

1/11/94

Second Quarter Business Review
February 18, 1994

Agenda

- FY94 Second Quarter Results
- FY95 Planning Process

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FY94 Second Quarter Results

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Q94-2 Hot Topics

Good News:

- WfW Upgrade sell-in 26% over plan
- NA retail Windows revenue more than twice YTD plan
- NT AS unit shipments continue to increase
- Controllable expenses 18% under plan

Things to watch:

- Inventory "adjustments" reduced Q94-2 BOI \$9.8 million
 - Mouse inventory write-down \$2.5 million
 - Win Sound System \$4.5
 - MS-DOS 6.0 \$2.8
- MS-DOS OEM reports are 8% below plan despite strong processor shipments

we think problem is under reporting by IBM

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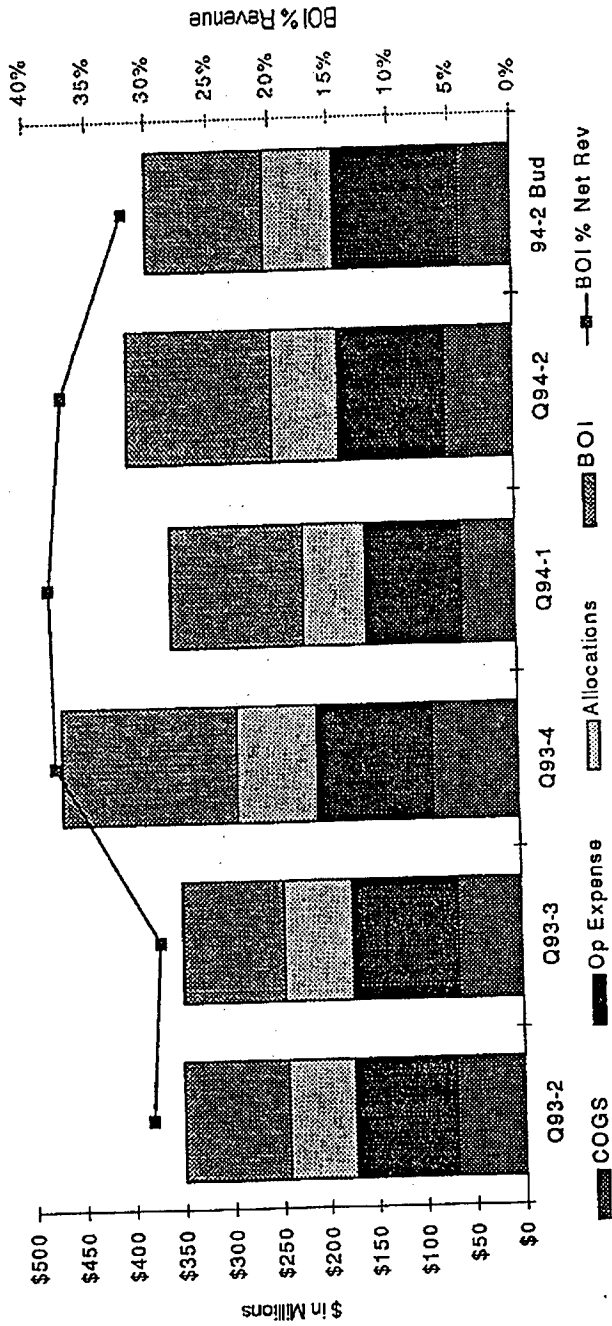
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- Revenues 5% over budget, up 12% from last quarter.
- COGS up from Q1 and over budget due to MS-DOS 6.2 and retail Windows.
- Marketing and Prod Dev spending under budget, BOI 23% over plan as a result.

