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Board of Directors Report

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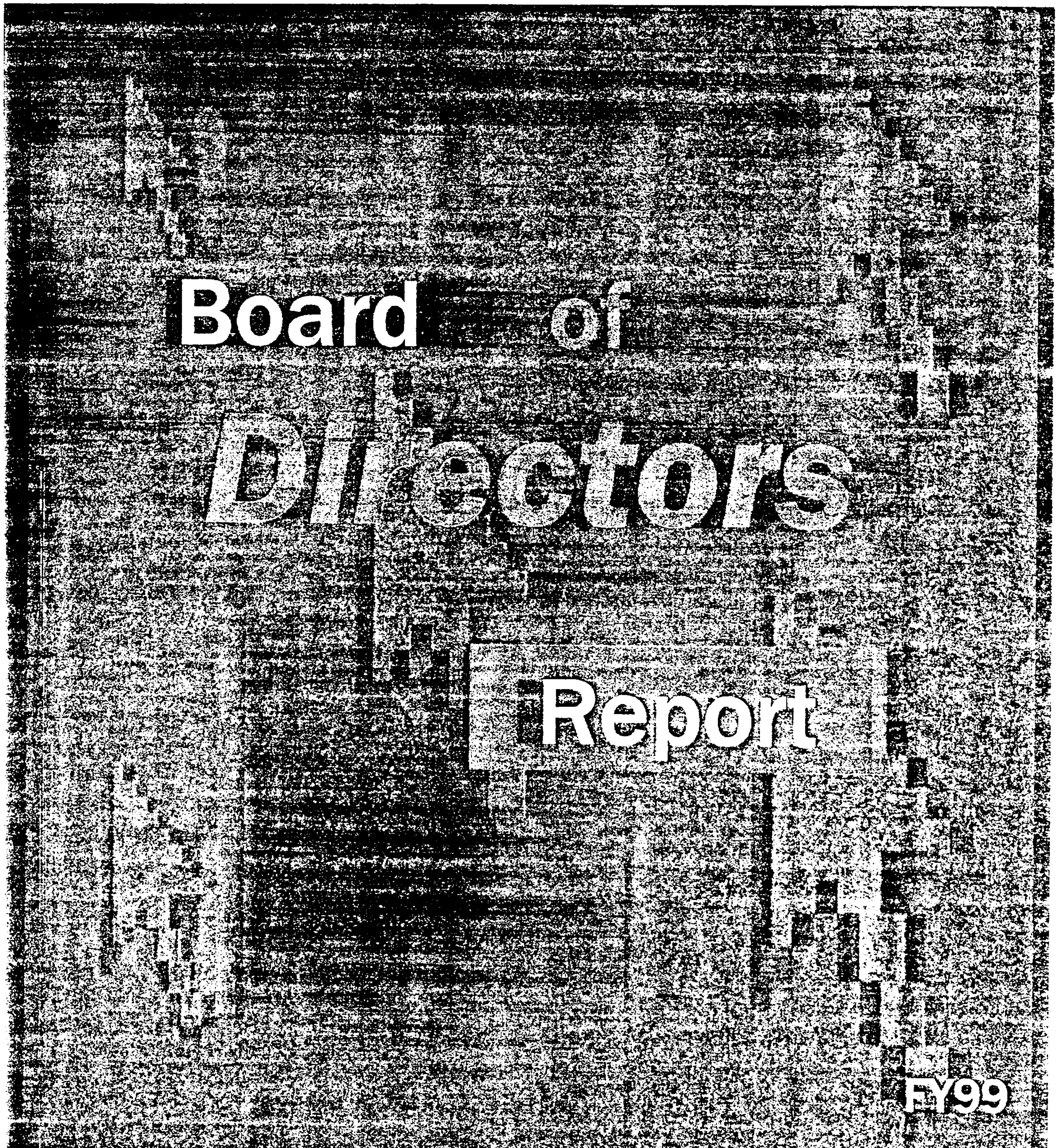

Board of
Directors
Report
FY99

Q99-4

Q99-4 BOARD OF DIRECTORS' REPORT

Contents

This report was prepared with Word 97 for Windows. All tables were created in Excel 97 and are either embedded in the document or linked to master spreadsheets. Additionally, most of the channel and product group tables were generated via automation from the general ledger. Each of these automated tables is made accurate in its calculations by using data at a lower level than the rounded amounts shown in this report. These lower level amounts are used to calculate variances and are then rounded and displayed in this report. Therefore, individual amounts are rounded perfectly but totals and variances may not foot precisely. All other tables have individual numbers that may be rounded. While these individual numbers may not tie precisely to supporting schedules, they will foot exactly as shown in this report.

Microsoft Results

GAAP RESULTS

EXECUTIVE SUMMARY

INCOME STATEMENT

(in millions, except earnings per share)	Q99-4		Q98-4		Grwth	Q99-3		Growth	FY99		FY98		Growth
Revenue	$5,764	100.0%	$4,152	100.0%	39%	$4,595	100.0%	25%	$19,747	100.0%	$15,262	100.0%	29%
Cost of revenue	669	11.6%	673	16.2%	(1%)	708	15.4%	(6%)	2,814	14.3%	2,460	16.1%	14%
Gross profit	5,095	88.4%	3,479	83.8%	46%	3,887	84.6%	31%	16,933	85.7%	12,802	83.9%	32%
Operating expenses:													
Research and development	940	16.3%	739	17.8%	27%	664	14.5%	42%	2,970	15.0%	2,601	17.0%	14%
Acquired in-process technology	-	-	-	-	nm	-	-	nm	-	-	296	1.9%	nm
Sales and marketing	900	15.6%	689	16.6%	31%	849	18.5%	6%	3,231	16.4%	2,828	18.5%	14%
General and administative	297	5.2%	128	3.1%	132%	144	3.1%	106%	689	3.5%	433	2.8%	59%
Other expenses	55	1.0%	49	1.2%	nm	1	0.0%	5,400%	115		230	1.5%	(50%)
Total operating expenses	2,192	38.0%	1,605	38.7%	37%	1,658	36.1%	32%	7,005	35.5%	6,388	41.9%	10%
Operating income	2,903	50.4%	1,874	45.1%	55%	2,229	48.5%	30%	9,928	50.3%	6,414	42.0%	55%
Investment income	485	8.4%	214	5.2%	127%	720	15.7%	(33%)	1,803	9.1%	703	4.6%	156%
Gain on sale	-	-	-	-	nm	-	-	nm	160	0.8%	-	-	nm
Income before income taxes	3,388	58.8%	2,088	50.3%	62%	2,949	64.2%	15%	11,891	60.2%	7,117	46.6%	67%
Provision for income taxes	1,186	20.6%	731	17.6%	62%	1,032	22.5%	15%	4,106	20.8%	2,627	17.2%	56%
Net income	$2,202	38.2%	$1,357	32.7%	62%	$1,917	41.7%	15%	$7,785	39.4%	$4,490	29.4%	73%
Diluted earnings per share	$ 0.40		$ 0.25		60%	$ 0.35		14%	$ 1.42		$ 0.84		70%
Weighted avg shares outstanding	5,521		5,412			5,512			5,482		5,362		

	Q97-4	Q98-1	Q98-2	Q98-3	Q98-4	Q99-1	Q99-2	Q99-3	Q99-4
Revenue (in millions)	$3,175	$3,334	$3,792	$3,984	$4,152	$4,193	$5,195	$4,595	$5,764
Operating income (% of net revenue)	47.2%	31.8%	42.5%	46.9%	45.1%	49.7%	52.2%	48.5%	50.4%
Net income (% of net revenue)	33.3%	19.9%	29.9%	33.6%	32.7%	40.1%	38.2%	41.7%	38.2%
Earnings per share	$0.20	$0.13	$0.21	$0.25	$0.25	$0.31	$0.37	$0.35	$0.40
Earnings per share growth	82%	4%	50%	25%	25%	138%	76%	40%	60%

Note: All historical GAAP presentations have been reclassified to reflect the change in reporting for revenue and costs associated with product support services (PSS), MS consulting (MCS), MSN access, and MCP/MCSP certification and training. This change did not affect internal management results.

