the 2013 Equity Plan. For the three and nine months ended September 30, 2015, the Company recognized approximately $4.5 million and $12.5 million, respectively, in share-based compensation expense from stock options granted under the 2013 Equity Plan. As of September 30, 2016, there was approximately $31.0 million of total unrecognized share-based compensation expense related to unvested stock options. The Company expects to recognize this remaining share-based compensation expense over a weighted average vesting period of approximately 2.3 years.

During the nine months ended September 30, 2016 and 2015, the Company was able to recognize and utilize tax deductions related to equity compensation in excess of compensation recognized for financial reporting that was generated under the 2013 Equity Plan.

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Accordingly, additional paid-in capital increased by $1.2 million and $1.0 million during the nine months ended September 30, 2016 and 2015, respectively.

During the nine months ended September 30, 2016, the Company wrote off $1.7 million of deferred tax assets related to certain vested stock options that were no longer exercisable. Accordingly, additional paid-in capital decreased by $1.7 million during the nine months ended September 30, 2016. No such adjustment was made during the nine months ended September 30, 2015.

During the nine months ended September 30, 2016, the Company paid $3.7 million to tax authorities related to the net exercise of a stock option under the 2013 Equity Plan. This payment resulted in a $3.7 million reduction to additional paid-in capital during the nine months ended September 30, 2016. No net exercises of stock options were made during the nine months ended September 30, 2015.

(11) Common Equity and Earnings per Share

The Company has two classes of common stock: class A common stock and class B common stock. Holders of class A common stock generally have the same rights, including rights to dividends, as holders of class B common stock, except that holders of class A common stock have one vote per share while holders of class B common stock have ten votes per share. Each share of class B common stock is convertible at any time, at the option of the holder, into one share of class A common stock. As such, basic and fully diluted earnings per share for class A common stock and for class B common stock are the same. The Company has never declared or paid any cash dividends on either class A or class B common stock. As of September 30, 2016 and December 31, 2015, there were no shares of preferred stock issued or outstanding.

Potential shares of common stock are included in the diluted earnings per share calculation when dilutive. Potential shares of common stock, consisting of common stock issuable upon exercise of outstanding stock options, are calculated using the treasury stock method. For the three and nine months ended September 30, 2016, stock options issued under the 2013 Equity Plan to purchase a weighted average of approximately 380,000 and 373,000 shares of common stock, respectively, were excluded from the diluted earnings per share calculation because their impact would have been anti-dilutive. For the three and nine months ended September 30, 2015, stock options issued under the 2013 Equity Plan to purchase a weighted average of approximately 318,000 and 276,000 shares of common stock, respectively, were excluded from the diluted earnings per share calculation because their impact would have been anti-dilutive.

(12) Segment Information

The Company manages its business in one operating segment. The Company's one operating segment is engaged in the design, development, marketing, and sales of our software platform through licensing arrangements and cloud-based subscriptions and related services. The following table presents total revenues, gross profit, and long-lived assets, excluding long-term deferred tax assets, (in thousands) according to geographic region:

Geographic regions:	Domestic	EMEA	Other Regions	Consolidated
Three months ended September 30, 2016				
Total revenues	$82,513	$34,636	$ 12,747	$ 129,896
Gross profit	$68,084	$28,183	$ 10,694	$ 106,961
Three months ended September 30, 2015				
Total revenues	$77,837	$40,450	$ 11,249	$ 129,536
Gross profit	$62,583	$32,802	$ 9,467	$ 104,852
Nine months ended September 30, 2016				
Total revenues	$228,427	$106,833	$ 36,793	$ 372,053
Gross profit	$185,052	$86,131	$ 31,011	$ 302,194
Nine months ended September 30, 2015				
Total revenues	$242,775	$109,447	$ 34,125	$ 386,347
Gross profit	$195,435	$84,637	$ 28,581	$ 308,653
As of September 30, 2016				
Long-lived assets	$70,257	$3,303	$ 1,729	$ 75,289
As of December 31, 2015				
Long-lived assets	$77,652	$3,701	$ 2,238	$ 83,591

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The domestic region consists of the United States and Canada. The EMEA region includes operations in Europe, the Middle East, and Africa. The other regions include all other foreign countries, generally comprising Latin America and the Asia Pacific region. For the three and nine months ended September 30, 2016 and 2015, no individual foreign country accounted for 10% or more of total consolidated revenues.

For the three and nine months ended September 30, 2016 and 2015, no individual customer accounted for 10% or more of total consolidated revenues.

As of September 30, 2016 and December 31, 2015, no individual foreign country accounted for 10% or more of total consolidated assets.

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

FORWARD-LOOKING INFORMATION

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

Overview

MicroStrategy® is a leading worldwide provider of enterprise software platforms. Our mission is to provide enterprise customers with a world-class software platform and expert services so they can deploy unique intelligence applications.

MicroStrategy 10™ consolidates analytics and mobility in a single unified platform, available both as on-premise software and as a hosted service offering in MicroStrategy Cloud™. Our enterprise platform combines traditional business intelligence functionality with data discovery, mobile analytics, and powerful digital credential and identity intelligence. MicroStrategy 10 builds on proven enterprise capabilities to make sophisticated, high-performance analytics more accessible, easier to use, and faster. MicroStrategy 10 consists of MicroStrategy Analytics™, MicroStrategy Mobile™, and Usher™.

MicroStrategy Analytics empowers large organizations to analyze vast amounts of data and securely distribute actionable business insight throughout an enterprise, while also being able to cater to smaller workgroups and departmental use via MicroStrategy Desktop™. MicroStrategy Analytics delivers reports and dashboards, and enables users to conduct ad hoc analysis and share insights anywhere, anytime, via mobile devices (via MicroStrategy Mobile) or the Web (via MicroStrategy Web™). It also combines the agility and productivity of self-service visual data discovery with the security, scalability, and governance features of enterprise-grade business intelligence. MicroStrategy Analytics is available both as on-premise software and as a hosted service offering in MicroStrategy Cloud.

MicroStrategy Web is the primary interface for analysts, data scientists, consumers and developers, offering interactive reporting, dashboarding, and ad-hoc data discovery capabilities through a Web browser. With MicroStrategy Web, a user can design and deliver dashboards across various styles of business intelligence, including scorecards, pixel-perfect documents and invoices, and interactive reports and statements, as well as for visual data discovery. MicroStrategy Web can also connect to a variety of data sources, and be used to build sophisticated advanced analytical models that may be inserted within dashboards and reports. MicroStrategy reports and dashboards can be personalized and automatically delivered to thousands of users with MicroStrategy Server™'s advanced distribution capabilities. Web applications can also be extensively customized and embedded into other applications using Web SDK for a branded experience.

MicroStrategy Desktop is a free standalone, on-premise, single-user tool for fast, powerful, and easy-to-use self-service visual data discovery. It enables business users to analyze and gain valuable insight and understanding

into their organizations' data by quickly creating stunning, useful visualizations and dashboards, without assistance from the IT department. MicroStrategy Desktop can be readily downloaded and installed on a PC or Mac, making the power of MicroStrategy 10 easily available. MicroStrategy Desktop can be used while offline and while not connected to MicroStrategy Server, and can connect to the MicroStrategy Server when needed.

MicroStrategy Mobile is fully integrated into the MicroStrategy Analytics platform, so it is easy to leverage existing visualizations, reports and dashboards to instantly deploy mobile business intelligence. In addition, MicroStrategy Mobile extends beyond analytics to enable organizations to rapidly build custom mobile applications that deliver analytics combined with transactions, multimedia and mapping to support business workflows. The robust code-free application development platform is designed to reduce development costs and accelerate the time it takes to deploy native mobile business apps—optimized for both iOS and Android™. Companies can build fully native iOS and Android apps that take advantage of the unique device and operating system capabilities (e.g., GPS/location, calendar and camera) on those devices. MicroStrategy Mobile is an easy, fast, and cost-effective vehicle for mobilizing an organization's information systems, including its data warehouses, business intelligence, ERP, CRM, and Web applications that are currently accessible only on the desktop. With MicroStrategy Mobile, businesses can transform their entire workforce into a connected and more productive mobile workforce using information-driven mobile apps that are significantly more robust and secure than their Web-only counterparts. With mobile access to critical corporate data and systems that drive the business, employees can

have a virtual office in their hands at all times. MicroStrategy Mobile is available both as on-premise software and as a hosted service offering in MicroStrategy Cloud.

Usher is a digital credential and identity intelligence offering that provides a highly secure, convenient way for organizations to dematerialize traditional forms of identity verification (such as passwords, tokens, and physical badges) and replace them with a single mobile identity badge that is cryptographically linked to its owner's smartphone and dynamically linked to an enterprise's existing identity repositories. Usher can be used as a powerful enterprise productivity and workforce management resource because it is designed to enable managers to gain an almost real-time window into the location and activity of their distributed workforces, while providing powerful interactive features to manage or direct them. With the addition of Usher Professional™, administrators can track user activity on a nearly real-time map using access telemetry. They can also engage in two-way communications with users from the Usher application. Usher works on standard smartphones running on iOS or the Android platform, and boasts an Apple Watch® integration. Through the use of Bluetooth®, QR codes, biometrics, push notifications, time-limited PIN codes, and other authentication methods, Usher users can log into applications, VPNs, and workstations, unlock doors and other physical gateways, and validate each other's identities. By delivering strong, multi-factor authentication that can be extended to nearly every corporate system, Usher's digital credential solution addresses some of the biggest challenges facing corporations today, including authentication, identity and access management, and resource authorization, while applying industry leading business intelligence and analytics to an enterprise's infrastructure. Usher is available both as on-premise software and as a hosted service offering in MicroStrategy Cloud.

MicroStrategy Cloud is a platform for organizations that want to harness the power of data through our enterprise solutions via the cloud. Compared to traditional on-premise approaches, MicroStrategy Cloud is architected to deliver best-of-breed MicroStrategy software via the cloud, with pre-configured, ready-to-go servers, coupled with the required supporting infrastructure with metadata databases, relational databases, and big data storage. With MicroStrategy Cloud, customers can launch enterprise analytics environments within minutes and use the full MicroStrategy 10 offering on a subscription basis.

MicroStrategy Analytics, offered via the on-premise enterprise platform, MicroStrategy Mobile, and MicroStrategy Cloud, together with related product and support services, continue to generate the vast majority of our revenue. During the three and nine months ended September 30, 2016 and 2015, we did not generate significant revenues from Usher.