Systems Division P&L



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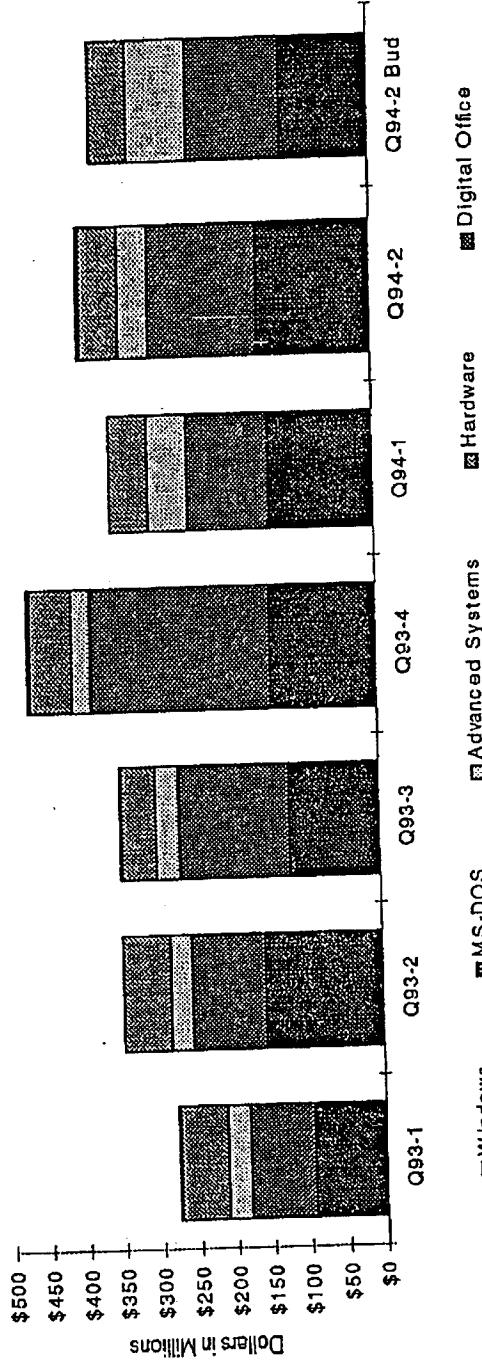
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- Windows revenues 121% over budget in NA retail channel; worldwide OEM revenues 35% over budget.
- MS-DOS V6.2 launch drove NA retail revenue 160% over plan. Total MS-DOS revenues are \$20 million (16%) over budget

Revenues by Business Unit



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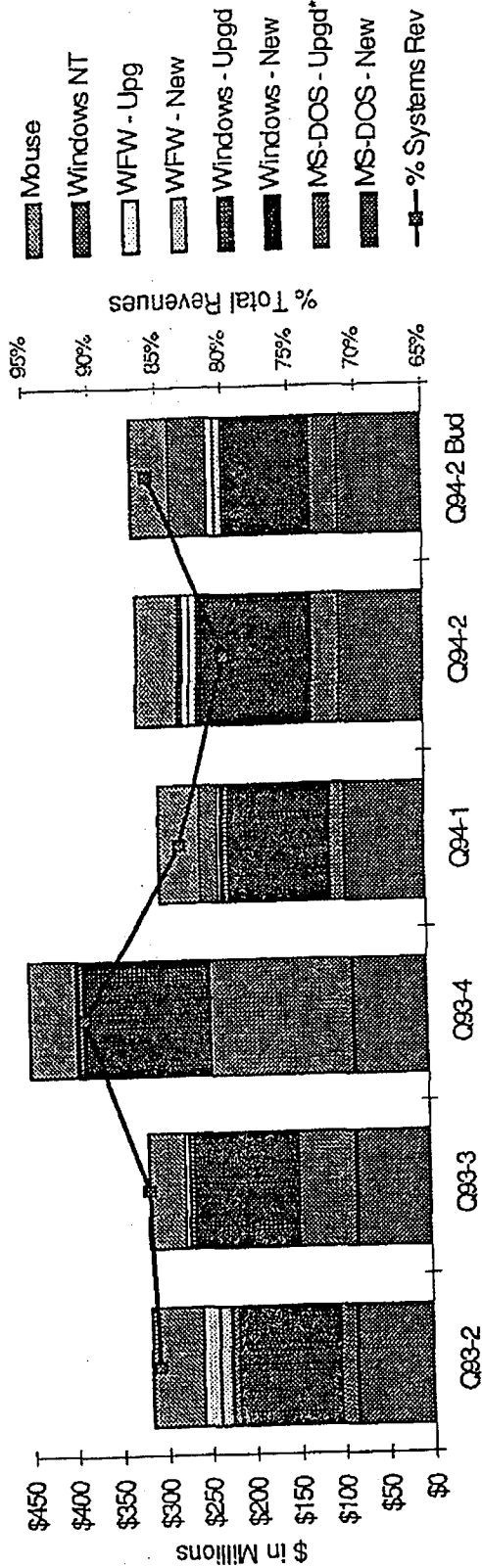
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- MS-DOS OEM revenues on plan, units 8% under budget - late reporting suspected.
- MS-DOS MED units (19% of YTD ships) resulting in higher rev/unit.
- New Windows revenues \$32mm (33%) over budget due to OEM and NA retail.
- Mouse revenues 11% over budget but rev/unit down due to increase in OEM units.