HIGHLIGHTS

- Q99-4 revenue was $5.76 billion, an increase of 39% over the fourth quarter of fiscal 1998 and 25% sequentially from Q99-3. The reported revenue includes $200 million related to the fulfillment of the Office 2000 Technology Guarantee. The remaining $200 million of unearned revenue as of June 30, 1999, will be earned upon the fulfillment of several localized versions of Office 2000. In addition to the strong sales of Office 2000, the quarterly growth was fueled by continued adoption of Windows 32-bit operating systems, particularly Windows NT Workstation and Windows NT Server, and related server applications. Growth was also influenced by a $250 million reduction in estimated channel returns.
- Operating expenses include a charge for the practice of setting the exercise price of employee stock options (ESO) at the lowest MS stock price in July for annual grants and the lowest price in the 30 days following the start date for new hires. This charge totaled $217 million in Q99-4.
- Q99-4 cost of revenue as a percent of revenue decreased to 11.6% from 16.2% in Q98-4. The decrease was driven by the mix shift to higher margin products and organizational licenses, a reduction in estimates of obsolete inventory reserves and other manufacturing costs, and a decrease in Online service and WebTV costs.
- Research and development totaled $940 million in the June quarter, an increase of 27% over Q98-4, primarily due to higher development headcount-related costs and the ESO charge.
- Sales and marketing expenses totaled $900 million in Q99-4, representing 15.6% of net revenue compared to 16.6% in Q98-4 as higher relative sales expenses offset lower relative marketing.
- General and administrative costs totaled $297 million, up 132% from Q98-4 due to higher legal fees and a one-time $80 million litigation expense. Other expenses reflect MS's share of JV activity.
- Investment income for the fourth quarter was $485 million, an increase of $271 million over Q98-4 due to a larger cash portfolio and gains on certain equity investments.
- For Q99-4, net income was $2.20 billion, compared to $1.36 billion in Q98-4. The net margin was 38.2%, 5.5 points improved from Q98-4. Q99-4 earnings per share were $0.40, representing growth of 60% over the prior year quarter of $0.25.

CONSOLIDATED MANAGEMENT P&L

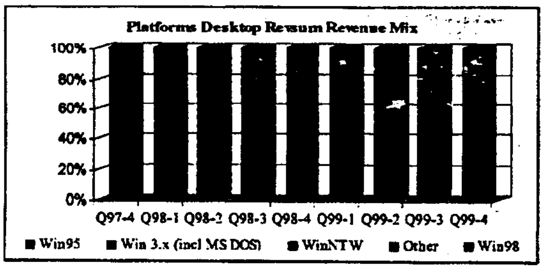
INTERNAL MANAGEMENT RESULTS

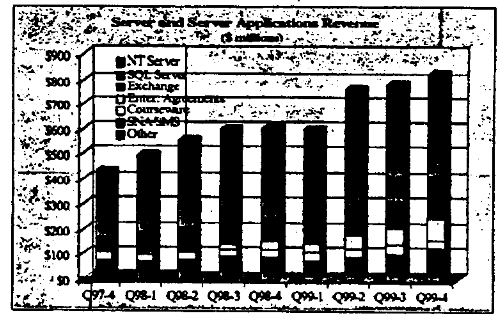
(in millions, variance to plan)	Q99-4 Actual		Q99-4 Plan		Q99-4 Var %	Q98-4	Growth %	FY99 Actual		FY99 Plan		FY99 Var %	FY98	Growth %
Revsum revenue	$5,448.9	114.6%	$4,794.3	103.6%	14%	$4,402.5	24%	$20,060.3	105.3%	$18,095.0	102.6%	11%	$16,427.2	22%
Revenue adjustments	(693.1)	(14.6%)	(168.5)	(3.6%)	(311%)	(371.7)	86%	(1,001.6)	(5.3%)	(462.4)	(2.6%)	(117%)	(968.4)	3%
Net revenue	4,755.9	100.0%	4,625.8	100.0%	3%	4,030.8	18%	19,058.7	100.0%	17,632.6	100.0%	8%	15,458.8	23%
Cost of revenue	370.5	7.8%	415.6	9.0%	11%	377.0	(2%)	1,570.0	8.2%	1,676.2	9.5%	6%	1,392.0	13%
Gross profit	4,385.3	92.2%	4,210.2	91.0%	4%	3,653.7	20%	17,488.7	91.8%	15,956.4	90.5%	10%	14,066.8	24%
Operating expenses:														
Product development:														
Business & Enterprise Group	145.2	3.1%	125.1	2.7%	(16%)	296.2	(51%)	480.4	2.5%	526.4	3.0%	9%	558.9	(14%)
Consumer Windows	39.4	0.8%	43.6	0.9%	10%	129.0	(69%)	170.9	0.9%	190.2	1.1%	10%	304.2	(44%)
Streaming Media	14.3	0.3%	9.7	0.2%	(48%)	11.1	29%	34.9	0.2%	50.5	0.3%	31%	98.3	(65%)
Business Productivity Group	224.0	4.7%	151.8	3.3%	(48%)	189.3	18%	667.6	3.5%	700.3	4.0%	5%	571.8	17%
Developer Group	103.5	2.2%	94.1	2.0%	(10%)	84.7	22%	345.7	1.8%	382.3	2.2%	10%	295.3	17%
Consumer & Commerce Group	242.8	5.1%	162.7	3.5%	(49%)	214.7	13%	669.6	3.5%	655.6	3.7%	(2%)	587.5	14%
Business Divisions	769.3	16.2%	586.9	12.7%	(31%)	925.0	(17%)	2,369.0	12.4%	2,505.3	14.2%	5%	2,416.0	(2%)
Home & Retail	81.0	1.7%	67.5	1.5%	(20%)	72.8	11%	264.0	1.4%	261.5	1.5%	(1%)	255.1	3%
MS Research	25.1	0.5%	26.0	0.6%	3%	17.9	41%	89.9	0.5%	94.5	0.5%	5%	58.3	54%
Unspecified & other products	6.3	0.1%	10.4	0.2%	40%	97.4	(94%)	49.2	0.3%	43.2	0.2%	(14%)	186.5	(74%)
	881.6	18.5%	690.7	14.9%	(28%)	1,113.1	(21%)	2,772.1	14.5%	2,904.5	16.5%	5%	2,916.0	(5%)
Product marketing	225.3	4.7%	122.9	2.7%	(83%)	134.3	68%	552.5	2.9%	521.1	3.0%	(6%)	407.8	35%
	1,106.9	23.3%	813.7	17.6%	(36%)	1,247.4	(11%)	3,324.6	17.4%	3,425.5	19.4%	3%	3,323.8	0%
Sales and marketing:														
Sales expense	421.9	8.9%	331.1	7.2%	(27%)	434.9	(3%)	1,377.8	7.2%	1,410.7	8.0%	2%	1,360.8	1%
Product support	166.4	3.5%	157.8	3.4%	(5%)	228.9	(27%)	624.7	3.3%	666.8	3.8%	6%	597.6	5%
Marketing	343.8	7.2%	265.8	5.7%	(29%)	346.3	(1%)	1,012.6	5.3%	1,016.9	5.8%	0%	924.1	10%
Broad reach	15.1	0.3%	14.7	0.3%	(2%)	23.6	(36%)	79.5	0.4%	79.6	0.5%	0%	127.9	(38%)
	947.1	19.9%	769.4	16.6%	(23%)	1,033.7	(8%)	3,094.7	16.2%	3,174.0	18.0%	3%	3,010.3	3%
General and administrative	187.8	3.9%	115.3	2.5%	(63%)	181.2	4%	566.2	3.0%	468.0	2.7%	(21%)	438.7	29%
Total operating expenses	2,241.8	47.1%	1,698.4	36.7%	(32%)	2,462.3	(9%)	6,985.5	36.7%	7,067.6	40.1%	1%	6,772.9	3%
Operating income	$2,143.5	45.1%	$2,511.9	54.3%	(15%)	$1,191.4	80%	$10,503.2	55.1%	$8,888.8	50.4%	18%	$7,293.9	44%
Avg worldwide headcount	30,633		32,315		5%	26,496	16%	28,965		30,652		6%	24,863	