The following table sets forth certain operating highlights (in thousands) for the three and nine months ended September 30, 2016 and 2015:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Revenues				
Product licenses	$29,632	$27,511	$75,490	$77,634
Subscription services	7,639	6,546	22,775	20,285
Total product licenses and subscription services	37,271	34,057	98,265	97,919
Product support	72,460	71,392	212,408	211,444
Other services	20,165	24,087	61,380	76,984
Total revenues	129,896	129,536	372,053	386,347
Cost of revenues				
Product licenses	2,370	2,680	6,828	5,895

Subscription services	3,219	3,075	9,667	9,800
Total product licenses and subscription services	5,589	5,755	16,495	15,695
Product support	3,959	3,174	10,919	9,734
Other services	13,387	15,755	42,445	52,265
Total cost of revenues	22,935	24,684	69,859	77,694
Gross profit	106,961	104,852	302,194	308,653
Operating expenses				
Sales and marketing	39,169	36,403	113,448	109,142
Research and development	18,069	17,789	54,804	48,051
General and administrative	19,703	19,843	63,014	63,071
Restructuring costs	12	86	45	261
Total operating expenses	76,953	74,121	231,311	220,525
Income from operations	$30,008	$30,731	$70,883	$88,128

The analytics market is highly competitive and our results of operations depend on our ability to market and sell offerings that provide customers with greater value than those offered by our competitors. Our success depends on the effectiveness with which we can differentiate our product from both large software vendors that provide products across multiple lines of business, including one or more products that directly compete with our products, and other analytics vendors across large, mid-sized, and small opportunities.

Organizations recently have sought, and we expect may continue to seek, to standardize their various analytics applications around a single software platform. This trend presents both opportunities and challenges for our business. It offers us the opportunity to increase the size of transactions with new customers and to expand the size of our analytics installations with existing customers. On the other hand, it presents the challenge that we may not be able to penetrate accounts that a competitor has penetrated or in which a competitor is the incumbent analytics provider.

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

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

We have undertaken multiple initiatives to address these opportunities and challenges, including:

- release of MicroStrategy 10, which consolidates analytics and mobility in a single unified platform;
- release of our free MicroStrategy Desktop product, which allows for more prospective customers and partners to download our software, and increases public awareness;
- making our free MicroStrategy Desktop product available to existing MicroStrategy Web users, who can seamlessly connect MicroStrategy Desktop to their existing projects, download dashboards from the server to MicroStrategy Desktop, and work locally or offline;
- improved access to MicroStrategy 10 via easy-to-access trial and evaluation versions of products on our website;
- improved access to MicroStrategy Analytics through MicroStrategy Cloud, optimally configured to be scalable and elastic, ready to grow with an enterprise's cloud applications, and built to scale to meet usage spikes from a user's analytics and mobile apps;
- enhancement of our ability to support new enterprise-scale requirements for analytics, where we are currently a technology leader, with a focus on supporting more varied database platforms, providing higher performance, and providing greater ability to manage and administer large-scale analytics operations, such as a massively scalable, in-memory analytics service designed to deliver high performance for complex analytical applications that have the largest data sets and highest user concurrency;

- extension of our technology to provide greater support for the latest trend in self-service analytics, which is often referred to as “governed data discovery” or “agile analytics,” by adding new user interface flows, new visualizations, new exploration features, and new self-service capabilities for the preparation of data;
- enhancement of our mobile application platform for creating and deploying analytics applications to the expanding community of mobile device users; and
- maintenance of a dedicated performance engineering team and conducting research and development focused on providing our customers with the highest levels of performance for analytics applications of all sizes and for security solutions.

As of September 30, 2016, we had a total of 2,120 employees, of whom 1,016 were based in the United States and 1,104 were based internationally. Of our 2,120 employees, 571 were engaged in sales and marketing, 528 in research and development, 704 in

subscription, product support, consulting, and education services, and 317 in finance, administration, and corporate operations. The following table summarizes employee headcount, as of the dates indicated:

	September 30, 2015	December 31, 2015	September 30, 2016
Subscription services	33	37	49
Product support	127	131	162
Consulting	480	467	458
Education	27	28	35
Sales and marketing	507	513	571
Research and development	464	461	528
General and administrative	301	310	317
Total headcount	1,939	1,947	2,120

We lease approximately 214,000 square feet of office space at a location in Northern Virginia that began serving as our corporate headquarters in October 2010. Our lease for this property expires in December 2020. We recognize lease expense on continuing operating leases ratably over the term of the lease.

As discussed in Note 10, Share-based Compensation, to the Consolidated Financial Statements, we have outstanding stock options to purchase shares of our class A common stock under our 2013 Equity Plan. Share-based compensation expense (in thousands) from these stock option awards was recognized in the following operating expense line items in our Consolidated Statements of Operations for the periods indicated:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Sales and marketing	$871	$808	$2,374	$2,022
Research and development	199	359	636	615
General and administrative	2,279	3,379	5,414	9,866
Total share-based compensation expense	$3,349	$4,546	$8,424	$12,503

As of September 30, 2016, we estimate that approximately $31.0 million of additional share-based compensation expense for options granted under the 2013 Equity Plan will be recognized over a remaining weighted average period of 2.3 years.

We base our internal operating expense forecasts on expected revenue trends and strategic objectives. Many of our expenses, such as office leases and certain personnel costs, are relatively fixed. Accordingly, any shortfall in revenue may cause significant variation in our operating results. We therefore believe that quarter-to-quarter comparisons of our operating results may not be a good indication of our future performance.

Non-GAAP Financial Measures

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

Non-GAAP financial measures are subject to material limitations as they are not in accordance with, or a substitute for, measurements prepared in accordance with GAAP. For example, we expect that share-based compensation expense, which is excluded from our non-GAAP financial measure, will continue to be a significant recurring expense over the coming years and is an important part of the compensation provided to certain employees, officers, and directors. Our non-GAAP financial measure is not meant to be considered in isolation and should be read only in conjunction with our Consolidated Financial Statements, which have been prepared in

accordance with GAAP. We rely primarily on such Consolidated Financial Statements to understand, manage, and evaluate our business performance, and use the non-GAAP financial measure only supplementally.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Reconciliation of non-GAAP income from operations:				
Income from operations	$30,008	$30,731	$70,883	$88,128
Share-based compensation expense	3,349	4,546	8,424	12,503
Restructuring costs	12	86	45	261
Non-GAAP income from operations	$33,369	$35,363	$79,352	$100,892

Critical Accounting Policies

Our discussion and analysis of our financial condition and results of operations are based on our Consolidated Financial Statements, which have been prepared in accordance with GAAP.

The preparation of our Consolidated Financial Statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, and equity, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. These estimates, particularly estimates relating to revenue recognition, allowance for doubtful accounts, valuation of property and equipment, litigation and contingencies, valuation of net deferred tax assets, and share-based compensation, have a material impact on our financial statements and are discussed in detail throughout our analysis of the results of operations below. In some cases, changes in accounting estimates are reasonably likely to occur from period to period.

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

We do not have any material ownership interest in any special purpose or other entities that are not wholly owned and/or consolidated into our Consolidated Financial Statements. Additionally, we do not have any material related party transactions.

The section “Critical Accounting Policies” included in Item 7 and the section “Summary of Significant Accounting Policies” (Note 2) included in Item 15 of our Annual Report on Form 10-K for the year ended December 31, 2015 provide a more detailed explanation of the judgments made in these areas and a discussion of our accounting estimates and policies. There have been no significant changes in such estimates and policies since December 31, 2015.

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Impact of Foreign Currency Exchange Rate Fluctuations on Results of Operations

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
International product licenses revenues	$(103)	$(1,857)	$(757)	$(4,663)
International subscription services revenues	(86)	(94)	(166)	(314)
International product support revenues	(678)	(5,302)	(3,293)	(15,714)
International other services revenues	(199)	(1,826)	(738)	(5,911)
Cost of product support revenues	(80)	(168)	(240)	(433)
Cost of other services revenues	(106)	(1,566)	(748)	(5,265)
Sales and marketing expenses	(178)	(2,462)	(1,447)	(6,987)
Research and development expenses	(241)	(69)	(710)	(100)
General and administrative expenses	(403)	(584)	(921)	(1,897)

For example, if there had been no change to foreign currency exchange rates from 2015 to 2016, international product licenses revenues would have been $7.8 million rather than $7.7 million and $28.1 million rather than $27.3 million for the three and nine months ended September 30, 2016, respectively. If there had been no change to foreign currency exchange rates from 2015 to 2016, international product support revenues would have been $29.4 million rather than $28.7 million and $87.2 million rather than $83.9 million for the three and nine months ended September 30, 2016, respectively. If there had been no change to foreign currency exchange rates from 2015 to 2016, sales and marketing expenses would have been $39.3 million rather than $39.2 million and $114.9 million rather than $113.4 million for the three and nine months ended September 30, 2016, respectively.

Results of Operations

Comparison of the three and nine months ended September 30, 2016 and 2015

Revenues

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

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

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2016	2015	% Change	2016	2015	% Change
Product Licenses and Subscription Services Revenues:						
Product Licenses						
Domestic	$21,981	$14,851	48.0 %	$48,148	$48,762	-1.3 %
International	7,651	12,660	-39.6 %	27,342	28,872	-5.3 %
Total product licenses revenues	29,632	27,511	7.7 %	75,490	77,634	-2.8 %
Subscription Services						
Domestic	6,587	5,702	15.5 %	19,757	17,946	10.1 %
International	1,052	844	24.6 %	3,018	2,339	29.0 %
Total subscription services revenues	7,639	6,546	16.7 %	22,775	20,285	12.3 %
Total product licenses and subscription services revenues	$37,271	$34,057	9.4 %	$98,265	$97,919	0.4 %

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Product Licenses Transactions with Recognized Licenses Revenue in the Applicable Period:				
More than $1.0 million in licenses revenue recognized	4	4	7	11
Between $0.5 million and $1.0 million in licenses revenue recognized	4	8	17	20
Total	8	12	24	31
Domestic:				
More than $1.0 million in licenses revenue recognized	4	2	6	9
Between $0.5 million and $1.0 million in licenses revenue recognized	3	4	11	13
Total	7	6	17	22
International:				
More than $1.0 million in licenses revenue recognized	0	2	1	2
Between $0.5 million and $1.0 million in licenses revenue recognized	1	4	6	7
Total	1	6	7	9

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

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2016	2015	% Change	2016	2015	% Change
Product Licenses Revenue Recognized in the Applicable Period:						
More than $1.0 million in licenses revenue recognized	$7,910	$6,053	30.7 %	$12,182	$18,238	-33.2 %
Between $0.5 million and $1.0 million in licenses revenue recognized	2,189	5,856	-62.6 %	10,288	14,454	-28.8 %

Less than $0.5 million in licenses revenue recognized	19,533	15,602	25.2	%	53,020	44,942	18.0	%
Total	29,632	27,511	7.7	%	75,490	77,634	-2.8	%
Domestic:								
More than $1.0 million in licenses revenue recognized	7,910	2,648	198.7	%	10,788	14,833	-27.3	%
Between $0.5 million and $1.0 million in licenses revenue recognized	1,687	3,030	-44.3	%	6,642	9,718	-31.7	%
Less than $0.5 million in licenses revenue recognized	12,384	9,173	35.0	%	30,718	24,211	26.9	%
Total	21,981	14,851	48.0	%	48,148	48,762	-1.3	%
International:								
More than $1.0 million in licenses revenue recognized	0	3,405	-100.0	%	1,394	3,405	-59.1	%
Between $0.5 million and $1.0 million in licenses revenue recognized	502	2,826	-82.2	%	3,646	4,736	-23.0	%
Less than $0.5 million in licenses revenue recognized	7,149	6,429	11.2	%	22,302	20,731	7.6	%
Total	$7,651	$12,660	-39.6	%	$27,342	$28,872	-5.3	%

Product licenses revenues increased $2.1 million for the three months ended September 30, 2016, as compared to the same period in the prior year. For the three months ended September 30, 2016 and 2015, product licenses transactions with more than $0.5 million in recognized revenue represented 34.1% and 43.3%, respectively, of our product licenses revenues. Product licenses revenues decreased $2.1 million for the nine months ended September 30, 2016, as compared to the same period in the prior year. For the nine months ended September 30, 2016, our top three product licenses transactions totaled $6.6 million in recognized revenue, or 8.7% of total product licenses revenues, compared to $6.5 million, or 8.4% of total product licenses revenues, for the nine months ended September 30, 2015.