Top Products



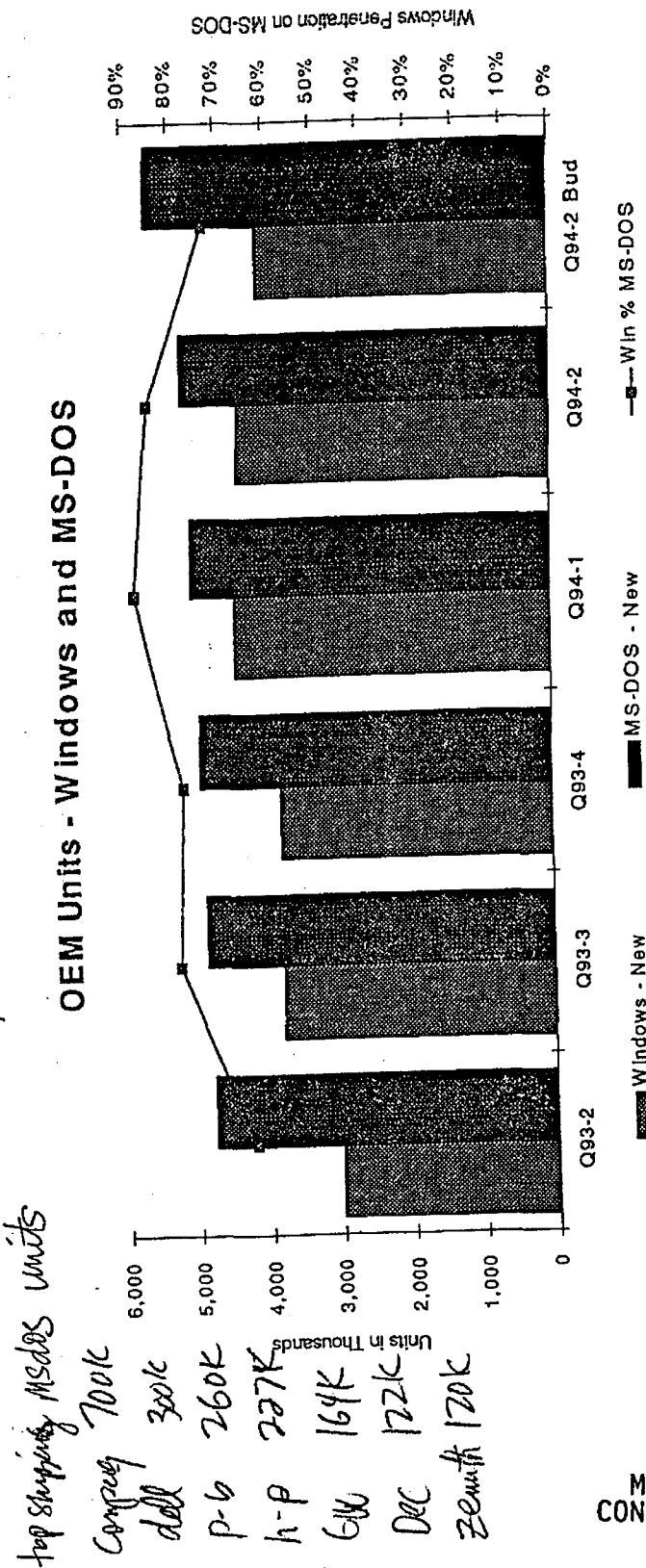
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- MS-DOS units up 3% from Q1, 8% from last year but 8% below budget- IBM 356K below budget (late reporting a factor). Other major OEMs over budget, small ones under.
- Windows units up 46% (1.4 mm units) from last year and 7% (300K units) versus budget. Q2 units flat vs Q1 due mainly to IBM down 420K units.



