Lotus Strategic Outlook

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Revenue Outlook through 1998

Our outlook shows the business growing 21% in 1997 and 20% in 1998 after three years of roughly flat revenues, and a return to profitability after the loss in 1995 and investment in 1996.

Our communications product and services business drives this growth, with product revenue growth rates of 25% in 1996, 30% in 1997 and 25% in 1998 and services growth rates of 41 % in 1996, 44% in 1997 and 37% in 1998. The combined Notes and cc:Mail business more than doubles from $316 million revenue in 1995 to $710 million in 1998. Comms products "add-ons" (calendaring, imaging, e-apps) grow from $61 million in 1995 to $85 million in 1998. Services grows from $121 million in 1995 to $339 million in 1998. Desktop applications regain momentum with the continuation of an OEM strategy and the emergence of a components strategy. We project growth of 9% in 96, 3% in 97 and 4% in 1998, and a stable market share.

Revenue ($ million)	1995	1996	1997	1998
Comms	370	462	600	750
Desktop	403	441	456	476
Services	121	171	247	339
Total	895	1,074	1,303	1,565

Communications Products Business

Market Conditions

Our last strategic outlook reported the stunning rise of the Internet and intranets and their direct impact on the Notes business. Since that report, Microsoft has rushed to embrace the Internet technologies: from its plans to make the Internet Explorer the file shell in the operating system, to ActiveX attempts to capture and extend Java, to aggressive moves with its Integrated Information Server in BackOffice. Netscape has also surged forward into a variety of server offerings in internet/intranet. The move of the industry to a set of universal standards based around TCP/IP, HTTP and HTML now seem assured.

In the December and January time frame, Lotus made great progress in positioning Notes as part and parcel of the net. The announcement of our intention to support HTTP and HTML in Notes was greeted with great enthusiasm by the press and our customers. At this point in time, we see that we have made inroads within our installed base of Notes customers, but that our value proposition for competing as a server for the Web has not been clearly enough or loudly enough articulated in the Internet marketplace.

Since our last report, Microsoft Exchange has also shipped. We now find ourselves competing for mail infrastructure versus a real product rather than a chimera. Initial competitive evaluations by the press have rated us a superior product. None of us are complacent about Microsoft's capabilities, however.

Achieving our Goals

In our previous strategy documents, we have noted that a fundamental measure of Notes success and a key to IBM's larger strategy is ubiquity as measured in seat penetration. Consequently, we have set a target to reach 30 million Notes seats by 1998. The key drivers will be Notes acceptance in mail infrastructure and applications deployment. The emergence of the Internet and intranets based on the standards TCP/IP, HTML and HTTP have both validated the applications pioneered by Notes, presented a tremendous opportunity for growth, and created tremendous challenges. At this point it is clear that browsers will be ubiquitous on desktops, becoming a universal, cross-platform communications window to the desktop. Notes needs to reshape its value proposition around this new phenomenon. In fact, our servers can serve browsers as well as Notes clients. Much of the value that Notes adds above the Web is inherent in its server capabilities to manage documents and document-based applications securely across a network. It is imperative that we drive our servers into the internet/intranet space aggressively, driving both Notes clients and web browsers. We will be developing metrics for server penetration as a part of this paper.

1996 Planned Notes Seats (million)	pre 1995	1995	1996	1997	1998
Mail			2.2	4	4
Apps/Intranet		1.5	3.3	4.3	6
OEM		1.5	1.3	0	0
Total	1.5	3	6.8	8.3	10

Our goal of 30 million Notes seats is attainable. In order to reach this goal, we set targets of 6.8 million seats in 96, 8.3 million in 97 and 10 million in 1998. Our first quarter Notes seat count was 500k behind, raising the possibility that we could be as much as 2 million seats behind the 6.8 million 1996 goal. Notes Mail in particular was well below the plan, probably for several reasons: pilots of the new product were just beginning in Q1, and the move to sell Notes as mail infrastructure is a new strategy. Of greatest concern is whether the Internet/Intranet phenomenon is slowing, rather than fueling, the Notes growth.

