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Message 69:
From tonya Tue May 8 14:21:18 1990
To: billg billp johnsa steveb
Cc: jonl jons mikehal paulma russw tonya
Subject: Re: Creativity needed/IBM
Date: Tue May 08 14:15:25 1990

IBM has agreed to pay us 50% of development costs (\$25M) plus per system royalties of about \$25M. Assuming they would have split development costs on OS/2 without the new deal, we are net \$8M ahead for their 50% of the DOS/WIN development. On the per system royalties, if we assume the FY 91 3 year plan number for IBM OS/2 royalties (\$6M) is good, we net \$19M. In total we are ahead by about \$27M.

The worst case IBM denial scenario costs us about \$29M. This is based on IBM selling 40% of the retail Win units (approx 400k) at a gross profit of \$60/unit (\$24M) plus 200k updates at a gross profit of \$26/unit (\$5.2M). Also assumes they don't provide any further assistance in the form of support, advertising, etc. So worst case we would be about breakeven. Not very interesting. The only good news is we can make this a 3 year deal (1 plus 2 yrs after BR).

Best case denial scenario would be MS selling all Win units to IBM users and paying IBM the CCP. Using the same units as the worst case (400k product and 200k updates) this would cost us about \$9M. So we would be about \$18M ahead. While neither of these cases are the most likely they define the edges. Also both would probably get worse from our perspective as we move forward in time because (1) OS/2 royalties without the new deal would continue to increase; (2) Win revenues/profit will ramp faster than their per system royalties even with inflators and (3) DOS/Win development exp will be relatively stable compared to Win revenue/profit ramp.

This leads to the conclusion that we should either be much more aggressive on the low end, ie, DOS RUPs and Win OR we have to believe in the 1+1=4 scenario where getting IBM's endorsement of Win will cause Compaq and HP to sign Win bundle deals and we will blow the FY 91 Win plan out of the water.

Other possible conclusions are we shouldn't do this deal or we should reconfigure the entire deal, eg, bill and steve's marketing idea. I think both of these should lead to the same action by us. kill this deal and then

come back in 6 months to the "right" people, like conrades or someone else. I don't think it will be very productive to present a radically new proposal to cannivino at this stage.

Bottom line: IBM needs this more than we do so we should be absolutely HARD CORE about the low end. if they walk, it will be much easier to go back to them then if we do. if the 1+1=4 scenario materializes it will be gravy.

as far as coming up with a creative label for the per system royalty, we need to tell them they are buying into existing technology. we could value the Win business and have them pay 50% of that value up front.

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but we would never agree on the value. so the staged buy-in payment makes more sense and is less risk for them than an up front payment. this deal is basically a cost sharing agreement(CSA) and buy-ins for CSAs are commonplace so they shouldn't have a problem with it. if there is something more meaningful than % of systems to base the buy-in payment on than we should use it. i thought about taking a % of their gross profit from Win sales but this would be difficult if not impossible to measure. buy-ins connote a partnership and royals connote a license relationship.

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