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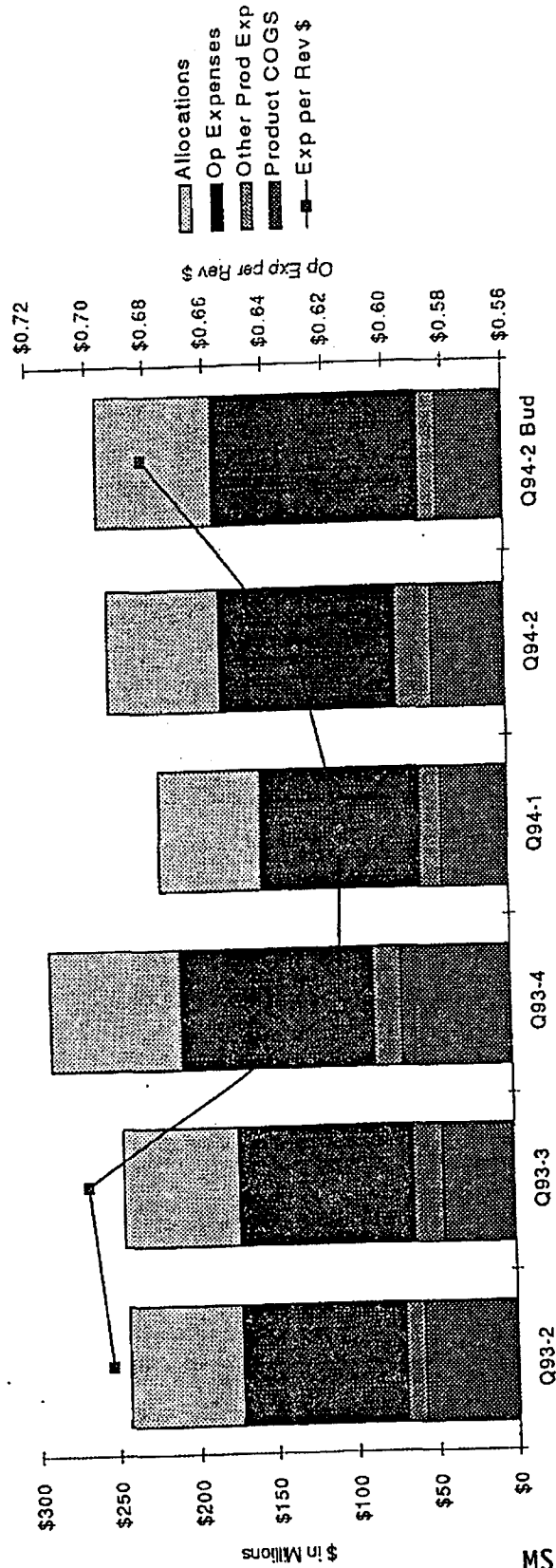
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- COGS over budget due to strong NA retail sales of MS-DOS V6.2 (+\$3 million) and Windows (+\$2 million).
- Other Product Expenses variance due to Mouse, Sound System and MS-DOS V6.0 inventory adjustments.