	Q97-4	Q98-1	Q98-2	Q98-3	Q98-4	Q99-1	Q99-2	Q99-3	Q99-4
Percentage of net revenue:									
Cost of revenue	9.5%	8.7%	8.9%	8.9%	9.4%	8.3%	8.5%	8.4%	7.8%
Marketing	11.9%	7.2%	9.4%	8.5%	12.6%	5.8%	9.0%	7.1%	12.3%
Product development	21.8%	15.2%	15.2%	15.7%	15.4%	14.3%	12.2%	13.4%	18.6%
PSS	3.7%	3.3%	3.0%	3.1%	5.6%	3.5%	3.0%	3.2%	3.3%
Average worldwide headcount	21,796	23,396	24,668	25,625	26,496	27,432	28,343	29,434	30,633

REVENUE BY PRODUCT

- Q99-4 consolidated revsum revenue was $5.45 billion, slowing growth of 24% over Q98-4. Volume was fueled by the launch of Office 2000, strong PC shipments and organizational licensing.
- Office/Office family revenue grew 40% over Q98-4 to $2.30 billion. The growth stemmed from the Office 2000 launch, Enterprise Agreements and the Word/Excel bundle sales in Japan. Office 2000 related products sold in $690 million in Q99-4. For internal management P&Ls, all channel inventory of $436 million was reserved so net revenue of Office 2000 products matched sell-through of $254 million. The FG channel increased 45% from Q99-4, including Office suite growth of 47%. By area, SPAR grew 55% and Asia grew 53%. EMEA grew 26%, which was lower than the other regions due to strong Q98-4 licensing. The OEM channel, however, decreased 5% from Q98-4 with weaknesses in both Office/SBE suite licensing and Standalone Office Apps. Including the reserve of $436 million for Office 2000 inventory in the channel, Office/Office family grew 13% over Q98-4.
- For the quarter, Desktop Windows Platforms (Windows 9x/NTW) sales grew 7% from Q98-4 to $1.70 billion, with most of the growth from Windows NTW OEM licensing ($187 million). The Windows NTW OEM license mix increased from 12.6% in Q98-4 to 18.1% in Q99-4, driving the larger revenue compared to license growth. Windows 98 OEM licenses made up 60% of total licenses in Q99-4. Windows 95 remains steady at 19% of total OEM licenses, which was stronger than expected due to prolonged corporate standardization on the platform. In the FG channel, revenue decreased 36% from Q98-4, due to the launch of Windows 98 late in Q98-4. However, Enterprise Agreements have grown 225% from Q98-4.





- Platform Server and Server Applications revenue for Q99-4 was $833 million, growing 37% over Q98-4. The largest factors for the growth were NT Server, Enterprise Agreements, and SQL Server. Windows NT Server revenue, including suite allocations, was $403 million, 40% over Q98-4 due to strong Terminal Server shipments ($44 million in servers and CALs) and Enterprise Edition growth (125% growth), but offset partially by weaker suite sales. Small Business Server revenue declined from Q98-4 to $18 million due to late in the quarter release of version 4.5 resulting in weak shipments in the United States. Systems Mgmt Server revenue was $53 million for the quarter, up 46% from Q98-4, due to strong CALs in the United States. Exchange Server revenue, including allocations, was $136 million, up 21% over Q98-4 due primarily to allocations from the BackOffice suite (up 45%). SQL Server revenue grew 67% over Q98-4 due to standard server shipments (92% growth), offset by a lower allocation from suites.
- Q99-4 Developer Tools increased 36% over Q98-4 to $152 million with most of the growth stemming from Visual Studio sales. Developer Tools were 19% over plan for the quarter due to strong sales with the launch of Office 2000 Developer Edition. FY99 Tools revenue was $675 million, 29% over FY98 and 19% over plan.
- Hardware sales were $78 million, 26% below Q98-4 with weak sales across all products. On a net revenue basis, Hardware sales decreased 32% over Q98-4 due to higher rebates and price adjustments. For the year, Hardware sales were essentially flat versus FY98 with growth stemming from Gamepad sales. Mouse sales were $282 million, 9% below FY98 due to lower OEM sales as a result of competition and price erosion. On a net revenue basis, FY99 Hardware sales were $480 million, 5% lower than FY98 and 14% below plan.
- Learning, Entertainment and Productivity Division (LEPD) gross sales were 23% lower than Q98-4 at $75 million with all products lines below the year ago levels except for Home Essentials & Works. Home Essentials & Works sales were flat compared to a year ago at $35 million. By region, LEPD revenue was down 27% in SPAR and 26% in EMEA compared to Q98-4. Q99-4 Asia revenue was up 40% versus Q98-4.
- Consumer and Commerce gross revenue totaled $226 million in the quarter, compared to the plan of $243 million. Weak subscription revenue in WebTV services ($10 million) and Internet access ($6 million) drove the unfavorable variance of $12 million due to below plan subscribers. MSN.com finished Q99-4 ahead of plan by $3 million due to strong advertising revenue and ISM was over plan by $4 million due to continued growth in transaction revenue.

NET REVENUE BY CHANNEL

- *Net* revenue for Q99-4 totaled $4.76 billion, $131 million (3%) over plan and $725 million (18%) over Q98-4. Total FG revenue totaled $3.05 billion, 20% over Q98-4. The EMEA and Asia regions grew 21% and 29% over Q98-4, versus the slower growth in the SPAR region (16% over Q98-4). Enterprise Agreement revenue reached record levels in Q99-4 in both gross receipts ($637 million) and recognized revenue ($391 million). The OEM channel grew 22% over Q98-4 to $1.65 billion, due to strong PC shipments and Windows NT Workstation licensing.

FINISHED GOODS

- For Q99-4, total finished goods net revenue was $3.05 billion, 7% over plan and 20% over Q98-4, due to strong Office sales in Japan and Latin America, but Western Europe slowed from the strong growth earlier in the year.
- South Pacific and Americas Region (SPAR) revenue was $1.6 billion, 16% higher than Q98-4 and 7% greater than plan, due to high Office 2000 sell-in in Q99-4. Revenue in Q98-4 reflected the sell-in of Windows 98. In SPAR, Office 2000 related products sell-in for Q99-4 was $447 million. In Latin America, revenue for the quarter grew 20% over Q98-4 due to strong licensing of Office products. Ecuador posted revenue growth of 158% over Q98-4 due to a successful anti-piracy campaign.
- Europe, Middle East and Africa Region (EMEA) net revenue for Q99-4 was $1.02 billion, 21% over Q98-4 and 6% over plan, due to Office 2000 sell-in and robust server/server applications licensing. Platforms Desktop sales were down from Q98-4, which included the launch of Windows 98. The Netherlands, Belgium, Spain, South Africa and Austria all had a strong quarter compared to Q98-4. Sweden's revenue growth slowed ($41 million, down 2% from Q98-4) after several strong quarters of growth due its positive tax legislation regarding home PCs. In the U.K., gross revenue for the year surpassed the billion mark and net revenue was $955 million, 26% over FY98.
- Asia net revenue grew 29% over Q98-4 to $439 million, which made it the fastest growing region for the quarter. The growth stemmed largely from the success in Japan on Office sales and version 6 Developer Tools as well as the successful anti-piracy campaign in Korea. Japan grew 48% over Q98-4 to $396 million. Korea grew 368% over Q98-4 due to strong Open and Academic licensing of Office products and Windows 9x. In South Asia, Q99-4 revenue was $43 million, 8% over Q98-4, as economic conditions did not improve substantially. Revenue in China was dampened by the boycott of American businesses and finished the quarter at $10 million. Compared to plan, Q99-4 Asia revenue was 11% over plan, but aided by a 5% bump compared to budgeted foreign exchange rates.