Domestic product licenses revenues. Domestic product licenses revenues increased $7.1 million for the three months ended September 30, 2016, as compared to the same period in the prior year, primarily due to an increase in the number and average deal size of transactions with more than $1.0 million in recognized revenue and an increase in the number of transactions with less than $0.5 million in recognized revenue, partially offset by a decrease in the number and average deal size of transactions with recognized revenue between $0.5 million and $1.0 million.

Domestic product licenses revenues decreased $0.6 million for the nine months ended September 30, 2016, as compared to the same period in the prior year, primarily due to a decrease in the number of transactions with more than $1.0 million in recognized revenue and a decrease in the number and average deal size of transactions with recognized revenue between $0.5 million and $1.0 million, partially offset by an increase in the number of transactions with less than $0.5 million in recognized revenue.

International product licenses revenues. International product licenses revenues decreased $5.0 million for the three months ended September 30, 2016, as compared to the same period in the prior year, primarily due to a decrease in the number of transactions with more than $0.5 million in recognized revenue, partially offset by an increase in the number of transactions with less than $0.5 million in recognized revenue.

International product licenses revenues decreased $1.5 million for the nine months ended September 30, 2016, as compared to the same period in the prior year, primarily due to a decrease in the number of transactions with more than $0.5 million in recognized revenue, partially offset by an increase in the number of transactions with less than $0.5 million in recognized revenue.

Subscription services revenues. Subscription services revenues are derived primarily from our cloud services offerings that are recognized on a subscription basis over the service period of the contract. Subscription services revenues increased $1.1 million and $2.5 million for the three and nine months ended September 30, 2016, respectively, as compared to the same periods in the prior year, primarily due to an increase in new subscription services customers and an increase in the use of subscription services by existing customers.

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

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2016	2015	% Change	2016	2015	% Change
Product Support Revenues:						
Domestic	$43,781	$43,071	1.6 %	$128,486	$129,225	-0.6 %
International	28,679	28,321	1.3 %	83,922	82,219	2.1 %
Total product support revenues	$72,460	$71,392	1.5 %	$212,408	$211,444	0.5 %

Product support revenues are derived from providing technical software support and software updates and upgrades to customers. Product support revenues are recognized ratably over the term of the contract, which is generally one year. Product support revenues increased $1.1 million for the three months ended September 30, 2016, as compared to the same period in the prior year, primarily due to new product and premium support contracts domestically, partially offset by a $0.7 million unfavorable foreign currency exchange impact. Product support revenues increased $1.0 million for the nine months ended September 30, 2016, as compared to the same period in the prior year,

primarily due to new product and premium support contracts in the international regions, partially offset by a $3.3 million unfavorable foreign currency exchange impact. See “Impact of Foreign Currency Exchange Rate Fluctuations on Results of Operations” for further information on the negative foreign currency exchange impact on our results of operations for the three and nine months ended September 30, 2016.

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

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2016	2015	% Change	2016	2015	% Change
Other Services Revenues:						
Consulting						
Domestic	$8,324	$12,826	-35.1 %	$27,154	$42,248	-35.7 %
International	9,345	9,192	1.7 %	27,143	28,227	-3.8 %
Total consulting revenues	17,669	22,018	-19.8 %	54,297	70,475	-23.0 %
Education	2,496	2,069	20.6 %	7,083	6,509	8.8 %
Total other services revenues	$20,165	$24,087	-16.3 %	$61,380	$76,984	-20.3 %

Consulting revenues. Consulting revenues are derived from helping customers plan and execute the deployment of our software. Consulting revenues decreased $4.3 million and $16.2 million for the three and nine months ended September 30, 2016, as compared to the same periods in the prior year, primarily due to a decrease in billable hours worldwide, partially offset by an increase in the average bill rate.

Education revenues. Education revenues are derived from the education and training that we provide to our customers to enhance their ability to fully utilize the features and functionality of our software. These offerings include self-tutorials, custom course development, joint training with customers' internal staff, and standard course offerings, with pricing dependent on the specific offering delivered. Education revenues increased $0.4 million and $0.6 million for the three and nine months ended September 30, 2016, as compared to the same periods in the prior year, primarily due to an increase in overall contract values.

Costs and Expenses

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

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2016	2015	% Change	2016	2015	% Change
Cost of Revenues:						
Product licenses and subscription services:						
Product licenses	$2,370	$2,680	-11.6 %	$6,828	$5,895	15.8 %
Subscription services	3,219	3,075	4.7 %	9,667	9,800	-1.4 %
Total product licenses and subscription services	5,589	5,755	-2.9 %	16,495	15,695	5.1 %
Product support	3,959	3,174	24.7 %	10,919	9,734	12.2 %

Other services:							
Consulting	11,909	14,723	-19.1 %	38,309	49,526	-22.6 %	
Education	1,478	1,032	43.2 %	4,136	2,739	51.0 %	
Total other services	13,387	15,755	-15.0 %	42,445	52,265	-18.8 %	
Total cost of revenues	$22,935	$24,684	-7.1 %	$69,859	$77,694	-10.1 %	

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

Cost of product licenses revenues decreased $0.3 million for the three months ended September 30, 2016, as compared to the same period in the prior year, due to a $0.5 million decrease in amortization of capitalized software development costs related to MicroStrategy 9.3, which became fully amortized in September 2015, partially offset by a $0.2 million increase in referral fees related to channel partners. Cost of product licenses revenues increased $0.9 million for the nine months ended September 30, 2016, as compared to the same period in the prior year, due to a $2.5 million increase in amortization of capitalized software development costs related to MicroStrategy 10, which was made generally available in June 2015, and a $0.3 million increase in referral fees related to channel partners, partially offset by a $1.9 million decrease in amortization of capitalized software development costs related to MicroStrategy 9.3, which became fully amortized in September 2015. We expect to amortize the remaining balance of our products'

capitalized software development costs as of September 30, 2016 ratably over the applicable remaining amortization periods as follows:

	Capitalized Software Development Costs, Net, as of September 30, 2016 (in thousands)	Remaining Amortization Period (in months)
MicroStrategy 10	9,997	20
Total capitalized software development costs, net	$ 9,997	

Cost of subscription services revenues. Cost of subscription services revenues consists of equipment, facility and other related support costs, and personnel and related overhead costs. Cost of subscription services revenues did not materially change for the three months ended September 30, 2016, as compared to the same period in the prior year, primarily due to a $0.8 million increase in third-party hosting service provider fees and a $0.2 million increase in compensation and related costs due to an increase in staffing levels, partially offset by a $0.7 million decrease in equipment, facility, and other related support costs. Subscription services headcount increased 48.5% to 49 at September 30, 2016 from 33 at September 30, 2015.

Cost of subscription services revenues did not materially change for the nine months ended September 30, 2016, as compared to the same period in the prior year, due to a $2.3 million increase in third-party hosting service provider fees, partially offset by a $2.0 million decrease in equipment, facility, and other related support costs and a $0.3 million decrease in compensation and related costs due to a decrease in average staffing levels.

Cost of product support revenues. Cost of product support revenues consists of product support personnel and related overhead costs. Cost of product support revenues increased $0.8 million for the three months ended September 30, 2016, as compared to the same period in the prior year, primarily due to a $0.7 million increase in compensation and related costs due to an increase in staffing levels. Product support headcount increased 27.6% to 162 at September 30, 2016 from 127 at September 30, 2015.

Cost of product support revenues increased $1.2 million for the nine months ended September 30, 2016, as compared to the same period in the prior year, primarily due to a $0.8 million increase in compensation and related costs due to an increase in staffing levels and a $0.3 million increase in subcontractor costs.

Cost of consulting revenues. Cost of consulting revenues consists of personnel and related overhead costs. Cost of consulting revenues decreased $2.8 million for the three months ended September 30, 2016, as compared to the same period in the prior year, primarily due to a $1.7 million decrease in compensation and related costs due to a decrease in staffing levels, a $0.6 million decrease in subcontractor costs, a $0.4 million decrease in travel and entertainment expenditures, and a $0.2 million decrease in facility and other related support costs. Consulting headcount decreased 4.6% to 458 at September 30, 2016 from 480 at September 30, 2015.

Cost of consulting revenues decreased $11.2 million for the nine months ended September 30, 2016, as compared to the same period in the prior year, due to a $6.3 million decrease in compensation and related costs due to a decrease in staffing levels, a $3.0 million decrease in subcontractor costs, a $1.3 million decrease in travel and entertainment expenditures, and a $0.9 million decrease in facility and other related support costs, partially offset by a $0.3 million increase in recruiting costs.

Cost of education revenues. Cost of education revenues consists of personnel and related overhead costs. Cost of education revenues increased $0.4 million for the three months ended September 30, 2016, as compared to the same period in the prior year, due to a $0.2 million increase in subcontractor costs and a $0.2 million increase in facility and other related support costs. Education headcount increased 29.6% to 35 at September 30, 2016 from 27 at September 30, 2015.

Cost of education revenues increased $1.4 million for the nine months ended September 30, 2016, as compared to the same period in the prior year, primarily due to a $0.6 million increase in compensation and related costs due to an increase in staffing levels, a $0.5 million increase in facility and other related support costs, and a $0.2 million increase in subcontractor costs.

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

	Three Months Ended September 30,		%	Nine Months Ended September 30,		%
	2016	2015	Change	2016	2015	Change
Sales and marketing expenses	$39,169	$36,403	7.6 %	$113,448	$109,142	3.9 %

Sales and marketing expenses increased $2.8 million for the three months ended September 30, 2016, as compared to the same period in the prior year, primarily due to a $2.0 million increase in compensation and related costs due to an increase in staffing levels, a $0.4 million increase in marketing and advertising costs, and a $0.3 million increase in facility and other related support costs. Included in the above sales and marketing components is an aggregate $0.2 million favorable foreign currency exchange impact. Sales and marketing headcount increased 12.6% to 571 at September 30, 2016 from 507 at September 30, 2015.

As a result of the grant of stock options under the 2013 Equity Plan, we expect that share-based compensation expense, a portion of which is recognized as sales and marketing expense, will continue to be a recurring expense. As of September 30, 2016, we estimate that approximately $9.1 million of additional share-based compensation expense will be recognized as sales and marketing expense over a remaining weighted average period of 2.8 years. See "Overview" and Note 10, Share-based Compensation, to the Consolidated Financial Statements for further information regarding the 2013 Equity Plan and related share-based compensation expense.