Current Forecast Notes Seats (million)	pre 1995	1995	1996	1997	1998
Mail			0.5	2.2	4
Apps/Intranet		1.5	3	4.6	6
OEM			1.5	2	3
Total	1.5	3	5	7.8	13

We will examine the major drivers to Notes growth in order to assess their soundness, and examine several additional possible strategies. The major drivers are:

- Office (mail and calendaring) Migration
- Networked applications development, including internets/intranets.
- We will look at the upside potential in an OEM strategy

Mail and Office Migration

With 6 million seats of Office Vision and 10 million current, largely enterprise, seats of cc:Mail, Notes should be able to secure 3 million conversion seats of mail, as well as 4 million new mail seats. That would represent an estimated market share of less than 10% in the LAN market mail seats in 1996, 97, and 98. cc:Mail's continued penetration of the smaller companies at 2-3 million seats per year would yield a total of 15-20% mail share. This merely maintains our current mail unit share. If we consider all Notes seats as being used for mail (as well as for networked applications development), the mail share would be 40%.

Selling Notes as mail infrastructure is a new value proposition first addressed with the shipment of Notes Mail in early 1996. The operational challenges to execute against this challenge include: the need enhance Lotus' reputation as a vendor of mission- critical infrastructure rather than departmental applications and the need to compete against the Microsoft architecture sell with a unified architecture of our own that spans Lotus and IBM. In addition, managing a transition from cc:Mail to Notes in the larger enterprises without losing customers is an executional challenge.

cc:Mail will continue to enhance its characteristics of having a smaller footprint and being simpler to administer than Notes, with an emphasis on the internet. We expect this lighter, faster, easier product to be popular in the mid-tier market and in emerging countries. It will also be targetted at companies who prefer separate mail and application infrastructures (eg Netscape and cc:Mail)

We look to capitalize on existing enterprise companies' desire to reduce the number of e-mail systems they operate and to offer mail with the highest overall user acceptance, the lowest cost of ownership and the lowest risk.

Our initial product reception vs. MS Exchange is positive. Migration tools from Office Vision, cc:Mail and MS Mail will be complete shortly. Service packages are being prepared. The Soft-Switch division is being folded into the longer term coexistence and migration offers. We believe we can convert 25% of the 6 million seat PROFS user base (50% win of 50% converting off PROFS) and and 15% of the cc:Mail base, or 3 of the total 7 million mail seats. The major worry in this area is the continued perception of complexity in administering Notes, compared to the MS simpler-to- administer argument based on its NT integration.

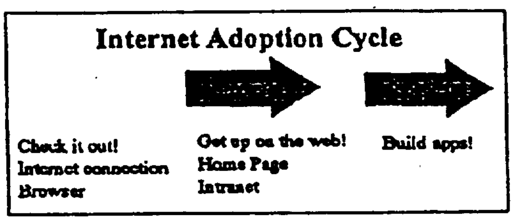
On our other competitive front, combinations of Netscape with Eudora or other Internet mail loom. These products offer lower client function and are not viewed as enterprise mail today. POP3 and IMAP4 will figure more prominently in e-mail market evolution. Netscape will use its Mail, Directory and Certificate servers to compete in the mail space.

Networked Applications Development

Notes has historically been viewed as a networked applications development environment. Its continued growth will be heavily dependent on its continued success in this area. We will examine the challenge and opportunity presented by the Internet, and other thrusts to improve potential to drive solutions based on Notes.

Internet Market Evolution

Business adoption of Internet solutions follows a common pattern. First the customer wants to get access to try out this much heralded phenomenon. Obtaining access at a minimum results in purchasing the services of an Internet Service Provider (ISP) and a browser (it may also result in the purchase of routers, proxy servers, etc). Next the organization wants to



get a web site for its own organization's presence on the net. Publishing the organization's own documents (such as policies and procedures manuals or price lists or other marketing and sales information) over an intranet is a common next step. Later on, the company's web site may grow more complex, or they wish to have a more interactive web site, which requires applications development. Like other new technology markets, early adopters try these technologies first and open the way for the next more conservative majority buyers.

Lotus' clear strength with Notes is in the interactive and applications hosting space, due to its complete application development facilities and built- in messaging and directory services. Our strategy to "make Notes part and parcel of the net" was well received and the product development is proceeding, with a combined Notes HTTP server due this summer. Native support for HTML will take longer, with Notes to HTML conversions required until early in 1997. Notes has unique value for internets and intranets, but our strategy is poorly understood outside the Notes installed base today.