Net Revenue by Channel

(in millions)	Quarter				Var % to			Year			Var % to	
	Q99-4	Plan	Q98-4	Q99-3	Plan	Q98-4	Q99-3	FY99	Plan	FY98	Plan	FY98
SPAR FG	$1,592.8	$1,492.8	$1,370.6	$1,398.4	7%	16%	14%	$6,000.9	$5,718.6	$4,977.1	5%	21%
EMEA FG	1,015.1	955.2	837.6	1,152.9	6%	21%	(12%)	4,458.5	3,981.3	3,514.6	12%	27%
Asia FG	439.0	393.9	340.6	505.5	11%	29%	(13%)	1,696.5	1,412.7	1,502.0	20%	13%
Total finished goods	3,046.9	2,841.9	2,548.7	3,056.9	7%	20%	(0%)	12,155.9	11,112.6	9,993.6	9%	22%
OEM	1,653.9	1,554.9	1,353.5	1,696.6	6%	22%	(3%)	6,527.0	5,865.9	5,012.8	11%	30%
Other	55.1	228.9	128.6	112.0	(76%)	(57%)	(51%)	375.8	654.1	452.4	(43%)	(17%)
Net revenue	$4,755.9	$4,625.8	$4,030.8	$4,865.4	3%	18%	(2%)	$19,058.7	$17,632.6	$15,458.8	8%	23%

FOREIGN EXCHANGE

(in millions)	Q99-4					FY99				
	Volume	FX	FX %	Total	Total %	Volume	FX	FX %	Total	Total %
SPAR FG	$329.2	($0.6)	(0%)	$328.6	21%	$494.5	($9.2)	-	$485.3	8%
EMEA FG	127.1	$19.9	2%	147.0	15%	359.4	$214.3	5%	573.7	14%
Asia FG	102.7	$21.0	5%	123.7	30%	367.6	$0.9	0%	368.5	25%
Total FG gross revenue	$559.0	$40.3	1%	$599.4	20%	$1,221.6	$206.0	2%	$1,427.5	12%

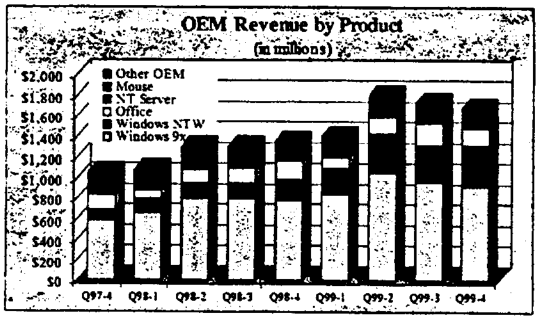
- Compared to planned rates, the strength of the Japanese yen and many European currencies caused a net positive foreign exchange bump. Budgeted foreign exchange rates were very conservative. The impact on gross revenue versus plan in the fourth quarter was $40 million. In terms of the impact as a percentage of total FG gross revenue, the percentage was minimal.
- In EMEA, the foreign exchange variance to budgeted rates was a bump of $20 million. Germany would have fallen slightly below plan without the 2% foreign exchange rate bump. missed plan by 7% for FG gross revenue without the bump. France's foreign exchange rate bump of 2% improved its results to 10% above plan. Results in Southern Europe, including Italy, Portugal, and Spain, were affected approximately 3% of gross revenue. Other countries were affected by the economic crisis including Russia and South Asia counties, however, these countries faced an immaterial *calculated* foreign exchange impact to planned rates due to billing in the United States dollar denominations. For the region, the exchange impact bump versus planned rates continued to decrease in magnitude compared to prior quarters

($20 million in Q99-4, compared to $61 million in Q99-3 and $96 million in Q99-2).

- The Japanese yen has remained fairly stable over the last quarter, but still stronger than planned. The Japanese yen averaged 117 yen per dollar in Q99-4, lower than Q99-3 and the conservative budgeted rate. As a result, Japan had a positive exchange variance of $20 million, 6% of budgeted revenue in Q99-4. In Korea, the won was stronger than anticipated, whereas the positive exchange rate variance was 9% of gross revenue, but the positive total variance to plan was 296%.

OEM

- For the quarter OEM licensing was 22% higher than Q98-4 to $1.65 billion, due to continued growth in Windows NTW licensing and PC shipment growth. Q99-4 OEM revenue decreased from Q99-3 due to out-of-period Office reporting in Q98-3. Windows NTW OEM license mix reach 18.1% for the quarter versus 15.9% last quarter. Mouse sales continued to lag plan and prior quarter results due to competition and price erosion.

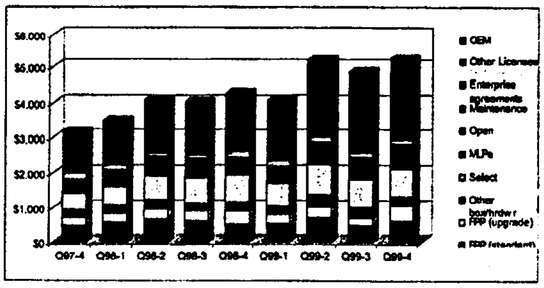


COST OF REVENUE

($ in millions)	Q99-4			FY99		
	Actual	Plan	Var %	Actual	Plan	Var %
Cost of revenue						
Online	$ 30.8	$ 72.7	57.7%	$ 228.7	$ 262.2	12.8%
WebTV	62.8	79.6	21.1%	279.6	314.3	11.1%
Press	18.6	18.9	1.7%	56.5	70.7	20.1%
Hardware	64.6	69.6	7.3%	303.0	317.4	4.5%
Software/Licensing/Programs	186.8	174.5	(7.0%)	689.7	710.7	2.9%
Other	7.1	0.3	nm	12.6	3.0	nm
Total cost of revenue	$ 370.5	$ 415.6	10.8%	$ 1,570.0	$ 1,678.2	6.4%
% of consolidated net revenue						
Online	0.6%	1.6%	0.9%	1.2%	1.5%	0.3%
WebTV	1.3%	1.7%	0.4%	1.5%	1.8%	0.3%
Press	0.4%	0.4%	0.0%	0.3%	0.4%	0.1%
Hardware	1.4%	1.5%	0.1%	1.6%	1.8%	0.2%
Software/Licensing/Programs	3.9%	3.8%	(0.2%)	3.6%	4.0%	0.4%
Other	0.1%	0.0%	(0.1%)	0.1%	0.0%	(0.0%)
% of consolidated net revenue	7.8%	9.0%	1.2%	8.2%	9.5%	1.3%

- Cost of revenue compared to plan continues to be positively impacted by the higher mix of licensed product and higher margin products. Q99-4 cost of revenue as a percentage of net revenue was 7.8%, 1.2 points below the budgeted amount of 9.0%. The significant variances to plan were due to sales of higher margin products, lower costs associated high Online and WebTV, and a greater mix of licensed products than planned.
- Software, licensing, and program costs were 3.9% of net revenue for the quarter, the largest component of cost of revenue, versus budgeted levels of 3.8% of net revenue, reflecting increased licensing - including Select, Open and Enterprise Agreements, but offset by the costs of Office 2000 product sold in, where only the sell-through revenue was recognized. The unit mix of FPP was 17% in Q99-4, flat with the prior quarter.
- WebTV costs of $63 million in Q99-4, versus a plan of $80 million, were influenced by lower subscribers than planned, but partially offset by higher subsidy costs. Online costs in the fourth quarter reflected a year to date restatement of server depreciation (previously server costs were expensed in the month purchased, they will now be depreciated over 3 years).