Sales and marketing expenses increased $4.3 million for the nine months ended September 30, 2016, as compared to the same period in the prior year, due to a $1.6 million increase in marketing and advertising costs, a $0.9 million increase in compensation and related costs due to an increase in staffing levels, a $0.6 million increase in recruiting costs, a $0.5 million increase in consulting and advisory costs, a $0.4 million increase in share-based compensation expense related to the grant of stock options under the 2013 Equity Plan, and a $0.3 million increase in travel and entertainment expenditures. Included in the above sales and marketing components is an aggregate $1.4 million favorable foreign currency exchange impact.

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

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2016	2015	% Change	2016	2015	% Change
General and administrative expenses	$19,703	$19,843	-0.7 %	$63,014	$63,071	-0.1 %

General and administrative expenses did not materially change for the three months ended September 30, 2016, as compared to the same period in the prior year, primarily due to a $1.1 million net decrease in share-based compensation expense related to the grant of stock options under the 2013 Equity Plan, a $0.7 million decrease in compensation and related costs primarily due to a reduction in compensation expenses associated with the two executives who departed as part of the executive management reorganization in January 2016, and a $0.2 million decrease in facility and other related support costs, partially offset by a $0.8 million increase in consulting and advisory costs, a $0.6 million increase in severance costs associated with the streamlining of our finance organization, a $0.3 million increase in travel and entertainment expenditures, and a $0.2 million increase in other aircraft-related operating costs. The $1.1 million decrease in share-based compensation expense is due to quarterly share-based compensation no longer being recognized for the two executives who departed as part of the executive management reorganization in January 2016. General and administrative headcount increased 5.3% to 317 at September 30, 2016

from 301 at September 30, 2015.

As a result of the grant of stock options under the 2013 Equity Plan, we expect that share-based compensation expense, a significant portion of which is recognized as general and administrative expense, will continue to be a significant recurring expense. As of September 30, 2016, we estimate that approximately $18.1 million of additional share-based compensation expense will be recognized as general and administrative expense over a remaining weighted average period of 2.1 years. See “Overview” and Note 10, Share-based Compensation, to the Consolidated Financial Statements for further information regarding the 2013 Equity Plan and related share-based compensation expense.

General and administrative expenses did not materially change for the nine months ended September 30, 2016, as compared to the same period in the prior year, primarily due to a $4.5 million net decrease in share-based compensation expense related to the grant of stock options under the 2013 Equity Plan, a $3.2 million decrease in compensation and related costs primarily due to a reduction in compensation expenses associated with the two executives who departed as part of the executive management reorganization in January 2016, a $0.6 million decrease in facility and other related support costs, a $0.2 million decrease in non-income taxes, and a $0.2 million decrease in bad debt expense, partially offset by a $3.4 million accrual for potential future payments in connection with the departure from the Company of two executives in connection with the executive management reorganization in January 2016, a $1.6 million increase in severance costs associated with the streamlining of our finance organization, a $1.6 million increase in consulting and advisory costs, a $0.8 million increase in travel and entertainment expenditures, a $0.7 million increase in other aircraft-related operating costs, and a $0.5 million increase in recruiting costs. The $4.5 million decrease in share-based compensation expense is primarily due to a $1.6 million reversal of previously recorded share-based compensation expense associated with the stock

options of the two executives who departed as part of the executive management reorganization in January 2016 that were unvested as of their departure dates, and a decrease of $3.2 million in share-based compensation no longer being recognized due to their departures.

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

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2016	2015	% Change	2016	2015	% Change
Gross research and development expenses before capitalized software development costs	$18,069	$17,789	1.6 %	$54,804	$57,649	-4.9 %
Capitalized software development costs	0	0	n/a	0	(9,598)	-100.0 %
Total research and development expenses	$18,069	$17,789	1.6 %	$54,804	$48,051	14.1 %
Amortization of capitalized software development costs included in cost of product licenses revenues	$1,952	$2,496	-21.8 %	$5,858	$5,260	11.4 %

Research and development expenses, before capitalization of software development costs, increased $0.3 million for the three months ended September 30, 2016, as compared to the same period in the prior year, primarily due to a $0.8 million increase in compensation and related costs due to an increase in staffing levels, partially offset by a $0.4 million decrease in recruiting costs and a $0.2 million decrease in share-based compensation expense related to the grant of stock options under the 2013 Equity Plan. Research and development headcount increased 13.8% to 528 at September 30, 2016 from 464 at September 30, 2015.

As a result of the grant of stock options under the 2013 Equity Plan, we expect that share-based compensation expense, a portion of which is recognized as research and development expense, will continue to be a recurring expense. As of September 30, 2016, we estimate that approximately $3.8 million of additional share-based compensation expense will be recognized as research and development expense over a remaining weighted average period of 2.7 years. See “Overview” and Note 10, Share-based Compensation, to the Consolidated Financial Statements for further information regarding the 2013 Equity Plan and related share-based compensation expense.

Research and development expenses, before capitalization of software development costs, decreased $2.8 million for the nine months ended September 30, 2016, as compared to the same period in the prior year, due to a $1.9 million decrease in compensation and related costs due to a decrease in average staffing levels, a $0.6 million decrease in facility and other related support costs, and a $0.3 million decrease in consulting and advisory costs.

Other (Expense) Income, Net

Other (expense) income, net is comprised primarily of foreign currency transaction gains and losses and realized and unrealized gains and losses on our foreign currency forward contracts. For the three months ended September 30, 2016, other expense, net, of $0.5 million was comprised primarily of $0.6 million in foreign currency transaction net

losses, arising mainly from the revaluation of outstanding balances denominated in the British Pound, which has declined in value as compared to the U.S. dollar and other currencies. For the three months ended September 30, 2015, other income, net, of $0.8 million was comprised primarily of $0.4 million in foreign currency transaction net gains, arising mainly from the revaluation of U.S. dollar-denominated cash balances held at international locations, and the reclassification of a $0.3 million foreign currency translation gain from other comprehensive income as a result of the completion of the liquidation of one of our foreign subsidiaries as part of our 2014 restructuring plan.

For the nine months ended September 30, 2016, other expense, net, of $0.4 million was comprised primarily of $0.5 million in foreign currency transaction net losses, arising mainly from the revaluation of outstanding balances denominated in the British Pound, which has declined in value as compared to the U.S. dollar and other currencies. For the nine months ended September 30, 2015, other income, net, of $2.6 million was comprised primarily of $1.4 million in foreign currency transaction net gains, arising mainly from the revaluation of U.S. dollar-denominated cash balances held at international locations, $0.5 million in net realized and unrealized gains from the settlement of certain foreign currency forward contracts, and the reclassification of a $0.3 million foreign currency translation gain from other comprehensive income as a result of the completion of the liquidation of one of our foreign subsidiaries as part of our 2014 restructuring plan.

Provision for Income Taxes

We have estimated an annual effective tax rate for the full fiscal year 2016 and applied that rate to the income before income taxes in determining the provision for income taxes for the nine months ended September 30, 2016. We also record discrete items in each respective period as appropriate. The estimated effective tax rate is subject to fluctuation based on the level and mix of earnings and losses by tax jurisdiction, foreign tax rate differentials, and the relative impact of permanent book to tax differences (e.g., non-deductible expenses). Each quarter, a cumulative adjustment is recorded for any fluctuations in the estimated annual effective tax rate as compared to the prior quarter. As a result of these factors, and due to potential changes in our period-to-period results, fluctuations in our effective tax rate and respective tax provisions or benefits may occur.

For the nine months ended September 30, 2016, we recorded a provision for income taxes of $12.2 million that resulted in an effective tax rate of 16.9%, as compared to a provision for income taxes of $24.0 million that resulted in an effective tax rate of 26.5% for the nine months ended September 30, 2015. The change in the effective tax rate in 2016 is mainly due to the change in the expected proportion of U.S. versus foreign income and certain discrete tax benefits recorded in the third quarter of 2016. The discrete tax benefits are comprised of a release of the valuation allowance against certain foreign tax credit deferred tax assets, the release of the liability for unrecognized tax benefits upon the settlement of the tax examination in the United States for tax years 2011 and 2012, and the change in an estimated amount of a provision as a result of additional analysis of certain foreign tax laws.

As of September 30, 2016, we had no U.S. federal NOL carryforwards and estimated that we had $0.7 million of foreign NOL carryforwards. As of September 30, 2016, we estimated that we had foreign NOL carryforwards, other temporary differences and carryforwards, and credits that resulted in deferred tax assets, net of valuation allowances and deferred tax liabilities, of $11.0 million. As of September 30, 2016, we had a valuation allowance of $1.0 million primarily related to certain foreign tax credit carryforwards that, in our present estimation, more likely than not will not be realized.

If we are unable to sustain profitability in future periods, we may be required to increase the valuation allowance against our deferred tax assets, which could result in a charge that would materially adversely affect net income in the period in which the charge is incurred. We will continue to regularly assess the realizability of deferred tax assets.

Deferred Revenue and Advance Payments

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

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

	September 30, 2016	December 31, 2015	September 30, 2015
Current:			
Deferred product licenses revenue	$ 11,401	$ 13,506	$ 13,155
Deferred subscription services revenue	12,820	15,763	11,172
Deferred product support revenue	140,593	158,738	135,999
Deferred other services revenue	9,226	9,149	6,794
Gross current deferred revenue and advance payments	174,040	197,156	167,120
Less: unpaid deferred revenue	(58,414)	(96,461)	(51,616)
Net current deferred revenue and advance payments	$ 115,626	$ 100,695	$ 115,504
Non-current:			
Deferred product licenses revenue	$ 9,918	$ 5,397	$ 6,344
Deferred subscription services revenue	1,594	2,138	808
Deferred product support revenue	6,394	7,607	6,962
Deferred other services revenue	763	795	1,166
Gross non-current deferred revenue and advance payments	18,669	15,937	15,280
Less: unpaid deferred revenue	(3,518)	(6,942)	(4,983)
Net non-current deferred revenue and advance payments	$ 15,151	$ 8,995	$ 10,297
Total current and non-current:			
Deferred product licenses revenue	$ 21,319	$ 18,903	$ 19,499
Deferred subscription services revenue	14,414	17,901	11,980
Deferred product support revenue	146,987	166,345	142,961
Deferred other services revenue	9,989	9,944	7,960
Gross current and non-current deferred revenue and advance payments	192,709	213,093	182,400
Less: unpaid deferred revenue	(61,932)	(103,403)	(56,599)
Net current and non-current deferred revenue and advance payments	$ 130,777	$ 109,690	$ 125,801

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

Total gross deferred revenue and advance payments decreased $20.4 million as of September 30, 2016, as compared to December 31, 2015, primarily due to the recognition of previously deferred product support and subscription services, partially offset by an increase in deferred revenue from new product licenses contracts. Total gross deferred revenue and advance payments increased $10.3 million as of September 30, 2016, as compared to September 30, 2015, primarily due to an increase in deferred revenue from new product support, subscription services, other services, and product licenses contracts.

We expect to recognize approximately $174.0 million of deferred revenue and advance payments over the next 12 months. However, the timing and ultimate recognition of our deferred revenue and advance payments depend on our performance of various service obligations, and the amount of deferred revenue and advance payments at any date should not be considered indicative of revenues for any succeeding period.