Our strategic challenge is to fully articulate our value to the early adopters at the Internet apps development stage; these are technical buyers. The choices they make will probably be echoed by millions of later buyers.

At the same time, we have been losing customers who are entering into this market with a Netscape browser and then potentially a Netscape proxy server or other server product at the early stages of the adoption cycle. By the time they get to the application development par t of the cycle, they may be ready to accept "addons" from their other already-established suppliers, and we will be in a position of having to switch the customer. We call this the "entry customer" challenge. The entry of millions of other majority as well as laggard buyers will fuel this market for years to come.

Therefore, it is imperative that Lotus portray Notes not only as a superior product in the high end, but also to generate momentum for Notes in the earlier stages of adoption as well. In addition, we must make it apparent that moving from a current publishing solutions to Notes will either be easy and/or will protect current investments in browsers, editors, and other tools.

Our response to these challenges will be a mixture of the following:

1. A new Notes server solution targeted at the entry customer which is easy to install and configure and has Internet/intranet value out of the box. Its clients will be web browsers.
2. A new Notes POP3 mail client solution targeted at the entry customer
3. A strategy to build on top of the population of 30 million browsers already out in the marketplace. This could include providing add-ons to browsersofthe Notes replication technology. We are considering the distribution of "Notes services," especially replication, to all Java developers in order to create ourselves as an Internet standard. This would create pull for our servers.
4. A marketing campaign directed to the internet/intranet market (as distinct from the Notes installed base) who needs to be technically convinced of Notes as an apps development platform for the Internet.

The first two products will be ready for beta in the fall and for delivery in early 1997. We have built a prototype add-on of Notes replication for web browsers. The distribution of Notes services, specifically the dll Noteslib which includes the replication engine (historically called ISV

Notes))is a discussion which is just starting. We are debating low prices or free distribution of the dll in order to secure server business and a flow of upgrades. In addition, our NetApps will be also be coming to market in late 1996.

On the marketing front, we are aggressively pursuing customer references and third party consultants to validate our story. We have contracted with an industry consultant to conduct a cost of ownership study comparing Notes and "roll-your own" Web solutions. We expect the first phase of this study to articulate clearly when Notes is more cost-effective than roll-your-own Web solutions.

We need a more active PR presence to be perceived as a player on the Net.

Notes distributed authoring capabilities, automatically refreshed views (i.e., indices), full text search, and bi-directional replication make Notes uniquely qualified as a Web server, using Notes and the InterNotes Web Publisher, and even more so using the Notes HTTP server.

The relative roles of Notes servers and clients

As a result of the transformation of the market by intranets, we will see more and more Notes servers hosting browsers as clients. Browsers now outnumber Notes clients 10 to 1 and are growing faster. We need to measure our success in driving Notes servers into the marketplace, with or without Notes clients. In essence, we need to position the web browser as the easiest, starter client for Notes, with Notes Mail and Notes Desktop as "step-up clients". Our Notes clients offer tremendous additional value beyond a simple browser: security, ability to store, forward, view the information received, and better mobile capabilities because of replication. This approach will require a significant reeducation of the market and our sales people, and could even require the bundling of a browser with certain Notes packages, e.g. the Internet-in-a-box offer.

Over the longer term, we expect Netscape to evolve its offerings to be directly competitive with Notes clients, by adding mail and other application development services. The Notes client should be considered an example of the "web client" of the future.

Our business model is quite dependent on the number of Notes clients that we sell. In 1996, servers will represent only $40 million of the total $360 million Notes revenue. The sheer number of clients supported by a server (50 minimum) causes the revenue to dominate servers (priced no more than 6x the client). We have introduced the $2295 SMP enterprise server this year and are considering introducing an even higher priced cluster server. Netscape's business is roughly 50/50 servers and clients today, with much of its development effort on servers.