LICENSE MIX



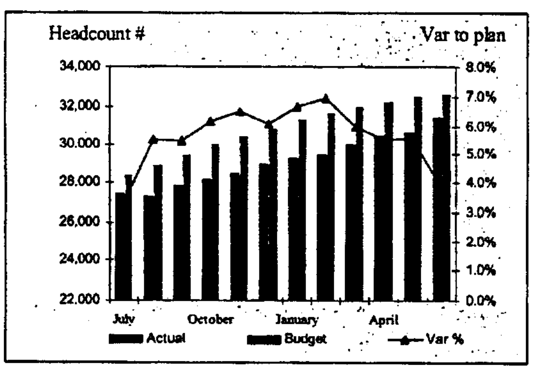
- Packaged product sales for Q99-4 increased 38% over Q99-3 due primarily to the Office 2000 related products sell-in in Q99-4. Packaged product sales for other products, including LEPD, Hardware, and operating systems decreased from year ago levels. Q99-4 FPP increased only 10% over Q98-4 due to Windows 98 sell-in at the end of Q98-4, which inflated packaged product sales for that quarter.
- FG licensing revenue increased 32% over Q98-4 primarily due to strong Enterprise Agreement and Open licensing, and to a lesser degree Academic licensing.
- Enterprise Agreement revenue reached record levels in Q99-4 in both gross receipts and recognized revenue due to several large renewals. Enterprise Agreement recognized revenue reached $390 million in Q99-4, three times the level in Q98-4.
- Open licensing was also at record levels for Q99-4 at $541 million, up 44% over Q98-4 due to strong licensing of server/server application products.
- Select licensing growth, however, has slowed due to cannibalization from Enterprise Agreements. Select licensing for Q99-4 grew only 4% over Q98-4 with lower Select Office licensing the main contributor. Maintenance revenue has also declined from Q98-4 falling to $139 million, down 20%.

OPERATING EXPENSES

(in millions, except cost per head, variance to plan)	Q99-4					FY99				
	Actual	Plan	Var %	Q98-4	Growth %	Actual	Plan	FY98	Var %	Growth %
People costs	$759.9	$777.9	2%	$638.4	19%	$2,777.4	$3,008.0	$2,267.6	8%	22%
Contingent staff and outsourcing	174.1	131.8	(32%)	160.9	8%	579.3	552.5	552.9	(5%)	5%
Vendors	135.5	113.0	(20%)	107.5	26%	469.0	471.3	341.0	0%	38%
Infrastructure costs	310.9	232.1	(34%)	561.0	(45%)	1,002.8	1,006.2	1,237.1	0%	(19%)
Marketing expenses	573.5	391.0	(47%)	483.6	19%	1,576.3	1,547.0	1,338.1	(2%)	18%
PSS/MCS cost recovery	(153.5)	(161.3)	(5%)	(44.8)	243%	(553.2)	(566.1)	(375.7)	(2%)	47%
Third party product development	168.6	77.4	(118%)	504.0	(67%)	455.3	477.4	859.5	5%	(47%)
Broad reach	15.1	14.7	(2%)	23.6	(36%)	79.5	79.6	127.9	0%	(38%)
Other misc. expenses	257.8	121.8	(112%)	28.2	814%	598.9	491.6	424.5	(22%)	41%
	$2,241.8	$1,698.4	(32%)	$2,462.3	(9%)	$6,985.5	$7,067.6	$6,772.9	1%	3%
Avg non-operations headcount	29,426	31,054	5%	25,377	16%	27,815	29,446	23,765	6%	17%
People cost per head	$103,297	$100,197	(3%)	$100,622	3%	$99,853	$102,151	$95,415	2%	5%
Infrastructure cost per head	$42,260	$29,895	(41%)	$88,418	(52%)	$36,053	$34,172	$52,054	(6%)	(31%)
(annualized cost per average MS head)										
Contingent staff and vendors	40.7%	31.5%		42.0%		37.7%	34.0%	39.4%		
(as a percentage of people costs)										

(Note: excludes heads and expenses related to operations included in cost of revenue)

- Operating expenses for Q99-4 were $2.24 billion, 32% above plan due to higher marketing spend, increased computer and lab spend, and third party development spend including purchased intellectual property rights.
- Q99-4 annualized people cost per head was $103,297, 3% above planned levels. Although payroll and payroll taxes per head were relatively on plan, other people-related expenses including employee recruiting, travel and entertainment were above plan. Average total headcount, excluding manufacturing operations, during Q99-4 was 29,426, 5% below plan.



- Contingent staff expenses were $174 million for the quarter, 32% above plan. Contingent staff spending was over planned levels in Business Productivity, Business & Enterprise, and Consumer and Commerce. The launch of Office 2000, the upcoming release of Windows 2000, and slower hiring of regular heads than planned in Consumer and Commerce increased contingent staff spend.
- Infrastructure costs in the quarter totaled $311 million, 34% over plan, as new headcount additions fuel the computer purchases. Computers and some servers are fully expensed in the quarter in which purchased.
- Marketing expenses for Q99-4 were $574 million, 47% higher than planned. Marketing expenses are net of marketing recovery from the Microsoft Solution Providers. Approximately $141 million of Q99-4 spend was to support the launch of Office 2000 and includes approximately $100 million of year end accounting accruals for expenses incurred but not yet paid. For the year, marketing expenses were $1.58 billion, 2% over plan due to incremental spend authorized at mid year.
- PSS revenue in the quarter totaled $63 million, slightly lower than planned levels due to delayed renewal of Premier contracts and slower than expected Premier for Developer contact sales. MCS Q99-4 revenue was $91 million, $6 million lower than planned with subcontractor revenue above plan and consultant revenue below plan.
- Q99-4 third party product development was $169 million, 118% above plan due to costs of several acquisitions and the ramp up in localization spending for Office 2000.
- Other expenses, which include bad debts, taxes and licenses, and miscellaneous operating expenses, were $258 million in Q99-4, 112% higher than plan, due to higher professional fees for legal and litigation, the $34 million MSNBC Cable write-off of a cable JV option, and $40 million for SoftArt intellectual rights.

PRODUCT DEVELOPMENT COSTS

(in millions, variance to plan)	Q99-4			FY99		
	Actual	Plan	Var %	Actual	Plan	Var %
Business Divisions						
Business & Enterprise Group	$145.2	$125.1	(16%)	$480.4	$526.4	9%
Consumer Windows	39.4	43.6	10%	170.9	190.2	10%
Streaming Media	14.3	9.7	(48%)	34.9	50.5	31%
Office	102.9	61.5	(67%)	272.5	256.7	(6%)
Office Family	12.8	13.7	7%	43.8	55.1	20%
Server Applications	41.7	40.2	(4%)	137.5	149.6	8%
Productivity Appliances	37.4	3.4	(989%)	117.7	117.4	(0%)
Other business productivity	29.3	33.0	11%	96.1	121.4	21%
Business Productivity Group	224.0	151.8	(48%)	667.6	700.3	5%
Developer Group	103.5	94.1	(10%)	345.7	382.3	10%
Consumer & Commerce Group	242.8	162.7	(49%)	669.6	655.6	(2%)
Total Business Divisions	769.3	586.9	(31%)	2,369.0	2,505.3	5%
Home & Retail						
Hardware	18.8	17.1	(10%)	70.9	68.7	(3%)
Learning, Entertain., & Product.	59.7	50.1	(19%)	191.1	191.7	0%
Dreamworks	2.4	0.3	(721%)	2.0	1.2	(73%)
Total Home & Retail	81.0	67.5	(20%)	264.0	261.5	(1%)
Other	31.4	36.4	14%	139.1	137.7	(1%)
Product marketing	225.3	122.9	(83%)	552.5	521.1	(6%)
Total	$1,106.9	$813.7	(36%)	$3,324.6	$3,425.5	3%

- Product development costs in the quarter totaled $1.11 billion, 36% above plan due to increased third-party development spend, localization, ramp up of headcount related expenses, marketing and several acquisitions within the quarter. Product marketing was 83% greater than plan, mainly due to the Office 2000 launch and year-end spending.
- For Q99-4, the Business and Enterprise Group product development spend reached $145 million, 16% over plan, led by contingent staff expenses, headcount related costs including computer expense and employee fringes, lab expense and third party development and localization. For the year, Business and Enterprise Group product development spend was 9% under plan due to lower hiring levels than planned and unspent localization and third party product development spend due to the delay of Windows 2000.
- Business Productivity Group spend was $224 million, 48% over plan due primarily to the Softart settlement expense in Office and the timing of product development reimbursements from semiconductor partners for work done by bSquare in Productivity Appliances. Other operating expenses, including contingent staff, computer expense and localization also contributed to the high quarterly spend.
- Consumer and Commerce product development spending was $243 million, 49% above plan for the quarter, due to the MSNBC Cable write-off of a cable JV option for $34 million, a contract payment to LookSmart for $17 million, the Jump acquisition for $3 million, the OmniBrowse acquisition for $3 million and OpenFind product development in Taiwan for $2 million as well as high contingent staff costs.
- Home and Retail product costs were 20% above plan due to $11 million in costs related to the FASA Interactive and Access Software acquisitions and higher contingent staff expenses.