Expenses by Major Category



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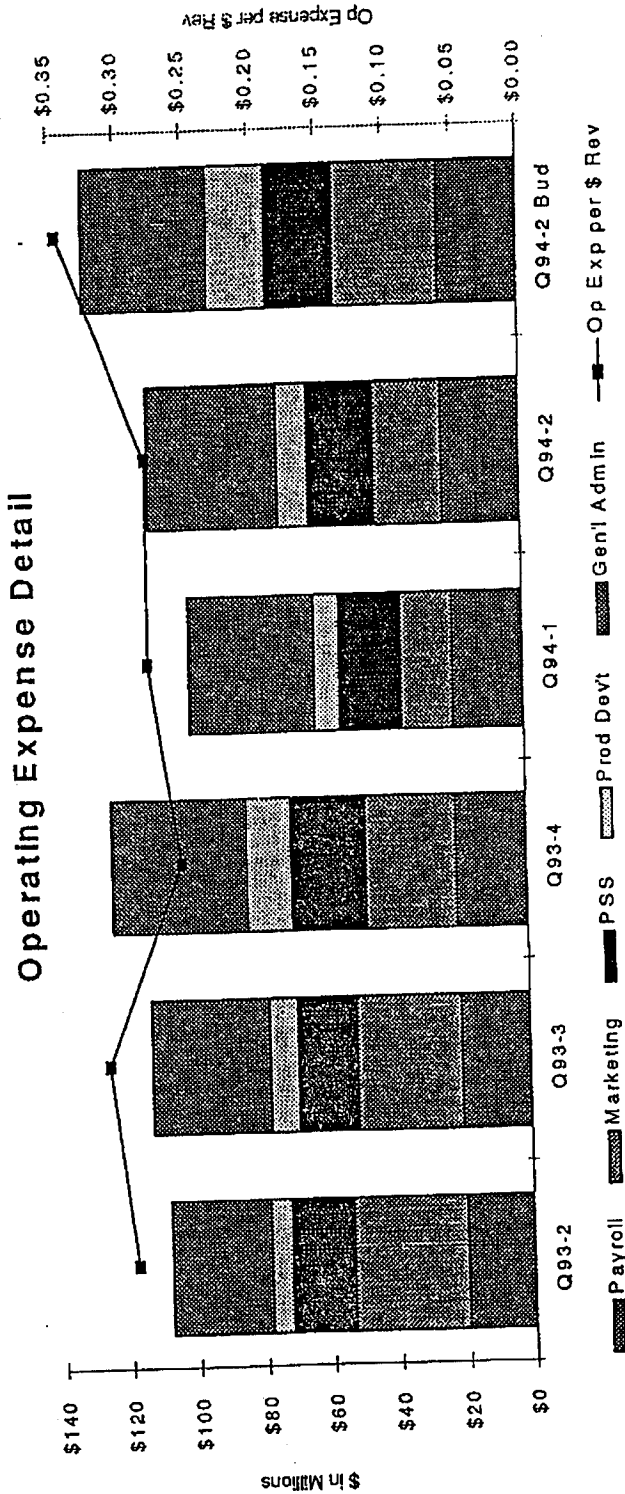
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- Operating Expenses 15% under budget - mainly Marketing and Product Development
- Only unfavorable variance vs budget is Bad Debt Expense (\$5 million); OEM is reserving for bad debts at small OEMs
- Marketing spend is up vs Q94-1 in Advanced Systems (\$3 million), and MS-DOS and HRD (\$1 million each).