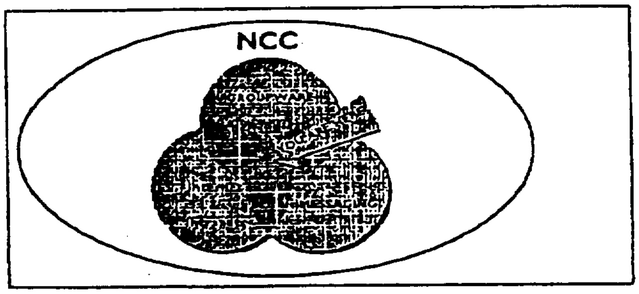
Our plans currently call for only modest penetration of servers. We need to focus on and drive these sales in addition to our client sales.

	1995	1996	1997	1998
Mail servers	326	406	575	697
Intranet servers	16	136	429	1,326
Total Market	342	542	1,004	2,023
Notes servers	38	69	122	187
% total	11%	13%	12%	9%

Source: IDC

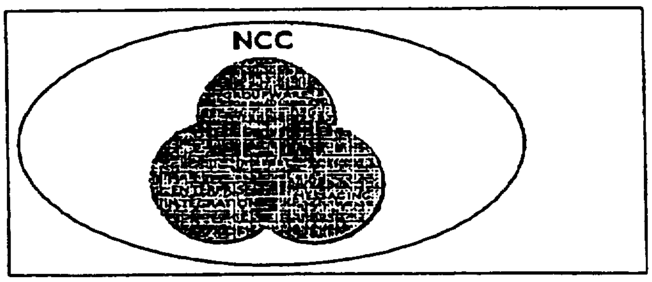
The Notes value proposition

Mail and networked applications development drive Notes business, but it offers special value to those who want a single infrastructure for both. With our continued work on internet capabilities, Notes sits at the convergence of these three key customer needs.



Customers need to integrate these elements of their infrastructure with their enterprise systems, and we have the opportunity to move toward a value proposition based on the the three legs of apps development (groupware), messaging and enterprise integration, with the internet technologies and protocols being incorporated intoour products.

We will ramp up our efforts to integrate Notes with leading backoffice systems, especially those from IBM, but also SAP, Oracle and other leading vendors.



It is important to note that both Microsoft, with BackOffice for NT, and Netscape's suite will also be targetting this space.

The value proposition of enterprise integration my have greatest meaning to the largest customers with an array of transactional systems, database systems and functional systems.

Marketing and Distribution Strategy

Our marketing and distribution strategy for communications products will continue to rely on direct sales (supported by business partners) into the enterprise accounts for infrastructure sales, and solutions selling into the mid-tier, led by business partners. We will continue large scale demand generation and add an emphasis on stimulating trial. The major area of discussion in our marketing strategy is with regard to the level of OEM sales.

OEM Strategy

In 1996 we are pursuing a modest OEM strategy. We are reviewing whether we should pursue a much more aggressive stance in order to reach our seat and revenue goals. The benefits to be gained from OEM distribution include new customer awareness and trial, improved Lotus market visibility, increased actual revenue per PC shipped, increased commitment from hardware and software providers to Lotus products, and additional Business Partners. If Notes is pre configured, OEM distribution could result in accelerated deployment. These benefits must be balanced against two significant potential downsides: cannibalization of revenue and attention from other channels, and the potential devaluation of Lotus products when they're included at no charge.

Server Bundles

Past server bundles have provided a heightened market image and increased actual revenue per PC shipped.. But despite market research suggesting high customer appeal, activation rates of Notes (as measured by requests for support) on bundles done with Sun and HP were very low — well below 5% of server shipments with the bundled software. Moreover, some of the activations took place with existing customers, highlighting the risk of cannibalization. Analysis suggested three major areas for improvement: easier installation and trial of the software; increased value of the Notes server through prepackaged applications, including ones that connect the buyer with the server vendor; and additional techniques for identifying the actual user of the server, so that follow-on marketing efforts can be targeted. Future server bundle efforts will likely focus on reaching new customers and directly identifying those customers; providing value-added content on the server, and more modest discounting to ensure increased actual revenue per PC shipped.

Intel-based server unit market volume in 1996 is expected to be approximately 1.5 million units. Prospective Lotus Notes server OEM bundles over the next 18 months could yield roughly 110,000 units, or about 4 % of annual server shipments. At average selling prices of $50 - $75, such a level of OEM server sales would result in $3 million of annual revenue, compared to $40 million of full price servers. Even if those OEM sales went completely to existing customers, we would be better off because the price discount (one sixth of ERP) is much less than the incremental volume we would gain (twenty times our average server share of 5%).