Liquidity and Capital Resources

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

As of September 30, 2016 and December 31, 2015, the amount of cash and cash equivalents and short-term investments held by U.S. entities were $261.0 million and $219.3 million, respectively, and by non-U.S. entities were $317.9 million and $266.4 million, respectively. We earn a significant amount of our revenues outside the United States and, except for Subpart F deemed dividends, we intend to indefinitely reinvest undistributed earnings of all of our non-U.S. entities. We do not anticipate needing to repatriate the cash or cash equivalents held by non-U.S. entities to the United States to finance our U.S. operations. However, if we were to elect to repatriate these amounts, we would generate U.S. taxable income to the extent of our undistributed foreign earnings, which amounted to $252.9 million at December 31, 2015. Although the tax impact of repatriating these earnings is difficult to determine and our

effective tax rate could increase as a result of any such repatriation, we would not expect the maximum effective tax rate that would be applicable to such repatriation to exceed the U.S. statutory rate of 35.0%, after considering applicable foreign tax credits.

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

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

	Nine Months Ended September 30,		% Change
	2016	2015	
Net cash provided by operating activities	$94,036	$123,443	-23.8 %
Net cash used in investing activities	$(20,896)	$(40,870)	-48.9 %
Net cash (used in) provided by financing activities	$(1,540)	$4,972	-131.0 %

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

Net cash provided by operating activities was $94.0 million and $123.4 million for the nine months ended September 30, 2016 and 2015, respectively. The decrease in net cash provided by operating activities during the nine months ended September 30, 2016, as compared to the same period in the prior year, was due to a $23.9 million decrease from changes in non-cash items, and a $7.0 million decrease in net income, offset by a $1.5 million increase from changes in operating assets and liabilities. Non-cash items consist of depreciation and amortization, bad debt expense, unrealized net loss on foreign currency forward contracts, the non-cash portion of adjustments to accrued restructuring costs, deferred taxes, release of liabilities for unrecognized tax benefits, share-based compensation expense, excess tax benefits from share-based compensation arrangements, and reclassification of foreign currency translation adjustments as a result of the completion of the liquidation of one of our foreign subsidiaries.

Net cash used in investing activities. The changes in net cash used in investing activities relate to purchases and redemptions of short-term investments, expenditures on property and equipment, capitalized software development costs, and changes in restricted cash. Net cash used in investing activities was $20.9 million and $40.9 million for the nine months ended September 30, 2016 and 2015, respectively. The decrease in net cash used in investing activities for the nine months ended September 30, 2016, as compared to the same period in the prior year, was due to a $51.1 million decrease in purchases of short-term investments, a $9.6 million decrease in capitalized software development costs, and a $1.8 million decrease in purchases of property and equipment, partially offset by a $42.5 million decrease in proceeds from the redemption of short-term investments.

Net cash (used in) provided by financing activities. The changes in net cash used in financing activities relate to the exercise of stock options under the 2013 Equity Plan, excess tax benefits from share-based compensation

arrangements, and payments on capital lease and other financing arrangements. Net cash used in financing activities was $1.5 million for the nine months ended September 30, 2016. Net cash provided by financing activities was $5.0 million for the nine months ended September 30, 2015. The increase in net cash used in financing activities for the nine months ended September 30, 2016, as compared to the same period in the prior year, was due to a $4.3 million decrease in proceeds from the exercise of stock options under the 2013 Equity Plan and a $3.7 million payment to tax authorities for shares withheld for taxes related to the net exercise of a stock option under the 2013 Equity Plan, offset by a $1.3 million decrease in payments on capital lease and other financing arrangements and a $0.2 million increase in excess tax benefits from share-based compensation arrangements.

Contractual obligations. As disclosed in Note 7, Commitments and Contingencies, to the Consolidated Financial Statements, we lease office space and computer and other equipment under operating lease agreements. We also lease certain computer and other equipment under capital lease agreements and license certain software under other financing arrangements. Under the lease agreements, in addition to base rent, we are generally responsible for certain taxes, utilities and maintenance costs, and other fees; and several leases include options for renewal or purchase. The following table shows future minimum rent payments under noncancellable operating and capital leases and agreements with initial terms of greater than one year, net of total future minimum rent payments to be received under noncancellable sublease agreements (in thousands), based on the expected due dates of the various installments as of September 30, 2016:

	Payments due by period ended September 30,				
	Total	2017	2018-2019	2020-2021	Thereafter
Contractual Obligations:					
Operating leases	$89,704	$21,025	$ 38,120	$ 24,476	$ 6,083
Capital leases and other financing arrangements	2,214	1,108	1,106	0	0
Total	$91,918	$22,133	$ 39,226	$ 24,476	$ 6,083

Unrecognized tax benefits. As of September 30, 2016, we had $3.4 million of total gross unrecognized tax benefits, including interest accrued, recorded in other long-term liabilities. The timing of any payments that could result from these unrecognized tax benefits will depend on a number of factors, and accordingly the amount and period of any future payments cannot be estimated. We do not expect a significant tax payment related to these obligations during 2016.

Off-balance sheet arrangements. As of September 30, 2016, we did not have any off-balance sheet arrangements that had or were reasonably likely to have a current or future material impact on our financial condition, revenues or expenses, results of operations, liquidity, capital expenditures, or capital resources.

Recent Accounting Standards

In May 2014, the FASB issued Accounting Standards Update No. 2014-09, Revenue from Contracts with Customers (Topic 606) (“ASU 2014-09”), which supersedes nearly all existing revenue recognition guidance. The standard’s core principle is that an entity should recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The standard creates a five-step model to achieve its core principle: (i) identify the contract(s) with a customer; (ii) identify the performance obligations in the contract; (iii) determine the transaction price; (iv) allocate the transaction price to the separate performance obligations in the contract; and (v) recognize revenue when (or as) the entity satisfies a performance obligation. In addition, entities must disclose sufficient information to enable users of financial statements to understand the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. Qualitative and quantitative disclosures are required about: (i) the entity’s contracts with customers; (ii) the significant judgments, and changes in judgments, made in applying the guidance to those contracts; and (iii) any assets recognized from the costs to obtain or fulfill a contract with a customer. In August 2015, the FASB issued ASU 2015-14, Revenue from Contracts with Customers (Topic 606) – Deferral of the Effective Date, which defers the effective date of ASU 2014-09 to interim and annual periods beginning January 1, 2018. The standard allows entities to apply the standard retrospectively to each prior reporting period presented (“full retrospective adoption”) or retrospectively with the cumulative effect of initially applying the standard recognized at the date of initial application (“modified retrospective adoption”). We are currently evaluating the impact of this

guidance on our consolidated financial position, results of operations, and cash flows.

In February 2016, the FASB issued Accounting Standards Update No. 2016-02, Leases (Topic 842) ("ASU 2016-02"), which requires lease assets and lease liabilities be recognized for all leases, in addition to the disclosure of key information to enable users of financial statements to assess the amount, timing, and uncertainty of cash flows arising from an entity's leasing arrangements. ASU 2016-02 defines a lease as a contract, or part of a contract, that conveys both (i) the right to obtain economic benefits from and (ii) direct the use of an identified asset for a period of time in exchange for consideration. Under ASU 2016-02, leases are classified as either finance or operating leases. For finance leases, a lessee shall recognize in profit or loss the amortization of the lease asset and interest on the lease liability. For operating leases, a lessee shall recognize in profit or loss a single lease cost, calculated so that the remaining cost of the lease is allocated over the remaining lease term, generally on a straight-line basis. ASU 2016-02 requires the recognition and measurement of leases at the beginning of the earliest period presented using a modified retrospective approach and is effective for interim and annual periods beginning January 1, 2019. Early adoption is permitted. We are currently evaluating the impact of this guidance on our consolidated financial position, results of operations, and cash flows.

In March 2016, the FASB issued Accounting Standards Update No. 2016-09, Compensation – Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting ("ASU 2016-09"), to simplify certain aspects of accounting for share-based payment transactions. Under ASU 2016-09, all excess tax benefits should be recognized as income tax expense or benefit in the

income statement, regardless of whether the benefit reduces taxes payable in the current period. The excess tax benefits will be combined with other income tax cash flows within operating activities in the statement of cash flows. In addition, excess tax benefits or tax deficiencies will no longer be included in the calculation of assumed proceeds under the treasury stock method of computing diluted earnings per share. ASU 2016-09 also allows companies to make an accounting policy election to either estimate the number of awards expected to vest or to account for forfeitures as they occur, when accruing share-based compensation expense. Lastly, ASU 2016-09 permits employers to withhold up to the employee's maximum statutory tax rate in applicable jurisdictions and still qualify for the exception to liability classification. Cash paid by an employer when directly withholding shares for tax-withholding purposes should be classified as a financing activity in the statement of cash flows. ASU 2016-09 is effective for interim and annual periods beginning January 1, 2017. Early adoption is permitted, however an entity that elects early adoption must adopt all of the amendments in the same period. We expect to adopt this guidance on January 1, 2017, and are currently evaluating the impact of this guidance and its various transition methods on our consolidated financial position, results of operations, and cash flows.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

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

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

Interest Rate Risk. We face exposure to changes in interest rates primarily relating to our investments. We generally invest our excess cash in short-term, highly-rated, fixed-rate financial instruments. These fixed-rate instruments are subject to interest rate risk and may fall in value if interest rates increase. We do not hold or invest in these fixed-rate instruments for trading purposes or speculation. As of September 30, 2016, we held approximately $213.3 million of investments in U.S. Treasury securities and certificates of deposit with stated maturity dates between three months and one year from the purchase date, and we intend to hold these investments until maturity.

Foreign Currency Risk. We conduct a significant portion of our business in currencies other than the U.S. dollar, the currency in which we report our Consolidated Financial Statements. International revenues accounted for 36.5% and 39.9% of our total revenues for the three months ended September 30, 2016 and 2015, respectively, and 38.6% and 37.2% of our total revenues for the nine months ended September 30, 2016 and 2015, respectively. We anticipate that international revenues will continue to account for a significant portion of our total revenues. The functional currency of each of our foreign subsidiaries is the local currency.

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

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

We cannot predict the effect of exchange rate fluctuations upon our future results. We attempt to minimize our foreign currency risk by converting our excess foreign currency held in foreign jurisdictions to U.S. dollar-denominated cash and investment accounts. Although we were not party to any foreign currency forward

contracts as of September 30, 2016, from time to time we have entered into foreign currency forward contracts to hedge certain risks associated with foreign currency exchange rate exposure, and may do so again in the future. We manage the use of foreign exchange derivative instruments centrally, and we do not hold or enter into derivative financial instruments for trading purposes or speculation. See Note 3, Fair Value Measurements, to the Consolidated Financial Statements for further information on foreign currency forward contracts. We cannot be certain that any future hedging techniques will be successful or that our business, results of operations, financial condition, and cash flows will not be materially adversely affected by exchange rate fluctuations.