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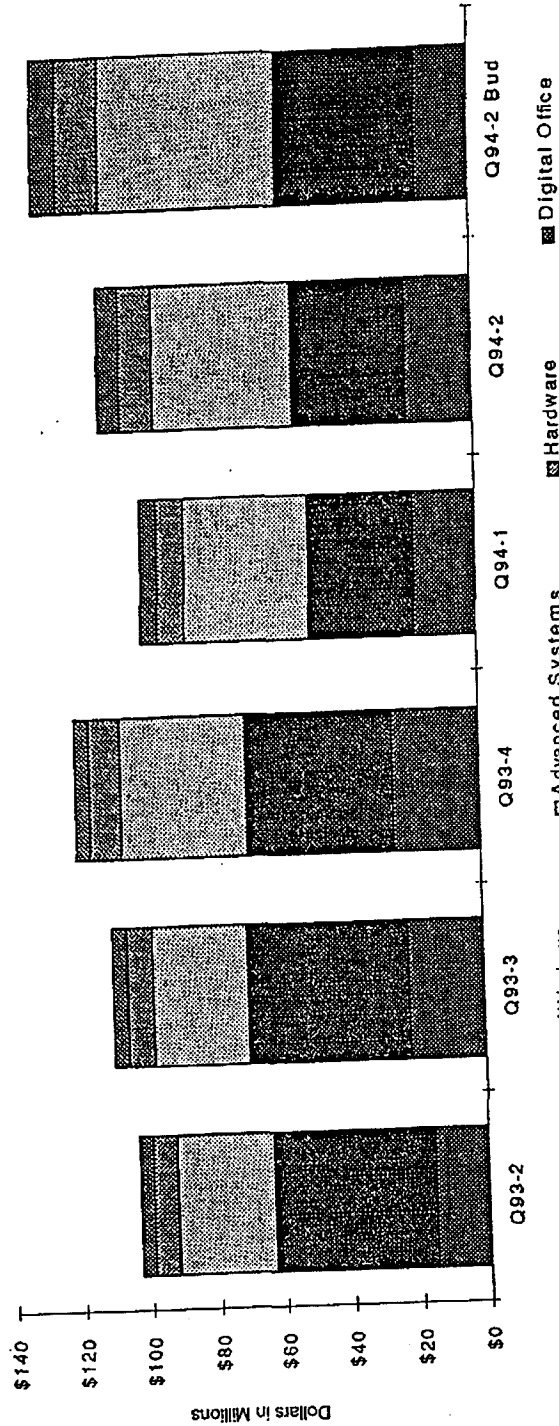
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- MS-DOS expenses 23% over budget due to Bad Debt (\$3 million over budget) and PSS (\$1 million).
- Advanced Systems \$4 million increase in spending vs Q94-1 reflects \$3 million increase in Marketing spend.