With the creation of an entry-level, Internet value-in-the-box offering that would be both suitable and attractive for more extensive server OEM activity, unit volumes in 1997-99 could be much higher, albeit at lower average prices.

Client Bundles

While the same benefits and concerns apply to desktop OEM activity, there are several significant opportunities for client bundling over the plan time period. Introduction of entry-level Notes clients — such as the Internet POP3 mail functionality in early 1997 — could have broad OEM appeal. POP3 mail clients work with any Internet mail server. We are also evaluating a proposal for selling Notes as a "personal filing assistant." Non-Windows client bundling could yield 2 million clients and $3 million in revenue. This assumes that non-Windows OS continue to gain 15% of total PCs shipped and we get a contract with one major vendor, either OS/2 or Sun. We believe there is less risk of cannibalization in the non-Windows markets.

Bundles of Notes clients on Windows hardware could be very substantial in unit volumes. For example, it would be possible to move 5 million Notes seats (10% PC shipments), but prices for such volumes would fall at or below $2 per unit, which is the standard for a single high value application. Clearly, the $10 million direct revenue from such OEM activity would not be as significant as follow-on revenue with customer upgrades, maintenance, and server revenue. It could drive trial Notes activity in the marketplace, however.

We have included 2-3 million units in the current 3 year view. We are reviewing more the aggressive strategies.

Bundles with software or systems solutions

Activities with ISVs represent a major thrust for Lotus starting in 1996, and given the lengthy time of ISV product development cycles, the fruits of that effort will be seen in 1997 - 1999. ISV solutions will embed Notes for all of the ISV's customers, or for particular applications in the ISV's target market. These solutions enable Lotus software to reach customers that otherwise would not use Notes, because the customers tend to rely on packaged solutions rather than developing such solutions using the tools themselves. The broader dissemination of Notes services would also fit in this category, but we would expect this to drive standardization rather than immediate revenue.

Other Strategies

Network Notes

The original vision for Network Notes, as the business Internet, would have driven substantial numbers of seats of Notes. Today, the Internet has grown in acceptance and the Network Notes effort has assumed the role of creating a class of major business partners for Lotus Notes among the telecommunications companies who will offer Notes hosting as an outsourced service to Notes customers, use Notes in their Internet hosting activities, and develop Notes-based solutions services. AT&T's investment did create substantial market awareness for Notes, and funded the development of what will become our cluster server. We do not see it as a major seat driver for Notes today.

International-Driven Growth

Lotus has a lower proportion of its sales coming from outside the United States than other software companies. Microsoft, Oracle and Sybase derive are roughly 55% of their revenue from international sales and we derive only 45%. Our relative share in Japan is good and is an excellent foundation for growth; in Europe our share is weaker, and Asia/Pacific and Latin America are emerging markets for us. International-driven growth represents an opportunity for Lotus Communications products.

Leverage with IBM ISUs

The IBM ISUs are 13 especially large system integrators focused on vertical industries which could drive substantial business if they formally adopt Notes as an applications environment for document centric apps delivered to PCs on a LAN or remotely. The effort to mobilize the ISUs as partners is proceeding slowly. Lotus believes that several related but independent initiatives would increase the contribution of the ISUs in marketing Notes: 1) additional education of ISU development management, so that Notes is included in more ISU solutions developed within IBM, 2) heightened promotion of Lotus BP and ISV solutions in the ISUs so that existing Notes solutions get broader reach 3) increased training of ISU Sales on identifying and capturing Notes opportunities, with appropriate usage of Lotus, ISSC, and/or BP resources to close and implement the business

Services

Lotus Services Group (LSG) activity is built atop the Lotus core technology and is a key part of the overall value proposition of Lotus' software business. Many customers, especially enterprise customers, prefer to have their services delivered by the product vendor. Lotus Services has demonstrated a very healthy revenue growth, and expectations are that as Notes seats grow from 5 million seats to 30 million seats, LSG will maintain its growth rate.