As of September 30, 2016 and December 31, 2015, a 10% adverse change in foreign currency exchange rates versus the U.S. dollar would have decreased our aggregate reported cash and cash equivalents and short-term investments by 0.2% and 0.3%, respectively. The exposure to an adverse change in foreign currency rates as of September 30, 2016 decreased primarily due to a decrease of cash balances in our non-U.S. dollar-based bank accounts as compared to December 31, 2015. If average exchange rates during the nine months ended September 30, 2016 had changed unfavorably by 10%, our revenues for the nine months ended September 30, 2016 would have decreased by 3.5%. During the nine months ended September 30, 2016, our revenues were lower by 1.3% as a result of a 2.6% unfavorable change in weighted average exchange rates, as compared to the same period in the prior year.

Item 4. Controls and Procedures

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

Changes in Internal Controls. During the third quarter of 2016, we began implementing a plan to transform our worldwide finance and accounting organization. Previously, our finance and accounting activities relating to each of the countries where we operate were decentralized, and conducted by personnel based within each respective country. The transformation will result in the consolidation of our worldwide finance and accounting functions into three geographically based centers of excellence. We expect this transformation to be substantially completed by the end of the first quarter of 2017. While the nature and operation of our key transaction-level controls will not materially change as a result of the transformation, the personnel executing the controls and the locations where the controls are performed have changed and will continue to change as we complete the implementation of this transformation. We believe that we have maintained appropriate internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the fiscal quarter ended September 30, 2016 and that our internal control over financial reporting has not been, and is not reasonably likely to be, materially affected by the finance and accounting transformation.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

In December 2011, DataTern, Inc. (“DataTern”) filed a complaint for patent infringement against the Company in the United States District Court for the District of Massachusetts (the “District Court”). The complaint alleged that the Company infringes U.S. Patent No. 6,101,502 (the “’502 Patent”), allegedly owned by DataTern, by making, selling, or offering for sale several of the Company’s products and services including MicroStrategy 9, MicroStrategy Intelligence Server, MicroStrategy Business Intelligence Platform, MicroStrategy Cloud Personal, and other MicroStrategy applications for creating or using data mining, dashboards, business analytics, data storage and warehousing, and Web hosting support. The complaint accused the Company of willful infringement and sought an unspecified amount of damages, an award of attorneys’ fees, and preliminary and permanent injunctive relief. In light of a judgment in a separate action involving DataTern in another jurisdiction, in February 2013, MicroStrategy and DataTern filed motions for summary judgment of non-infringement and the District Court entered summary judgment against DataTern. In March 2013, DataTern filed a notice of appeal with the United States Court of Appeals for the Federal Circuit (the “Federal Circuit”). In December 2014, the Federal Circuit issued an opinion vacating the District Court’s summary judgment, stating that the claim construction on which the summary judgment was based was incorrect. A claim construction hearing was held in September 2016, the outcome of which is still pending. We have received indemnification requests from certain of our channel partners and customers who were sued by DataTern in the District Court in lawsuits alleging infringement of the ’502 Patent. The proceedings against these channel partners and customers have been stayed pending the resolution of DataTern’s lawsuit against the Company. The outcome of these matters is not presently determinable.

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

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

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

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

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

- the size, timing, volume, and execution of significant orders and shipments;
- the mix of products and services ordered by customers, including product licenses and subscription offerings, which can affect the extent to which revenue is recognized immediately or over future quarterly periods;

- the timing of the release or delivery of new or enhanced offerings, which may affect the period in which we can recognize revenue;
- the timing of announcements of new offerings by us or our competitors;
- changes in our pricing policies or those of our competitors;
- market acceptance of new and enhanced versions of our products and services;
- the length of our sales cycles;
- seasonal or other buying patterns of our customers;
- changes in our operating expenses, including as a result of various cost-saving initiatives that we are implementing;
- planned major maintenance activities related to our corporate aircraft;

- the timing of research and development projects and the capitalization of software development costs;
- personnel changes, including as a result of our recent executive management reorganization;
- our use of channel partners;
- utilization of our consulting and education services, which can be affected by delays or deferrals of customer implementation of our software products;
- changes in foreign currency exchange rates;
- our profitability and expectations for future profitability and their effect on our deferred tax assets and net income for the period in which any adjustment to our net deferred tax asset valuation allowance may be made;
- increases or decreases in our liability for unrecognized tax benefits; and
- changes in customer decision making processes or customer budgets.

Limited Ability to Adjust Expenses. We base our operating expense budgets on expected revenue trends and strategic objectives. Many of our expenses, such as office leases and certain personnel costs, are relatively fixed. We may be unable to adjust spending quickly enough to offset any unexpected revenue shortfall. Accordingly, any shortfall in revenue may cause significant variation in operating results in any quarter. For example, although we have reduced our operating expenses in certain recent periods, if our revenues in the future are not sufficient to offset our operating expenses, or we are unable to adjust our operating expenses in a timely manner in response to any shortfall in anticipated revenue, we may incur operating losses.

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

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

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

- quarterly variations in our results of operations or those of our competitors;
- announcements about our earnings that are not in line with analyst expectations, the likelihood of which may be enhanced because it is our policy not to give guidance relating to our anticipated financial performance in future periods;
- announcements by us or our competitors of acquisitions, dispositions, new offerings, significant contracts, commercial relationships, or capital commitments;
- the emergence of new sales channels in which we are unable to compete effectively;
- our ability to develop, market, and deliver new and enhanced offerings on a timely basis;
- commencement of, or our involvement in, litigation;
- any major change in our Board of Directors, management, or governing documents;
- changes in governmental regulations or in the status of our regulatory approvals;
- recommendations by securities analysts or changes in earnings estimates;
- announcements by our competitors of their earnings that are not in line with analyst expectations;
- the volume of shares of our class A common stock available for public sale;
- sales or purchases of stock by us or by our stockholders, and issuances of awards under our stock incentive plan;
- short sales, hedging, and other derivative transactions involving shares of our class A common stock; and
- general economic conditions and slow or negative growth of related markets.

In addition, the stock market in general, and the market for technology companies in particular, have experienced extreme price and volume fluctuations that have often been unrelated or disproportionate to the operating performance

of technology companies. These

broad market and industry factors may seriously harm the market price of our class A common stock, regardless of our actual operating performance.

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

We generated net income for the nine months ended September 30, 2016; however, we may not be able to sustain or increase profitability on a quarterly or annual basis in the future. If our revenues are not sufficient to offset our operating expenses, or we are unable to adjust our operating expenses in a timely manner in response to any shortfall in anticipated revenue, our profitability may decrease, we may cease to be profitable, or we may incur operating losses. As a result, our business, results of operations, and financial condition may be materially adversely affected.

As of September 30, 2016, we had $11.1 million of deferred tax assets, net of a $1.0 million valuation allowance. If we are unable to sustain profitability in the future, we may be required to increase the valuation allowance against these deferred tax assets, which could result in a charge that would materially adversely affect net income in the period in which the charge is incurred.

We face risks arising from our restructuring activities and other cost-saving initiatives

In 2014, we implemented substantially all of a restructuring plan to streamline our workforce and spending to better align our cost structure with our business strategy. The restructuring, including the organizational, operational, and strategic changes that have taken place during and following the implementation of the restructuring plan, as well as other cost-savings initiatives that we have implemented or are implementing, present significant potential risks that may impair our ability to achieve anticipated cost reductions or otherwise harm our business, including:

- a decrease in employee morale, which could lead to voluntary departures of key employees;
- failure to meet operational targets or customer requirements due to the termination or attrition of employees, or a decrease in employee morale; and
- diversion of management attention from ongoing business activities.

Economic uncertainty, particularly in the retail industry, could materially adversely affect our business and results of operations

In recent years, the U.S. and other significant markets have experienced cyclical downturns and worldwide economic conditions remain uncertain. Economic uncertainty and associated macroeconomic conditions make it extremely difficult for our customers and us to accurately forecast and plan future business activities, and could cause our customers to slow spending on our products and services, which could delay and lengthen sales cycles. Furthermore, during uncertain economic times, our customers may face issues gaining timely access to sufficient credit, which could result in an impairment of their ability to make timely payments to us. If that were to occur, we may be required to increase our allowance for doubtful accounts and our results would be negatively impacted.

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

We cannot predict the timing, strength, or duration of any economic slowdown or any subsequent recovery generally, or in the retail industry in particular. If the conditions in the general economy and the markets in which we operate

worsen from present levels, our business, financial condition, and results of operations could be materially adversely affected.

We may have exposure to greater than anticipated tax liabilities

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

Further changes in the tax laws of foreign jurisdictions could arise, including as a result of the base erosion and profit shifting ("BEPS") project undertaken by the Organisation for Economic Co-operation and Development ("OECD"). The OECD, which represents a coalition of member countries, has issued recommendations that, in some cases, would make substantial changes to numerous long-standing tax positions and principles. These contemplated changes, to the extent adopted by OECD members and/or other countries, could increase tax uncertainty and may adversely affect our provision for income taxes. In addition, in the United States, proposals for broad reform of the existing U.S. corporate tax system are under evaluation by various legislative and administrative bodies, but it is not possible to accurately determine the overall impact of such proposals on our effective tax rate at this time.

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

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

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

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

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

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

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

The analytics market is highly competitive and subject to rapidly changing technology paradigms. Within the analytics space, we compete with many different vendors, including (i) large software vendors, such as IBM (Cognos), SAP (BO), Microsoft (Power BI), and Oracle (OBIEE), that provide one or more products that directly compete with our products, (ii) open source analytics vendors, such as OpenText Analytics and Hitachi (Pentaho), (iii)

various other analytics software providers, such as Qlik, Tableau Software, TIBCO, Information Builders, and the SAS Institute, and (iv) other vendors offering cloud-based offerings, such as GoodData and Birst. Our future success depends on the effectiveness with which we can differentiate and compete with these vendors and other potential competitors across analytics implementation projects of varying sizes. Failure to maintain adequate technology differentiation from these competitors could materially adversely affect our revenue from both existing and prospective customers.

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

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

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

Usher competes with companies with technologies categorized as user authentication products. These competitors focus primarily on traditional forms of identity verification such as smart cards, tokens, and password managers. These companies have significant name recognition and offer solutions with security architectures that are familiar to IT buyers. Usher also competes with companies with newer solutions, often involving mobile technology. To date, we have expended significant resources in the development and marketing of Usher, which has not generated significant revenues. Failure to adequately differentiate and market our technology from these competitors could materially adversely affect our ability to generate significant revenues from Usher.

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

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

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

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

- continue to support a number of popular operating systems and databases;
- maintain and improve our current offerings; and
- rapidly develop new offerings and product enhancements that achieve market acceptance, maintain technological competitiveness, and meet an expanding range of customer requirements.

Analytics applications are inherently complex, and it can take a long time and require significant research and development expenditures to develop and test new offerings and product enhancements. In addition, customers may delay their purchasing decisions because they anticipate that new or enhanced versions of our offerings will soon become available. We cannot be sure that we will succeed in developing, marketing, and delivering on a timely and cost-effective basis new or enhanced offerings that respond to technological change or new customer requirements, nor can we be sure that any new or enhanced offerings will achieve market acceptance. Moreover, even if we

introduce a new offering, we may experience a decline in revenues of our existing offerings that is not fully matched by the new offering's revenue. For example, customers may delay making purchases of a new offering to permit them to make a more thorough evaluation of the offering, or until industry and marketplace reviews become widely available. Some customers may hesitate migrating to a new offering due to concerns regarding the complexity of migration and product infancy issues on performance. In addition, we may lose existing customers who choose a competitor's offering rather than migrate to our new offering. This could result in a temporary or permanent revenue shortfall and materially adversely affect our business.