SALES, MARKETING & SUPPORT COSTS

(in millions, variance to plan)	Q99-4 Actual	Q99-4 Plan	Q99-4 Var %	FY99 Actual	FY99 Plan	FY99 Var %
Sales Expenses						
SPAR FG	$157.9	$131.2	(20%)	$515.6	$592.1	13%
EMEA FG	120.0	108.6	(10%)	450.6	470.7	4%
Asia FG	44.8	37.1	(21%)	149.9	150.9	1%
OEM	66.9	45.5	(47%)	175.9	179.6	2%
Other	32.2	8.7	nm	85.8	17.4	nm
Total sales expenses	421.9	331.1	(27%)	1,377.8	1,410.7	2%
Product support	166.4	157.8	(5%)	624.7	666.8	6%
Channel marketing	343.8	265.8	(29%)	1,012.6	1,016.9	0%
Broad reach	15.1	14.7	(2%)	79.5	79.6	0%
Total	$947.1	$769.4	(23%)	$3,094.7	$3,174.0	3%

- Sales, marketing and support expenses were $947 million for the fourth quarter, $178 million and 23% above plan, with most of the variance stemming from the timing of new hire additions, related headcount expenses and year-end marketing spend. For the year, sales and marketing spend was 3% below plan at $3.09 billion.
- Channel marketing was 29% over plan, primarily due to year-end marketing spend and related Office 2000 launch activities. For the year, channel marketing expense totaled $1.01 billion, on plan.
- Broad reach marketing was $15 million for the quarter, 2% above plan, but significantly lower than a year ago. FY99 Broad reach spending was $80 million, approximating plan. Broad reach marketing has been narrowed to a United States program only in FY99.
- Product support *net* costs were 5% higher than plan due to expense timing related to IT networking, computers and the delayed launch of Office 2000. Also contributing to the higher net costs, revenue for the quarter fell below plan due to delayed Premier contract renewals and slower than expected Premier for Developer contract sales.

GENERAL & ADMINISTRATIVE COSTS

(in millions, variance to plan)	Q99-4 Actual	Q99-4 Plan	Q99-4 Var %	FY99 Actual	FY99 Plan	FY99 Var %
HR/Admin Services	$77.5	$79.4	2%	$289.8	$310.6	7%
ITG	70.8	59.0	(20%)	237.7	247.5	4%
Legal	82.6	44.6	(85%)	262.5	179.7	(46%)
Finance	111.5	99.1	(12%)	375.7	388.8	3%
Other	2.9	3.1	7%	5.6	12.6	56%
Gross spending	345.3	285.3	(21%)	1,171.4	1,139.3	(3%)
Distribution	(157.6)	(170.0)		(605.1)	(671.3)	
Net general & administrative	$187.8	$115.3		$566.2	$468.0	

- General and administrative (G&A) costs include corporate cost centers that support MS on a worldwide basis. Net expenses, after distributions, include IT project development and regional support, finance, legal and corporate affairs, HR services such as employee development, compensation, and administrative support service. Distributed costs include employee benefits, IT and support, recruiting, real estate expenses and services for the copy center and company store.
- Q99-4 gross G&A costs were $345 million, 21% over plan, due to increased legal expenses and litigation costs. Legal expenses were $83 million for the quarter, 85% over plan and totaled $263 million for the year, 46% over plan. IT expenses and finance costs were over plan for the quarter due primarily to timing of invoices for services. IT expenses were over plan for the quarter due to capital purchases related to network infrastructure.

CASH FLOW SUMMARY

(in millions)	Three months ended March 31, 1999	June 30, 1999	Change
Operations			
Net income	$1,917	$2,202	$ 285
Depreciation and amortization	158	496	338
Unearned revenue	1,768	1,738	(30)
Recognition of unearned revenue from prior periods	(1,125)	(1,694)	(569)
Other current liabilities	(248)	495	743
Accounts receivable	294	(495)	(789)
Other current assets	(80)	(131)	(51)
Net cash from operations	2,684	2,611	(73)
Financing			
Common stock issued	488	248	(240)
Common stock repurchased	(755)	(1,423)	(668)
Put warrant proceeds	402	9	(393)
Preferred stock dividend	(7)	(7)	-
Stock option income tax benefits	1,020	869	(151)
Net cash from (used for) financing	1,148	(304)	(1,452)
Investments			
Additions to property and equipment	(50)	(292)	(242)
Equity investments and other	(1,134)	(6,464)	(5,330)
Purchases of short-term investments	(8,844)	(9,297)	(453)
Maturities of short-term investments	1,576	1,289	(287)
Sales of short-term investments	4,729	11,216	6,487
Net cash used for investments	(3,723)	(3,548)	175
Net change in cash and equivalents	109	(1,241)	(1,350)
Effect of exchange rates on cash and equivalents	(19)	13	32
Beginning balance of cash and equivalents	6,113	6,203	90
Ending balance of cash and equivalents	6,203	4,975	(1,228)
Ending balance of short term investments	15,558	12,261	(3,297)
Ending cash & short term investments	$21,761	$17,236	($4,525)

- Cash and short-term investments at the end of June were $17.24 billion, a decrease of $4.52 billion from March 31, 1999.
- Cash from operations was $2.61 billion, a decrease of $73 million from the prior quarter primarily due to increased accounts receivable balances associated with the launch of Office 2000 late in the quarter. The decrease in cash from operations was partially offset by the recognition of unearned revenue.
- Net cash used for financing was $304 million due to greater amount of share repurchases, partially offset by a high volume of stock option exercises.
- Cash used for equity investments increased due to many equity investments throughout the quarter, including AT&T, Nextel, and WebMD.

Operations

TOTAL COST OF REVENUE SUMMARY

- Q99-4 cost of revenue as a percentage of net revenue was 7.8%, 1.2 points below the budgeted amount of 9.0 % driven by lower Online and Web TV COGS. Online COGS was below plan due to the year to date restatement for server depreciation (servers previously expensed in the month purchased, now depreciated over 3 years).

($ in millions)	Q99-4		
	Actual	Plan	Variance
COGS Mix			
Online	30.6	72.7	58%
Web TV	62.8	79.6	21%
Press	18.6	18.9	2%
OEM	44.1	41.8	-6%
FG	207.2	202.4	-2%
Other	7.3	-	nm
Total	370.5	415.6	11%
% of Consolidated net revenue			
Online	0.6%	1.6%	1.0%
Web TV	1.3%	1.7%	0.4%
Press	0.4%	0.4%	0.0%
OEM	0.9%	0.9%	0.0%
FG	4.4%	4.4%	0.0%
Other	0.2%	-	-0.2%
Total	7.8%	9.0%	1.2%

FINISHED GOODS SUMMARY

Note: The Finished Goods category represents all Software (licensing and finished packaged products), Hardware, and Programs business that are distributed or sold, including Retail OEM but excluding business sold through the OEM channel, Press, Online and WebTV.