	Industry Average Svcs. Growth Rate 94 - 95*	Lotus Svcs. Growth Rate 94 - 95 (actual)	96 to 95 Svcs. Growth Plan	97 to 96 Svcs. Growth Projected
Consulting	14.3%	56%	51%	51%
Education	13.1%	112%	54%	45%
Support		51%	35%	35%

* *IDC WW Services Report #10903 (1/10/96)*

The major operational challenges Lotus Services faces during this rapid expansion are to grow its work force and its skills and capabilities quickly enough, to improve profitability, and to manage relationships with our business partners at the same time we capture a part of the services business ourselves. LSG plans to grow its work force through an aggressive hiring and training plan, increasing total head count by 41% in '96, 17% in '97, and 24% in '98. While growing, LSG plans to increase consultant utilization in order to improve profitability. LSG's strategy is to serve the enterprise segment directly while leveraging IBM/Integrated Systems Solutions Corporation (ISSC) and enabling business partners.

The Enterprise segment (including but not limited to the Global 2000) consists of organizations having the following broad attributes: large, multinational, prone to exploit leading edge technology, where much if not most of their competitive advantage is gained through the exploitation of knowledge. LSG provides the business thinking, the methods and tools, and the infrastructure for disseminating, processing and enhancing the knowledge contained within the enterprise. Lotus Consulting encounters the Big Six, as well as ISSC, in large accounts. However, LC is focused only on Notes deployment. Lotus partners with one of the Big Six or ISSC for the Notes specific part of a larger Business Partner or SI engagement.

Lotus must continue to leverage business partners. If the Notes services business in total is 5 times as large as the product business, LSG represented less than 8% of the total Notes services market in 1995.

The Desktop Business

Over the next 3 years, Lotus looks to stabilize what had been an eroding position in the desktop business applications market. In Q1 1996 a 20% unit share of this market has been achieved through aggressive OEM bundling. Our target is to move to around 24% by the end of this year and maintain that unit share over the ensuing two years. Our revenue share plan is for 9% of the

business, marginally higher than we achieved in 1995. The major risks to this plan would be if Microsoft decides that a 25% unit share is too much. This is unlikely given that the desktop apps business now represents 40% of their revenues and more of their profits.

During the plan period, we expect to rejuvenate our business by driving the market back to standalone applications by focusing on components.

Current Market Situation

Today, Lotus is a distant second-place vendor of productivity software at a relative share disadvantage of nearly 7:1 versus Microsoft Office. Considering only the three major revenue players making suite software, Microsoft commands 80% market share, followed by Lotus with 12% and Corel with 8%. Despite the industry's apparent disinterest in the productivity software market, it continues to be large and growing. It is estimated that the market will grow to $5,000M by 1997, representing a CAGR of 9% over 3 years.

Over the past 4 years, the market has shifted toward suites of productivity applications and away from standalone products. This trend is expected to continue, though Lotus' standalone application sales (primarily Lotus 1-2-3) are projected at a healthy $130-140M in 1996.

Achieving our Goals

For the next 18 months, we do not expect the general market trends to change significantly. We believe the desktop market will continue to grow at 5-6%, with Microsoft Office dominating the market. The market perceives the products are "commodities," with little opportunity for functional differentiation. Given the fact that the decision to purchase any suite product typically involves a large and strategic investment for the customer, the safe decision is to go with the market leader. Despite these difficult circumstances, it is important for Lotus to continue to maintain its reputation as a credible productivity software vendor. The business can also be managed as a profit contributor to Lotus.

Lotus' primary short-term goal is to achieve a unit market share of 24% by the end of 1996, up from 11% in 1995. We have already reached 20% in Q1. The major plans to maintain unit market share goals are:

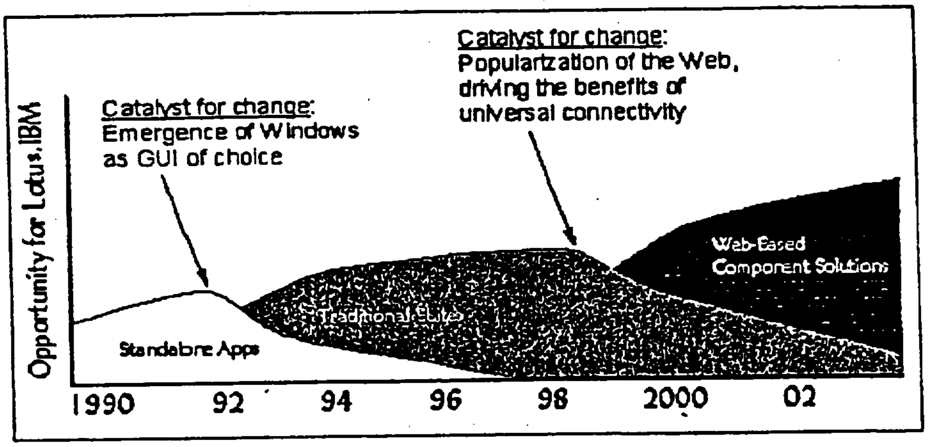
1. Aggressive OEM bundling with IBM, Acer, AST, Epson, HP Deskjet printers, and others. We anticipate over 7.5 million licenses of Smart Suite will be distributed through these channels in 1996.
2. Target the mid-tier and general business markets (research indicates these segments are more open to considering a non-Microsoft solution for desktop applications)
3. Message "All the Software Your Business Needs" as opposed to "The Suite for You and Your Team"
4. Heavily invest in print and radio advertising (thanks to a 35% increase in marketing budget)
5. Establish price leadership with a simple $149 price (about 30% lower than Microsoft Office)
6. Gain trial and encourage migration from WordPerfect through targeted programs.

In addition, we anticipate that a new release of Smart Suite will ship in the fall. Including the much anticipated, rewritten, 32-bit version of Lotus 1-2-3, Smart Suite 97 will factor heavily in our ability to regain momentum in this market. Finally, "features-parity" releases of Word Pro and Freelance for OS/2 will ship in the second half of 1996.

Given these plans, we expect Lotus Smart Suite to add one share point, adding revenue growth of $25 million in 1997 and in 1998. Beyond that, we look to drive fundamental changes in the market to create opportunity for Lotus.

Impact of the Internet on Business Productivity Apps

We expect that, much like the dramatic effect the adoption of Windows 3.0 had on the productivity applications market (to the severe detriment of Lotus, WordPerfect, etc.), the rapid emergence of the Internet also has the potential to change the fortunes in the desktop applications market. Representing this graphically, we think the Internet boom represents a fundamental opportunity for Lotus in productivity software:



Note: The Y-Axis of this graphic is a very loosely defined "opportunity." It is not revenue, seats, share, potential, leadership, etc... It represents all of these.

The tremendous popularity of the Web is driving people to get connected via a common protocol (TCP/IP). *Lotus believes that it is clearly possible to define a viable market based on Web-connected users in 1997.* The Web presents an opportunity as a broadly used container for components, as well as the facilitator of electronic commerce in software components.

Enter Components

Ask any productivity application user if their software is easy enough to use or fast enough, and they will tell you a resounding "No." Redefining our productivity products as more focused (therefore easier) and faster (therefore possibly smaller) components enables end-user benefits. In addition, it enables a product proposition that competes well against Microsoft Office.

The current suites are extremely large, slow and overly feature rich. A recent *Business Week* article nicknamed these products as "bloatware," a term that resonates with customers. In response to these sentiments, Lotus will ship this summer the Lotus Components, a set of more focused, faster productivity components. Built on the OCX technology, these components plug into Lotus Notes and add value to the Notes end user and application developer. We expect that Lotus Components will achieve sales of $7M in 1996, but more importantly, we expect that we will have the opportunity to use Lotus Components to grab the mantle of innovation in productivity applications definition.

To extend the market potential of "components," Lotus intends on refocusing on the Web as the primary container for components. Additionally, we plan to apply the core Suite productivity assets in building components. By identifying the core benefits of "components" as software that launches faster and presents a more focused purpose, we think we can quickly shape virtually all of Lotus' current productivity products to be "components." That way, Lotus Components will offer what simply stripped-down components solutions can't — compatibility with users' current files.

Lastly, we are studying a plan, code-named Lotus Web Suite, to enable the aggressive distribution of the components through free CD-ROM distribution to stimulate trial (a la America OnLine), coupled with license management and payment over the Internet.