A substantial customer shift from the deployment of MicroStrategy Analytics based on a perpetual software license to our cloud services offerings could affect the timing of revenue recognition and materially adversely affect our operating results

We offer our analytics platform in the form of a perpetual software license and a cloud-based platform-as-a-service subscription. The payment streams and revenue recognition timing for our perpetual software licenses are different from those for our subscription services. For perpetual software licenses, customers typically pay us a lump sum soon after entering into a software license agreement

and revenue is typically recognized upon delivery of the software to the customer. For subscription services, customers typically make periodic payments over the subscription period and revenue is typically recognized ratably over the subscription period. As a result, if a substantial number of current or new customers shift to subscribing to our cloud services offerings instead of purchasing perpetual software licenses for MicroStrategy Analytics, the resulting change in payment terms and revenue recognition may materially adversely affect our operating results and cash flows for the reporting periods during which such a shift occurs.

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

We have invested, and in the future may invest, in new business strategies and initiatives. For example, in recent years we have introduced a number of innovative technologies designed to enable companies to capitalize on Big Data, mobile applications, cloud-based services, and security trends in the marketplace. These endeavors may involve significant risks and uncertainties, including distraction of management from other business operations, the dedication of significant research and development, sales and marketing, and other resources to these new initiatives at the expense of our other business operations, generation of insufficient revenue to offset expenses associated with new initiatives, incompatibility of our new technologies with third-party platforms, inadequate return of capital, and other risks that we may not have adequately anticipated. For example, we have expended significant resources in the development and marketing of Usher, which has not generated significant revenues to date. Because new strategies and initiatives are inherently risky, these strategies and initiatives may not be successful and could materially adversely affect our financial condition and operating results.

Business disruptions, including interruptions, delays, or failures of our systems, third-party data center hosting facilities or other third-party services, could materially adversely affect our operating results or result in a material weakness in our internal controls that could adversely affect the market price of our stock

A significant portion of our research and development activities or certain other critical business operations are concentrated in facilities in Northern Virginia, China, and Poland. In addition, we serve our customers, and manage certain critical internal processes, using third-party data center hosting facilities located in the United States and England and other third-party services, including Amazon Web Services and other cloud services. We could experience a disruption or failure of our systems, or the third-party hosting facilities or other services that we use. Such disruptions or failures could include a major earthquake, fire, cyber-attack, act of terrorism or other catastrophic event, as well as power outages or telecommunications infrastructure outages, or a decision by one of our third-party service providers to close facilities that we use without adequate notice or other unanticipated problems with the third-party services that we use, including a failure to meet service standards.

We are a highly automated business and any such disruptions or failures could (i) result in the destruction or disruption of any of our critical business operations, controls or procedures, or information technology systems, (ii) severely affect our ability to conduct normal business operations, including delaying completion of sales and provision of services, (iii) result in a material weakness in our internal control over financial reporting, (iv) cause our customers to terminate their subscriptions, (v) result in our issuing credits to customers or paying penalties or fines, (vi) harm our reputation, (vii) adversely affect our attrition rates or our ability to attract new customers, or (viii) cause our offerings to be perceived as not being secure, any of which could materially adversely affect our future operating results.

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

In addition to our direct sales force, we use channel partners such as resellers, value-added resellers, system integrators, consulting firms, original equipment manufacturers, and technology partners to license and support our products. For the nine months ended September 30, 2016, transactions by channel partners for which we recognized revenues accounted for 17.0% of our total product licenses revenues. Our channel partners may offer customers the products and services of several different companies, including offerings that compete with ours. Because our channel partners generally do not have an exclusive relationship with us, we cannot be certain that they will prioritize or devote adequate resources to selling our products. Moreover, divergence in strategy or contract defaults by any of these channel partners may materially adversely affect our ability to develop, market, sell, or support our offerings.

Although we believe that direct sales will continue to account for a majority of product licenses revenues, we seek to maintain a significant level of sales activities through our channel partners. There can be no assurance that our channel partners will continue to cooperate with us. In addition, actions taken or not taken by such parties may materially adversely affect us. Our ability to achieve revenue growth in the future will depend in part on our ability to maintain successful relationships with our channel partners. If we are unable to maintain our relationships with these channel partners, our business, results of operations, and financial condition could be materially adversely affected.

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

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

Our gross current and non-current deferred revenue and advance payments totaled $192.7 million as of September 30, 2016. We offset our accounts receivable and deferred revenue for any unpaid items, which totaled $61.9 million, resulting in net current and non-current deferred revenue and advance payments of $130.8 million as of September 30, 2016. The timing and ultimate recognition of our deferred revenue and advance payments depend on various factors, including our performance of various service obligations.

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

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

We receive a significant portion of our total revenues from international sales, and conduct our business activities in various foreign countries, including some emerging markets where we have limited experience, where the challenges of conducting our business can be significantly different from those we have faced in more developed markets, and where business practices may create internal control risks. International revenues accounted for 36.5% and 39.9% of our total revenues for the three months ended September 30, 2016 and 2015, respectively, and 38.6% and 37.2% of our total revenues for the nine months ended September 30, 2016 and 2015, respectively. Our international operations require significant management attention and financial resources.

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

- fluctuations in foreign currency exchange rates;
- new, or changes in, regulatory requirements;
- tariffs, export and import restrictions, restrictions on foreign investments, sanctions, and other trade barriers or protection measures;
- costs of localizing offerings;
- lack of acceptance of localized offerings;
- difficulties in and costs of staffing, managing, and operating our international operations;
- tax issues, including restrictions on repatriating earnings;
- weaker intellectual property protection;
- economic weakness or currency related crises;
- the burden of complying with a wide variety of laws, including those relating to labor matters, consumer and data protection, privacy, network security, and encryption;
- generally longer payment cycles and greater difficulty in collecting accounts receivable;
- our ability to adapt to sales practices and customer requirements in different cultures;
- corporate espionage; and
- political instability and security risks in the countries where we are doing business.

We may face heightened risks in connection with our international operations as a result of the referendum vote held on June 23, 2016 in the United Kingdom, commonly referred to as “Brexit,” which favored the United Kingdom leaving the European Union. The announcement of Brexit caused significant volatility in global stock markets and currency exchange rate fluctuations that resulted in a sharp decline in the value of the British pound, as compared to the U.S. dollar and other currencies. The future effects of Brexit are

uncertain and will depend on any agreements the United Kingdom makes to retain access to E.U. markets either during a transitional period or more permanently. Brexit could, among other outcomes, disrupt the free movement of goods, services and people between the United Kingdom and the European Union, and significantly disrupt trade between the United Kingdom and the European Union. In addition, Brexit could lead to legal uncertainty and potentially divergent national laws and regulations, including tax laws and regulations, as the United Kingdom determines which E.U. laws to replace or replicate. Disruptions to trade, weakening of economic conditions, economic and legal uncertainties, or changes in currency rates may adversely affect our business, financial condition, operating results and cash flows.

Various corporate tax reform bills and other proposals have been or are currently under consideration by Congress and the Obama Administration. These proposals include, among other items, corporate income tax rate changes in varying, uncertain, or unspecified amounts, the reduction or elimination of certain corporate tax incentives, modifications to the existing regime for taxing overseas earnings (including consideration of a minimum tax on adjusted unrepatriated foreign earnings), and measures to prevent base erosion and profit shifting. It is not clear whether, or to what extent, these proposals may be enacted. Although the overall impact that such proposals may have on our future effective tax rate is unclear at this time, significant changes to the U.S. taxation of our international income could have a material adverse effect on our results of operations.

From time to time, we may undertake various potential intercompany transactions and legal entity restructurings that involve our international subsidiaries. We consider various factors in evaluating these potential transactions and restructurings, including the alignment of our corporate structure with our organizational objectives, the operational and tax efficiency of our corporate structure, and the long-term cash flows and cash needs of our business. Such transactions and restructurings could negatively impact our overall tax rate and result in additional tax liabilities.

In addition, compliance with foreign and U.S. laws and regulations that are applicable to our international operations is complex and may increase our cost of doing business in international jurisdictions, and our international operations could expose us to fines and penalties if we fail to comply with these regulations. These laws and regulations include anti-bribery laws, such as the U.S. Foreign Corrupt Practices Act, the U.K. Bribery Act, and local laws prohibiting corrupt payments to governmental officials. These laws and regulations also include import and export requirements and economic and trade sanctions administered by the Office of Foreign Assets Control and the U.S. Commerce Department based on U.S. foreign policy and national security goals against targeted foreign states, organizations, and individuals. 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 and our brand.

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

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

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

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

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

As existing and potential customers seek to standardize on a single analytics vendor or require greater vendor capacity to meet their growing analytics needs, our business may experience larger transactions at the enterprise level and larger transactions may account for a greater proportion of our business. The presence or absence of one or more large transactions in a particular period may have a material positive or negative effect on our revenue and operating results for that period. For the nine months ended September 30,

2016 and 2015, our top three product licenses transactions with recognized revenue totaled $6.6 million and $6.5 million, respectively, or 8.7% and 8.4% of total product licenses revenues, respectively. These transactions represent significant business and financial decisions for our customers, require considerable effort on the part of customers to assess alternative products, and often require additional levels of management approval. In addition, large transactions are often more complex than smaller transactions. These factors generally lengthen the typical sales cycle and increase the risk that customers may postpone or delay purchasing decisions from one period to another subsequent or later period or that customers will alter their purchasing requirements. We may also encounter greater competition and pricing pressure in larger transactions and the sales effort and service delivery scope for larger transactions may require us to use additional resources to execute the transaction. These factors could result in lower than anticipated revenue and earnings for a particular period or in lower estimated revenue and earnings in future periods.

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

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

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

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

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

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

Our customers also include a number of foreign governments and government agencies. Similar procurement, budgetary, contract, and audit risks also apply to our doing business with these entities. In addition, compliance with complex regulations and contracting provisions in a variety of jurisdictions can be expensive and consume significant management resources. In certain jurisdictions, our ability to win business may be constrained by political and other

factors unrelated to our competitive position in the market. Each of these difficulties could materially adversely affect our business and results of operations.

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

We license third-party technologies that are incorporated into or utilized by our existing offerings. There can be no assurance that the licenses for such third-party technologies will not be terminated or that we will be able to license third-party software for future offerings. In addition, we may be unable to renegotiate acceptable third-party license terms, or we may be subject to infringement liability if third-party software that we license is found to infringe intellectual property rights of others. Changes in or the loss of third-party licenses could lead to a material increase in our costs, or to our software offerings becoming inoperable or their performance being materially reduced. As a result, we may need to incur additional development costs to ensure continued performance of our offerings, and we may experience a decreased demand for our offerings.

