To: Bill Gates   Date: March 2, 1991

Re: Federal Systems Status

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Bill, this memo addresses your request for an update on a number of Federal Systems programs.

Desktop III

Ever since its award, Desktop III (DT3) has been a perpetual challenge. Unisys is literally losing money with every box they ship. While we are not entirely certain of the number, we believe their loss per CPU to be in the $700-$800 range. Early on, Unisys found themselves in a serious backlog situation. This problem stemmed predominantly from the fact that the majority of orders were being submitted with errors. A DT3 customer had over 4,000 configuration options. This led to the incredibly high error rate. Per the letter of the law, Unisys was not allowed to ship any product, hardware or software, on an order that was incorrectly processed. Of note, this was <u>not</u> the case on the Desktop II (Zenith) contract. In addition, with their loss per machine, as noted above, their motivation to was/is questionable. To date, Unisys has shipped 34,741 machines. Some 92% are DOS machines which ship with DOS, Windows 386, and the Microsoft Mouse. Enable software has modified their Posix product to allow the user a dual boot situation, so upon loading the product, the user can choose to run in either a DOS or Posix environment. It appears from data we have from both the Air Force as well as Unisys, that Enable sales are under a 5% hook.

At Unisys' request a meeting took place in Redmond on 1/24/91 to discuss a proposal which would have the AF commit to 300,000 machines over the remaining life of the contract (3.5 years). This is inclusive of the current 70,000+ CPU backlog. Unisys intends to immediately book the revenue and take the profit to the bottom line this FY. In fact this is far and away the overriding motivation for Unisys. Shipments would be scheduled quarterly over the next 42 months. In this scenario MS Office will be pre-installed and configured on every DOS machine. March 8 is the target date for the Unisys to submit this proposal to the AF. If accepted, Unisys expects to begin volume shipments of the bundled configuration on April 1. At the January meeting MS OEM agreed to an <u>additional 46% discount</u> on Office. This brings the price of Office down to $85.00.

Desktop 4?

It is possible a CBD announcement will appear within the next two weeks for Desktop 4. Desktop 3 is a two year contract with three one year options. November of 1991 marks the end of year two. So, the announcement of Desktop 4 is two years earlier than expected. It's <u>very</u> rare not to have option years renewed. However, given the current state of DT3, it's a real possibility that Unisys and the Air Force will mutually agree to call it quits in November. A lot depends on the reaction of the Air Force to the Unisys proposal mentioned above. We are in discussions with the Air Force regarding what, if any, role software will play on DT4. As they have a very aggressive target date, 11/91, the addition of software specifications will only serve to slow the procurement down. At least this will be one of the arguments we use with the Air Force. More on DT4 as it develops.

Issues

1). Delivery and First Customer Experience

DT3 software (including DOS and Windows 386) is shipped on diskettes, not pre-installed. The customer is faced with loading DOS 4.01, Windows 386 and ALL the MS applications. This procedure can take hours, if done correctly. Customer dissatisfaction is a problem. MS has created a direct upgrade program available for DT3 customers to ease the situation with Windows and Powerpoint.

2). Windows 3.0

Windows 386 is still bundled with DOS. Unisys has not, despite the efforts of MS and the AF, been able to stop shipping Win386 due to driver and app compatibility. Win3.0 upgrades are being sold in addition to Windows 386. Win3 should replace Win2.11 within 1-2 months according to Unisys, but this is what they have been telling us for months on end.

3). Unisys Reputation

Order processing delays and poor customer service have earned Unisys a very poor reputation as a PC vendor. Many customers are seeking other contracts, including Army SMC (more on this later), to purchase desktop computers.

4). Slow delivery and quotas

With Unisys producing only the minimally required number of systems, 6,000 a month, the Govt. is rationing systems at a unbelievably low rate. For example, an entire Base may order 360 machines, their monthly allocation may be as low as 10 PCs over the next three years. Users are not able to create a "new" software standard when it will be years before that software will be in the majority.

5). Reporting

We are not getting timely or accurate reporting from Unisys. It is difficult to gauge our success without knowing what is being shipped.