- Total Q99-4 FG cost of revenue (COGS) was unfavorable to plan by $5 million (2.4%) but 0.3 points favorable as a percentage of net revenue. FY99 FG COGS was favorable to plan by $30 million or 0.9 points favorable. The following table highlights the major category drivers for Q99-4:

Q99-4	Variance	
Category	$ Million	Pts.
Product costs	0.4	0.27
Royalties	5.1	0.19
Business operations	(4.0)	(0.04)
Obsolete/scrapped Inventory	(0.9)	0.01
Channel costs	(5.4)	(0.10)
Total variance	(4.8)	0.32

- Product costs favorability to plan of 0.3 points was driven by standard product costs (0.8 points favorable), the reversal of over-accrued costs for MSDN refresh kits and the reversal of over-accrued CD royalty costs following a favorable settlement with Sony/Phillips. These were partly offset by the unplanned scrapping of non-Java compliant product, the recosting of Hardware products to lower of cost or market (LCM) and Office 2000 Technology Guarantee costs. Standard product costs were driven by a favorable mix shift from hardware and full packaged product (FPP) to licensing. In addition, unfavorable revenue adjustments driven by the deferral of Office 2000 revenue had a negative impact on COGS as a percentage of net revenue.

- Business operations were unfavorable by $4 million driven by OPS IT spend on capabilities and unplanned spend on Retail 2000 implementation.

- Channel costs were $5 million unfavorable driven by freight charges, FPP channel costs and unplanned costs for the "Referral Network" program (which generates revenue whenever a Windows user signs up with an Internet service provider via the Get Connected Wizard), partly offset by lower programs fulfillment costs. Freight was driven by increased shipment of packaged product from Singapore to Japan, due to fulfillment out of the Asia Operations Center (APOC) and freight driven by MSDN refreshes. FPP channel costs were driven by higher activity and storage costs at Distribution Turnkey Vendors (DTV's). Programs fulfillment costs were lower than planned due to the delay of Platforms 2000, low activity from on-line initiatives ("The Store", Terminal Server and the License Verification Program) and the cancellation of the Windows Update Program.

- Compared to Q98-4, COGS decreased by 0.2 points as a percent of net revenue. The decrease occurred due to a favorable shift in license mix from FPP to licensed product (license mix Q98-4 69% versus Q99-4 83%) that caused standard product costs to improve by 0.9 points (Q98-4 3.4% versus Q99-4 2.5%). COGS increased, driven by the scrapping of non-Java compliant product, OPS IT online capabilities spend, implementation of SAP and Retail2000, recosting to LCM, freight charges, FPP channel costs, the "Referral Network" program and the Office 2000 Technology Guarantee Program. Lower royalty expenses due to lower volumes of royalty bearing products and lower standard product costs partly offset these unfavorable variances. Higher revenue adjustments related to the deferral of Office 2000 revenue had a negative impact on COGS as a percentage of revenue.

Q99-4 FG AND OEM COST OF REVENUE BY BUSINESS STREAM

Note: This presentation of Cost of Revenue by business stream reflects the Finished Goods and OEM business cut by operational supply chain. See attached summary variances on bottom of next page.

PACKAGED PRODUCTS

- Software cost of revenue for Q99-4 was $4 million below plan (1.4 points favorable). This was driven by a favorable product mix shift away from LEPD & Consumer Windows to Office, lower CD royalty expense due to a settlement with Sony & Phillips and lower royalty bearing sales, and the Softart settlement. Unplanned Java scrapping expenses, higher channel costs due to Office 2000 and shipping costs, online capabilities spend and the unplanned Retail2000 implementation partly offset the favorable variances. FY99 COGS was $24 million favorable, driven by lower standard product costs, royalties, obsolete product and rework, partly offset by Java scrapping and channel costs.
- Hardware COGS was $5 million below plan for Q99-4. This was driven by lower than planned volume of mice, gaming devices, phones and Actimates. Partly offsetting this was the recosting of Actimates, speakers and phones inventory to lower cost of market coupled with the unplanned reserve for obsolete OEM Serial Mice. Revenue adjustments had a negative impact on the COGS percentage of net revenue due to the reservation of year-end hardware inventory at 100%. FY99 COGS was $12 million below plan driven by a change of scope for planned Hardware Tooling and the lower than planned volume of Actimates, phones and mice.

LICENSING

- ***OEM licensing*** COGS for Q99-4 was $12 million higher than plan (0.6 points unfavorable) due to costs for disk drop-ins designed to replace non-Java compliant code. Favorable obsolescence/scrap costs and rework charges partly offset the unfavorable variance. FY99 COGS was $14 million higher than plan due to Java scrapping and royalties, partially offset by lower obsolescence/scrap and rework costs.
- ***Retail licensing*** COGS for Q99-4 was slightly above plan (but 0.3 points favorable) due to Java costs and OPS IT capabilities spend, partially offset by lower standard product costs. FY99 COGS was $2 million higher than plan due to Java scrapping, higher than expected Select CD volumes, royalties and OPS IT capability spend, offset by lower standard product costs and online data center allocations.

PROGRAMS

- ***Subscription*** COGS for Q99-4 was $4 million below plan (13 points favorable), primarily driven by releasing $5 million in over accrued MSDN product costs due to shipping fewer CDs per subscription than plan. The plan included a full MSDN refresh, but only a limited refresh was actually done for the Universal subscribers. FY99 COGS was favorable to plan by $9 million (10.8 points favorable) due to the $5 million reversal of MSDN accrued cogs in Q4 and favorable Vendor Fulfillment expenses due to fewer telephone service representatives needed as a result of fewer phone calls per subscriber.
- ***Fulfillment*** COGS for Q99-4 was $7 million above plan (6.6 points unfavorable) driven higher product costs, obsolescence scrap costs and higher channel costs. Higher product costs were caused by increased Courseware volumes in EMEA, the Office 2000 Technology Guarantee and Java scrapping. Channel costs were higher due to unplanned charges for the "Referral Network" program. This was partially offset by the delay in Platforms 2000 (NT) and low activity from Online initiatives ("The Store", Terminal Server and License Verification Program). FY99 COGS was favorable to plan by $7 million (8.3 points favorable) primarily in channel costs (freight & fulfillment) due the delay and cancellation of planned campaigns such as Platforms 2000 and other online initiatives.

Q99-4 Business Stream Cost Of Revenue Summary Variances

(in millions)	Channel FPP				Licensing									
	Software		Hardware		OEM License		Retail License		Subscriptions		Fulfillment		Total	
Variance Fav/(Unfav)														
Net revenue	$ (155.4)	(16.1) %	$ (107.4)	-96.5%	$ 124.4	8.3 %	$ 391.9	23.3 %	$ 5.8	11.2%	$ 6.4	12.9 %	$ 265.6	6.1 %
Product costs	5.5	(0.3) pts	7.3	NM pts	(12.0)	(0.7) pts	(1.6)	(0.0) pts	4.9	11.5 pts	(3.7)	(4.4) pts	0.5	0.2 pts
Royalties	4.0	0.4	0.4	(0.4)	0.1	0.0	0.4	0.0	0.0	0.1	0.2	0.3	5.1	0.1
Business operations	(2.2)	(0.5)	(0.5)	(106.0)	(0.3)	0.0	(0.4)	0.1	(0.2)	0.3	(0.6)	(0.2)	(4.2)	(0.0)
Obsolete/scrapped inv	(0.7)	(0.3)	(2.0)	(83.2)	0.6	0.0	0.0	0.0	(0.2)	(0.2)	(1.1)	(1.8)	(3.2)	(0.0)
Channel costs	(3.1)	(0.5)	(0.8)	(72.5)	(0.0)	0.0	0.3	0.1	(0.2)	1.4	(1.6)	(0.5)	(5.4)	(0.1)
Cost of revenue	3.6	(1.4)	4.5	NM	(11.6)	(0.7)	(1.3)	0.2	4.4	13.0	(6.7)	(6.6)	(7.2)	0.2
Gross margin	$ (151.8)	(1.4) pts	$ (102.9)	NM pts	$ 112.7	(0.7) pts	$ 390.6	0.2 pts	$ 10.1	13.0 pts	$ (0.3)	(6.6) pts	$ 258.4	0.2 pts