Microsoft Applications Revenue as % of Total Revenues			
	1995	1996E	1997E
Office	37.9%	35.5%	36.7%
Office + Standalone App	46.9%	40.1%	40.0%

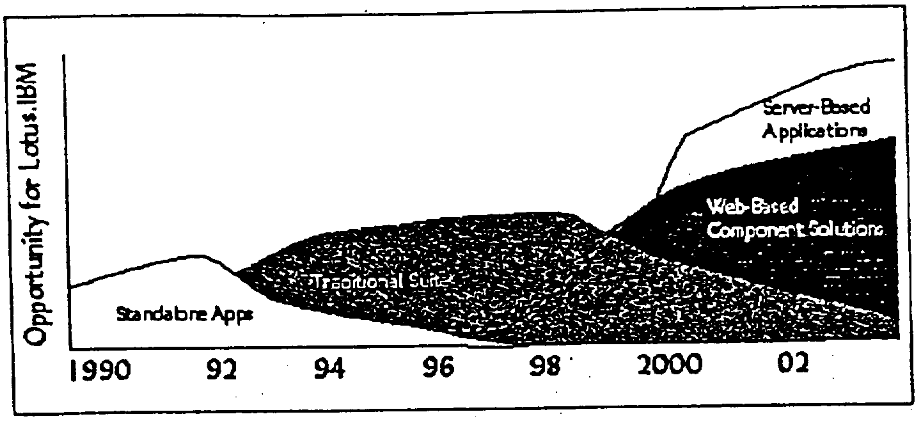
We believe this Web Suite components strategy offers substantial user benefit, great opportunities for volume market penetration, and will be difficult for Microsoft to respond to in kind. By breaking the suite apart and offering the customer *a la carte* pricing for the component pieces, Lotus challenges Microsoft to threaten its cash cow, Microsoft Office.

Representing 40% of Microsoft's total revenue, Office captures $150 of revenue per seat for Microsoft. It is this dependence on Office revenues that will hamper Microsoft's ability to compete financially and gives the Web Suite the chance for a sustainable market advantage. Through the Web Suite and its high volume distribution strategy, Lotus will be actively encouraging users to satisfy their productivity software needs for substantially less. Therefore, the combination of aggressive trial and distribution, with a compelling value proposition will result in a significant unit and share growth opportunity for the Lotus Business Applications Division.

Many significant questions remain such as how Web-based licensing affects current channel policies, what specific issues arise in application of this strategy internationally, how we can execute this strategy for OS/2, etc. We are actively investigating these questions now. The impact of this strategy will be felt in 1997 and 1998.

Longer Term Planning

Beyond the Web-Based Components Solutions initiatives, Lotus sees a definite path of opportunity to capitalize on the longer term dynamics of the industry. Server-Based applications represent that dynamic and create tremendous synergy opportunities for Lotus and IBM. The graphic below maps the opportunity:



Clearly, since the inception of the computer, applications have been run from the server. However, most productivity applications are today run from the local PC. Today, PC-based applications offer greater mobility, personal control, and functionality versus server-based solutions. Nevertheless, the proliferation of PC-based applications has driven the total cost of ownership of computing resources through the roof. Through central management and administration of server-based solutions, server-based applications potentially offer the best of both worlds.

Lotus plans on building its productivity components to be deployable in a server-based world. We feel there are three driving forces behind the creation of a viable market for server-based applications:

1. Development of lower-cost connectivity devices (the IBM netstation concept),
2. Emergence of platform- and processor-independent programming languages (e.g. Java),
3. Widespread installation of a high bandwidth connected infrastructure.

Clearly, all of these items are getting a tremendous amount of market energy directed at them. We feel that of the three, the widespread adoption of a high bandwidth infrastructure is the gating issue. Our current assumption is that it will be at least 3 years before the market has a high enough bandwidth infrastructure to create a viable market.

To accommodate this longer term strategy within the development plan, the Lotus Business Applications Division plans on investing in both current embedding technologies (e.g. ActiveX) as well as in Java. The Java initiatives will be targeted longer term, and will result in Java-based components as well as Java-based front-ends to our core applications for server deployment.

Summary

We expect the growth of the Internet technologies and marketplace to continue to transform our product businesses. We must improve our visibility in this space. Microsoft competition with BackOffice and with its components will demand a crisp response from Lotus and other IBM