Operating Expenses by Business Unit



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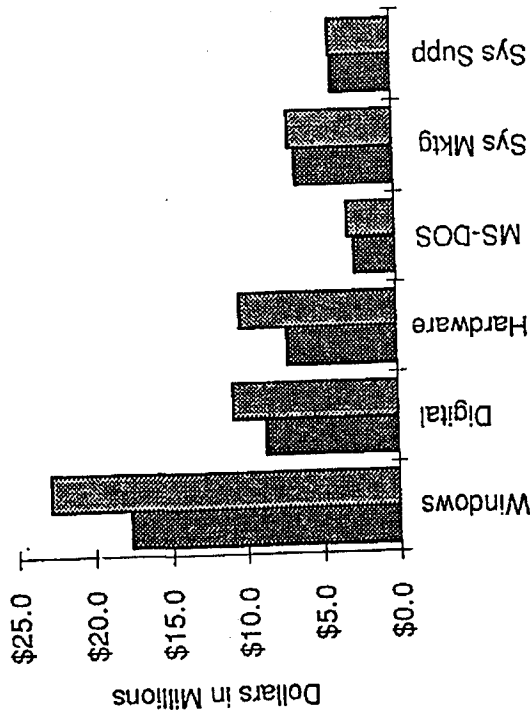
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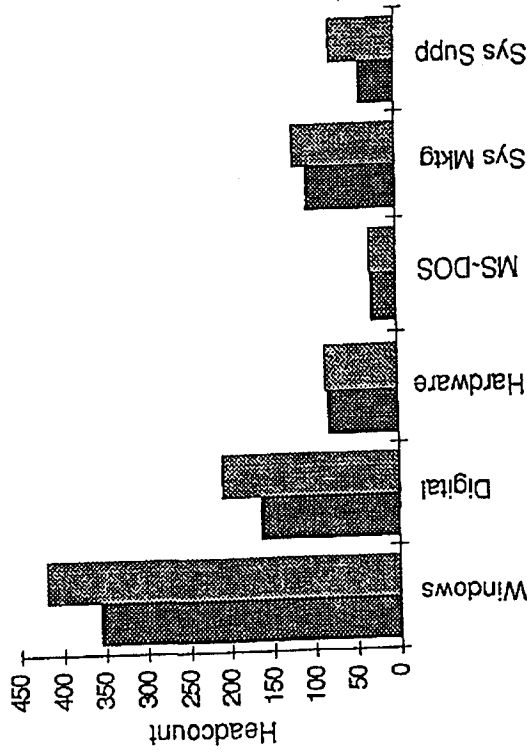
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- Controllable department expenses 18% under budget.
- Current headcount is 18% under year-end budget level.

Q94-2 YTD Dept Expenses



Headcount Performance vs. Plan



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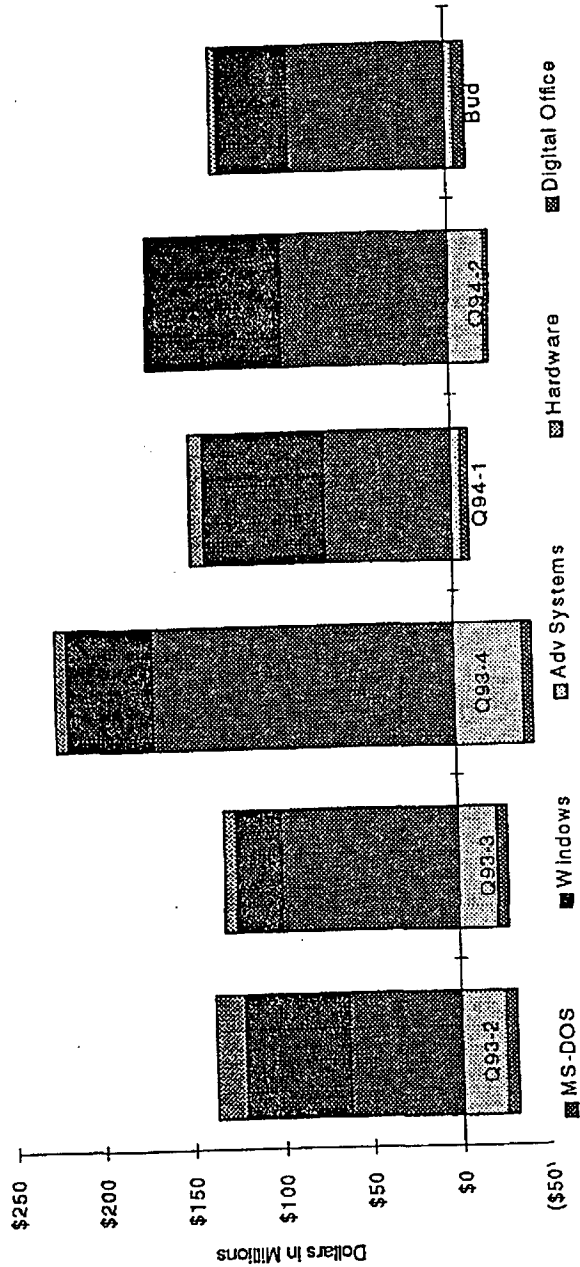
ASG 38/45 Expense Q94-2
 45/567 Headcount

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- Windows BOI 85% over budget as a result of OEM revenues well over budget.
- Decrease in Hardware BOI from Q94-1 reflects inventory adjustments (\$7 million) and increased Marketing spending (\$1 million)
- Decrease in Advanced Systems BOI from Q94-1 is reflects \$14 million decrease in net revenues.