DT3 Statistics: (As of 2/1/91)

MS Products on contract:	DOS, Win386, Win3, Mouse, PP, MSDB (Superbase4), XL2.1,WW1.0
DOS hook rate:	92% (DOS to CPU)
DOS CPUs Shipped:	34,741 (DOS, Win386, MS-Mouse)
Office Shipped:	6909 (20.4%), 424 (8-user LANs) 10% Total: 30.4% hook
DT3 Revenue:	$1.32M for Office, $1.82M (DOS, apps, mouse): Total: $3.15M
DOS CPUs Backlogged:	70,304
Office Backlogged:	12,202 (17%), 681 (8-user LANs) 7.7% Total: 25% hook
Backlog Revenue:	$2.5M for Office, $3.5M (other), Total: $6.0M

Total to date: $9.15M shipped and backlog

Army SMC

Army SMC was awarded to EDS, products consist of Everex 386 machines, Uniplex Integrated OA (DOS and Unix) and ISC's Interactive Unix. The Army SMC contract is not yet shipping in volume, 3,000 units have shipped to date. A high priority effort is underway to position MS Apps for addition to the SMC contract. There is strong interest in the Army and there is a reasonable chance MS apps will be added by the end of the year. This will help cushion us in case Unisys and/or DT3 fails. There is an active proposal underway to replace Windows 2.11 with Win3 and (hopefully) bundle with DOS.

MS Products currently on SMC: Win2.11, MS-Mouse

Navy PC LAN

The Navy PC LAN contract, awarded to DEC, is a major setback. To have DEC, a Lan Man OEM, bid Novell, highlights a significant problem that we have when dealing with OEM's in a federal government procurement.

Bids were submitted in March 1990, prior to SMSD's involvement in LM. We did, however, make a reasonably successful effort to manipulate the specs to favor LM. We actively pursued the contract as a "3rd" party trying to position OEMs in teaming relationships with prime bidders. This was a very difficult task since we spent much time attempting to co-ordinate efforts with MS-OEM and the OEM vendors, etc. We were able to work with 3Com, due to an established relationship. NCR, DEC and Taurus were also involved and we never had the necessary working relationship to insure success. Instead, we bypassed the OEM and tried to work directly with the prime bidder (TRW for NCR, ISN for Taurus, respectively). DEC bid as the prime, and we were unable, even with OEM to have discussions with DEC.

Sysorex is planning to file a protest the day of formal award to DEC. It is believed that DEC bid Oracle · for the RDBMS, which must run on the file servers (Netware v3.0 and v2.15) and the application servers (probably OS/2). The Oracle NLM is not yet shipping and an Oracle VAP was never announced, so we believe that DEC bid a commercially unavailable product. The protest may help stall the initial delivery but is not expected to overturn the award.

While addressing the contracts that you specifically requested an update on, I thought I would also bring you up to speed on other key programs.

SSRC1

ZDS (Zenith) won SSRC1. SSRC 1 is the software upgrade contract for DT2. Microsoft products specified include Languages (PASCAL, FORTRAN, BASIC PDS, COBOL, MASM), DOS 4.01 and Windows 3.0. This is a straightforward upgrade vehicle, so only products on the original Zenith DT2 contract were specified. SSRC1 is significant in several ways. The good news is that it provides a convenient way for the 400,000+ Z248 users to upgrade immediately to Windows 3. The bad news is that it will negatively impact DOS revenue potential throughout the Dept of Defense by cannibalizing the DOS 5.0 RUP program. It also provides an easy way for Enable users to upgrade. The Enable upgrade price is (S67).

An initial inventory order for S400,000 of language upgrades was placed by ZDS.

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SSRC2

This contract, designed to purchase software for all levels of DoD computers, has been revived. Specs are being written and we are in the process of attempting to influence those specifications. We expect a draft RFP to be released within the calendar year. As you know from your discussions with the Air Force, this is a mammoth contract, estimated to be worth $1 to $2 Billion. There is however, some discussion about breaking SSRC2 into 3 smaller contracts.

LAN OS

This AF NOS contract for the ULANA hardware (EDS/3Com and TRW) contracts in the AF. DCA's 10-Net is currently shipping as the standard NOS (about 6.000 nodes installed during the 8 months of the contract). We are in the final stages of adding LM to the contract, thus providing a vehicle for LM. This will allow us to claim to be the "Air Force Standard". Novell will of course claim the Navy. The prime is FSG, a small 8A integrator.

Issues: OS/2 SCSI support for DT3 machines has been extremely slow. Routable TCP/IP is missing.

We are also proposing to swap the installed base of 10-Net, under the same guidelines and pricing as the 3Com upgrade program.

VA NOAVA

The VA award was made to Lockheed Integrated Systems Corporation, a division of Lockheed Space and Missiles. Lockheed bid the full suite of Microsoft applications in both DOS and Mac environments. There is significant customer demand in the agency already for our products. In addition, Lockheed will be providing a $4 million upgrade payment to Microsoft the day the first machine is formally accepted by the VA and a payment of $3.5 million one year thereafter. At present, the NOAVA award is under protest. Unisys has protested on what are believed to be trivial items. It is expected this will be resolved in Lockheed's favor shortly. Notably, both the VA and Lockheed have expressed interest in moving to Lan Manager from PC NFS.

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