If we are unable to recruit or retain skilled personnel, or if we lose the services of our Chairman of the Board of Directors, President & Chief Executive Officer, our business, operating results, and financial condition could be materially adversely affected

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

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

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

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

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

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

Changes in laws or regulations relating to privacy or the collection, processing, disclosure, storage, or transmission of personal data, or any actual or perceived failure by us or our third-party service providers to comply with such laws and regulations or applicable privacy policies, could materially adversely affect our business

Aspects of our business, including our cloud services offerings and Usher, involve collecting, processing, disclosing, storing, and transmitting personal data, which is subject to certain privacy policies and certain federal, state, and foreign laws and regulations relating to privacy and data protection. The amount of customer and employee data that we store through our cloud services offerings, networks, and other systems, including personal data, is increasing. In recent years, the collection and use of personal data by companies have come under increased regulatory and public scrutiny, especially in relation to the collection and processing of sensitive data, such as healthcare, financial services, and government data. For example, in the United States, protected health information is subject to the Health

Insurance Portability and Accountability Act ("HIPAA"). HIPAA has been supplemented by the Health Information Technology for Economic and Clinical Health Act with the result of increased civil and criminal penalties for noncompliance. Entities performing certain functions that engage in creating, receiving, maintaining, or transmitting protected health information provided by covered entities and other business associates are directly subject to enforcement under HIPAA. Our access to protected health information through our cloud services offerings triggers obligations to comply with certain privacy rules and data security requirements under HIPAA. Furthermore, any systems failure or security breach that results in the release of, or unauthorized access to, personal data, or any failure or perceived failure by us or our third-party service providers to comply with applicable privacy policies or any applicable laws or regulations relating to privacy or data protection, could result in proceedings against us by domestic or foreign governmental entities or others. Such proceedings could result in the imposition of sanctions, fines, penalties, liabilities, and/or governmental orders requiring that we change our data practices, any of which could have a material adverse effect on our business, operating results, reputation, and financial condition.

Various federal, state, and foreign legislative, regulatory, or other governmental bodies may enact new or additional laws or regulations, or issue rulings that invalidate prior laws or regulations, concerning privacy, data storage, and data protection that could

materially adversely impact our business. For example, in October 2015, the Court of Justice of the European Union issued a ruling that declared the U.S.-EU Safe Harbor Framework invalid. Following this ruling, U.S. and European authorities agreed to, and in July 2016 the European Commission formally adopted, a new mechanism for lawfully transferring personal data from the European Union to the United States, referred to as the "Privacy Shield." In addition, in April 2016, the European Parliament and the Council of the European Union formally adopted a comprehensive general data protection regulation, which will take effect in 2018. Complying with these and other changing requirements could cause us or our customers to incur substantial costs, require us to change our business practices, or limit our ability to provide certain products and services in certain jurisdictions, any of which could materially adversely affect our business and operating results. Additionally, new laws or regulations restricting or limiting the collection or use of mobile data could reduce demand for certain of our services or require changes to our business practices, which could materially adversely affect our business and operating results.

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

As part of our business, we process, store, and transmit our customers' and channel partners' information and data as well as our own, including in our cloud services offerings, networks, and other systems. There can be no assurance that any security measures that have been implemented will be effective against all current or future security threats. For example, security measures may be breached as a result of technological error, computer viruses, or third-party action, including intentional misconduct by computer hackers, physical break-ins, the actions of state actors, industrial espionage, fraudulent inducement of employees, customers, or channel partners to disclose sensitive information such as user names or passwords, and employee, customer or channel partner error or malfeasance. High-profile security breaches at other companies have increased in recent years. A security breach could result in unauthorized access to or disclosure, modification, misuse, loss, or destruction of our customers' or channel partners' data, our data (including our proprietary information, intellectual property, or trade secrets), or our cloud services offerings, networks, or other systems. Because there are many different security breach techniques and such techniques continue to evolve, we may be unable to anticipate attempted security breaches and implement adequate preventative measures. Third parties may also conduct attacks designed to temporarily deny customers access to our services. Any security breach or successful denial of service attack could result in a loss of customer confidence in the security of our offerings and damage to our brand, reducing the demand for our offerings and our revenue, disrupt our normal business operations, require us to spend material resources to investigate or correct the breach, expose us to legal liabilities, including litigation, regulatory enforcement, and indemnity obligations, and materially adversely affect our operating results. These risks will increase as we continue to grow the number and scale of our cloud-based offerings, and process, store, and transmit increasingly large amounts of our customers', channel partners', and our own information and data, which may include proprietary or confidential data or personal or identifying information.

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

We rely on a combination of copyrights, patents, trademarks, trade secrets, confidentiality procedures, and contractual commitments to protect our intellectual property. Despite our efforts, these measures can only provide limited protection. Unauthorized third parties may try to copy or reverse engineer portions of our products or otherwise obtain and use our intellectual property. Any patents owned by us may be invalidated, circumvented, or challenged. Any of our pending or future patent applications, whether or not currently being challenged, may not be issued with the scope of the claims we seek, if at all. Moreover, recent amendments to and developing jurisprudence regarding U.S. patent

law may affect our ability to protect our intellectual property and defend against claims of patent infringement. In addition, although we generally enter into confidentiality agreements with our employees, our former employees may seek employment with our business partners, customers, or competitors and there can be no assurance that the confidential nature of our intellectual property will be maintained. Furthermore, the laws of some countries do not provide the same level of protection of our intellectual property as do the laws of the United States. If we cannot protect our intellectual property against unauthorized copying or use, we may not remain competitive.

Third parties may claim we infringe their intellectual property rights

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

- be time-consuming, costly, and/or result in litigation;
- divert management's time and attention from developing our business;
- require us to pay monetary damages or enter into royalty and licensing agreements that we would not normally find acceptable;
- require us to stop selling certain of our offerings;
- require us to redesign certain of our offerings using alternative non-infringing technology or practices, which could require significant effort and expense;
- require us to rename certain of our offerings or entities; or
- require us to satisfy indemnification obligations to our customers and channel partners.

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

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

For example, in December 2011, DataTern filed a complaint alleging that certain of our analytics products infringe a patent allegedly owned by it, and we have received indemnification requests from certain of our channel partners and customers who were also named as defendants in connection with this matter. This matter is described in further detail in this Quarterly Report under "Part II. Item 1. Legal Proceedings."

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

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

Because of the rights of our two classes of common stock and because we are controlled by Michael J. Saylor, who beneficially owns the majority of our class B common stock, Mr. Saylor could transfer control of MicroStrategy to a third party without the approval of our Board of Directors or our other stockholders, prevent a third party from acquiring us, 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 October 19, 2016, holders of our class B common stock owned 2,035,184 shares of class B common stock, or 68.4% of the total voting power. As of October 19, 2016, Mr. Saylor, our Chairman of the Board of Directors, President & Chief Executive Officer, beneficially owned 2,011,668 shares of class B common stock, or 67.6% of the total voting power. Accordingly, Mr. Saylor can control MicroStrategy through his ability to determine the

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

Our certificate of incorporation allows holders of class B common stock to transfer shares of class B common stock, subject to the approval of stockholders holding a majority of the outstanding class B common stock. Mr. Saylor or a group of stockholders holding 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 holding a majority of the outstanding class B common stock could also prevent a change of control of MicroStrategy, regardless of whether holders of class A common stock might otherwise receive a premium for their shares over the then current market price. In addition, this concentrated control limits stockholders' ability to influence corporate matters and, as a result, we may take actions that our non-controlling stockholders do not view as beneficial or that conflict with their interests. As a result, the market price of our class A common stock could be materially adversely affected.

Our status as a "controlled company" could make our class A common stock less attractive to some investors or otherwise materially adversely affect our stock price

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

In light of our status as a controlled company, our Board of Directors has determined not to establish an independent nominating committee or have its independent directors exercise the nominating function, and has elected instead to have the Board of Directors be directly responsible for nominating members of the Board. A majority of our Board of Directors is currently comprised of independent directors, and our Board of Directors has established a Compensation Committee comprised entirely of independent directors. The Compensation Committee determines the compensation of our Chief Executive Officer. However, our Board of Directors has authorized our Chief Executive Officer to determine the compensation of executive officers other than himself, rather than having such compensation determined by the Compensation Committee, except that certain executive officer compensation that is intended to qualify as performance-based compensation for purposes of Section 162(m) of the Internal Revenue Code is determined by the Compensation Committee pursuant to the requirements of Section 162(m). Awards under our 2013 Equity Plan are also approved by the Compensation Committee. Additionally, while our Compensation Committee is empowered with the authority to retain and terminate outside counsel, compensation consultants, and other experts or consultants, it is not required to assess their independence.

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

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

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

We continuously review our compliance with all new and existing revenue recognition accounting pronouncements. In May 2014, the FASB issued Accounting Standards Update No. 2014-09, Revenue from Contracts with Customers (Topic 606) ("ASU 2014-09"), which supersedes nearly all existing revenue recognition guidance. See Note 2, Recent Accounting Standards, to the Consolidated Financial Statements in "Part I. Item 1. Financial Statements" of this Quarterly Report for further information regarding ASU 2014-09. We are currently evaluating the impact of this guidance on our consolidated financial position, results of operations, and cash flows. Depending on the outcome of these ongoing reviews and the potential issuance of further accounting pronouncements, implementation guidelines, and interpretations, we may be required to modify our reported results, revenue recognition policies, or business practices, which could materially adversely affect our results of operations.

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

During the three months ended September 30, 2016, we did not repurchase any equity securities registered by us pursuant to Section 12 of the Exchange Act. See Note 8, Treasury Stock, to the Consolidated Financial Statements in "Part I. Item 1. Financial Statements" for further information regarding our share repurchase plan.

Item 6. Exhibits

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

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

SIGNATURES

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

MICROSTRATEGY INCORPORATED

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

By: /s/ Phong Le
Phong Le
Senior Executive Vice President &
Chief Financial Officer

Date: October 27, 2016

INDEX TO EXHIBITS

Exhibit Number	Description
3.1	Second Restated Certificate of Incorporation of the registrant (incorporated herein by reference to Exhibit 3.1 to the registrant's Quarterly Report on Form 10-Q for the fiscal quarter ended March 31, 2003 (File No. 000-24435)).
3.2	Amended and Restated By-Laws of the registrant (incorporated herein by reference to Exhibit 3.1 to the registrant's Current Report on Form 8-K filed with the SEC on January 30, 2015 (File No. 000-24435)).
4.1	Form of Certificate of Class A Common Stock of the registrant (incorporated herein by reference to Exhibit 4.1 to the registrant's Quarterly Report on Form 10-Q for the fiscal quarter ended June 30, 2003 (File No. 000-24435)).
31.1	Certification pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Chairman of the Board of Directors, President & Chief Executive Officer.
31.2	Certification pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Senior Executive Vice President & Chief Financial Officer.
32.1	Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS	XBRL Instance Document.
101.SCH	XBRL Taxonomy Extension Schema.
101.CAL	XBRL Taxonomy Extension Calculation Linkbase.
101.DEF	XBRL Taxonomy Extension Definition Linkbase.
101.LAB	XBRL Taxonomy Extension Label Linkbase.
101.PRE	XBRL Taxonomy Extension Presentation Linkbase.