BOI by Business Unit



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FY95 Planning Overview

- Schedule
- Budget Approach by Category
- Next Steps

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FY94 Planning Process

What worked...

- Up-front planning with USFG to get agreement on US revenue plan
- Bobmu's detailed tracking of Advanced System's external product development
- SysCost localization model

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Areas for improvement...

- Budget tools, especially reporting
- Handling of beta program expenses
- Efficiency - more than 60 Systems people were involved in last year's effort
- Implementation of changes late in the cycle
- Accuracy - especially in operating expenses

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FY95 Systems Budget Philosophy

- Keep It Simple - minimize effort, and maximize value and efficiency
- Employ a tops-down, per-head approach for most headcount-driven expenses
- Identify and plan Beta programs, External Product Development, and Localization in more detail

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FY95 Preliminary Schedule

- February**
- Submit *preliminary* org structures and product families
 - Update PRS with latest product release and localization plans; finalize in March
- March**
- Complete per-unit COGS budget
 - Joachimk publishes Intel processor forecast
 - Mikemap guidance package published
 - Begin revenue discussions with US retail channel
- April**
- BWB V2 releases April 1; revenue budgets loaded and scrubbed by 10th
 - US-FG Revenue budget approved by Mikemap and channel by 20th
- May**
- Operating expense, headcount and capital budgets completed
 - FY95 Management P&L's available on-line

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Revenue Goals

- Focus on developing *realistic and achievable* revenue plans
- Work with US FG early to get buy-in
 - Jeffsa, Mikeap and BUMs need to sign off on revenue plans by April 20
 - Outstanding issues will be escalated to Mikemap / Steveb
- Get plan into BWB promptly - PMs will have around one week to enter and scrub detail

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Headcount

- FY95 Headcount targets will be set by Mikemap and Paulma - preliminary guideline is no growth.
- Paulma will assign headcount targets by business unit.
- Far East headcount in Redmond on extended assignment should be budgeted as "Redmond heads" by respective departments.

Operating Expenses

- Budget headcount-driven expenses centrally
 - Will reflect actual FY94 spending plus reasonable growth
 - Will be tuned to function and product - i.e. Marketing T&E will be higher than User Ed, etc.
- Detail Beta Program and External Product Development expenses
 - template to break down beta expenses by product, category, timing, number of sites, etc
 - template to detail purchased code, contractor expense, definition, name of vendor (if known), estimated amount, etc.
- Business Unit Management Review and Approval- adjust as necessary

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Localization

- Project list based on Plan of Record
 - Information must be loaded into PRS ASAP
 - Final changes need to be reflected in PRS by March 16
- Business Units budget Redmond costs only
 - Out-of-pocket costs only - localization vendor costs, temps and contractors, etc.
 - MS headcount-related expenses included with department expenses
 - Guidelines will be provided
- IRL, MS-KK, other Subs will budget their costs locally
- SysCost model used for costing localization projects

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Marketing Budget

- FY95 plan still being devised; Product Group expected to play a more active role in FY95 Marketing
- Preliminary discussions center around planning marketing around "missions", with less emphasis on project-by-project detail.
- Will provide updates as more information is available.

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Next Steps

- Davidbr/Normanto will meet with BUMs in early March to review 3-year plans and to understand business-specific issues.
- Detailed schedule/process memo will be distributed after Mikemap's guidance memo is published.
- PMs/BUMs will begin creating FY95 revenue plans and identifying potential US retail channel issues.

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