Product Development

CONSOLIDATED BUSINESS DIVISIONS

Q99-4

(in millions, variance to plan)	Windows Platforms	Prod. Apps. & Dev	CCG & Other	Total
Net revenue	$2,246.4	$2,924.9	$593.3	$5,764.6
Cost of revenue	58.2	98.0	512.2	668.5
% of net revenue	*2.6%*	*3.4%*	*86.3%*	*11.6%*
Gross margin	2,188.2	2,826.9	81.1	5,096.1
% of net revenue	*97.4%*	*96.6%*	*13.7%*	*88.4%*
Operating expenses				
People	96.4	141.5	349.0	586.9
Infrastructure	38.2	46.7	44.5	129.4
Contingent staff	43.8	33.6	(292.0)	(214.5)
Product development	63.0	145.0	211.6	419.6
Other	(15.8)	(2.3)	279.5	261.3
Product marketing	67.1	81.9	64.9	213.8
Channel mktg controllable	0.0	0.0	11.2	11.2
Direct controllable oper expenses	292.6	446.4	668.7	1,407.8
Taxes, insurance, & settlements	(0.1)	39.3	79.2	118.4
Product support services	72.5	70.8	(602.0)	(458.7)
Bad debt expense	10.3	17.1	8.0	35.4
R&D shared resources	6.1	(3.6)	(2.5)	(0.0)
Product-related oper expenses	88.9	123.6	(517.4)	(304.9)
Total operating expenses	381.5	570.1	151.3	1,102.9
Responsibility margin	1,806.6	2,256.8	(70.2)	3,993.2
% of net revenue	*80.4%*	*77.2%*	*(11.8%)*	*69.3%*
Corporate allocations	358.8	423.4	253.0	1,035.3
Contribution margin	$1,447.8	$1,833.4	($323.2)	$2,958.0
% of net revenue	*64.5%*	*62.7%*	*(54.5%)*	*51.3%*

FY99

(in millions, variance to plan)	Windows Platforms	Prod. Apps. & Dev	CCG & Other	Total
Net revenue	$8,503.9	$8,815.9	$2,427.0	$19,746.8
Cost of revenue	180.5	345.7	2,287.8	2,814.0
% of net revenue	*2.1%*	*3.9%*	*94.3%*	*14.3%*
Gross margin	8,323.3	8,470.1	139.3	16,932.7
% of net revenue	*97.9%*	*96.1%*	*5.7%*	*85.7%*
Operating expenses				
People	365.4	535.3	723.2	1,624.0
Infrastructure	157.5	186.7	161.7	505.9
Contingent staff	143.5	111.4	(210.1)	44.8
Product development	185.6	263.5	291.0	740.2
Other	(7.0)	(5.2)	347.9	335.7
Product marketing	148.5	141.4	236.1	525.9
Channel mktg controllable	0.0	0.0	86.0	86.0
Direct controllable oper expenses	993.5	1,233.2	1,635.8	3,862.5
Taxes, insurance, & settlements	1.2	42.4	95.2	138.7
Product support services	267.7	266.0	(534.7)	(1.0)
Bad debt expense	37.4	49.5	32.2	119.1
R&D shared resources	80.4	(66.6)	(11.4)	2.4
Product-related oper expenses	386.6	291.3	(418.7)	259.3
Total operating expenses	1,380.1	1,524.5	1,217.0	4,121.7
Responsibility margin	6,943.2	6,945.6	(1,077.8)	12,811.0
% of net revenue	*81.6%*	*78.8%*	*(44.4%)*	*64.9%*
Corporate allocations	1,106.8	1,342.3	318.0	2,767.0
Contribution margin	$5,836.4	$5,603.3	($1,395.8)	$10,044.0
% of net revenue	*68.6%*	*63.6%*	*(57.5%)*	*50.9%*

WINDOWS PLATFORMS

Q99-4

(in millions, variance to plan)	BED Actual	BED Var %	Cons. Windows Actual	Cons. Windows Var %	Streaming Media Actual	Streaming Media Var %	Research Actual	Research Var %	GAAP	Windows Platforms
Net revenue	$1,107.4	15%	$1,056.4	9%	($0.2)	47%	$0.0	nm	$82.9	$2,246.4
Cost of revenue	30.7	(25%)	25.4	(59%)	0.3	(34%)	0.0	nm	1.9	58.2
% of net revenue	*2.8%*		*2.4%*		*(121.3%)*		*nm*		*2.3%*	*2.6%*
Gross margin	1,076.7	15%	1,031.0	9%	(0.5)	21%	0.0	nm	81.0	2,188.2
% of net revenue	*97.2%*		*97.6%*		*221.3%*		*nm*		*97.7%*	*97.4%*
Operating expenses										
People	57.8	7%	19.7	31%	4.6	(5%)	14.3	24%	0.0	96.4
Infrastructure	27.4	(29%)	12.4	(29%)	4.4	(191%)	5.1	(1%)	(11.1)	38.2
Contingent staff	29.0	(25%)	11.6	(35%)	1.8	(95%)	1.5	(2%)	0.0	43.8
Product development	19.8	(60%)	6.4	(83%)	2.4	nm	0.3	87%	34.1	63.0
Other	(0.0)	422%	(0.9)	210%	0.0	100%	0.7	(665%)	(15.6)	(15.8)
Product marketing	24.0	(153%)	35.8	(73%)	3.9	(66%)	3.3	(7%)	0.0	67.1
Channel mktg controllable	0.0	nm	0.0	nm	0.0	nm	0.0	nm	0.0	0.0
Direct controllable oper expenses	158.1	(23%)	85.0	(20%)	17.1	(87%)	25.1	17%	7.4	292.6
Taxes, insurance, & settlements	(0.1)	122%	0.1	81%	(0.0)	118%	0.0	nm	0.0	(0.1)
Product support services	34.5	(25%)	38.1	(45%)	(0.0)	151%	0.0	nm	0.0	72.5
Bad debt expense	5.8	(40%)	4.5	4%	0.0	9%	0.0	nm	0.0	10.3
R&D shared resources	4.5	80%	2.4	38%	(0.7)	nm	(0.1)	13%	0.0	6.1
Product-related oper expenses	44.6	19%	45.1	(28%)	(0.7)	654%	(0.0)	(25%)	0.0	88.9
Total operating expenses	202.7	(11%)	130.0	(23%)	16.4	(76%)	25.1	17%	7.4	381.5
Responsibility margin	874.1	16%	901.0	7%	(16.9)	(70%)	(25.1)	17%	73.6	1,806.6
% of net revenue	*78.9%*		*85.3%*		*nm*		*nm*		*88.8%*	*80.4%*
Corporate allocations	191.8	(33%)	152.5	(33%)	8.6	(58%)	5.9	(66%)	0.0	358.8
Contribution margin	$682.2	12%	$748.5	3%	($25.5)	(65%)	($31.0)	8%	$73.6	$1,447.8
% of net revenue	*61.6%*		*70.9%*		*nm*		*nm*		*88.8%*	*64.5%*

FY99

(in millions, variance to plan)	BED Actual	BED Var %	Cons. Windows Actual	Cons. Windows Var %	Streaming Media Actual	Streaming Media Var %	Research Actual	Research Var %	GAAP	Windows Platforms
Net revenue	$3,895.2	14%	$4,694.1	13%	($0.2)	87%	$0.0	nm	($85.2)	$8,503.9
Cost of revenue	103.1	0%	74.6	(11%)	1.0	(12%)	0.0	nm	1.9	180.5
% of net revenue	*2.6%*		*1.6%*		*(433.3%)*		*nm*		*(2.2%)*	*2.1%*
Gross margin	3,792.2	15%	4,619.5	13%	(1.2)	53%	0.0	nm	(87.1)	8,323.3
% of net revenue	*97.4%*		*98.4%*		*533.3%*		*nm*		*102.2%*	*97.9%*
Operating expenses										
People	206.7	14%	89.1	20%	14.1	26%	55.5	13%	0.0	365.4
Infrastructure	83.9	8%	42.9	(4%)	7.5	(3%)	17.2	5%	6.1	157.5
Contingent staff	86.6	5%	47.7	(10%)	3.8	(8%)	5.3	15%	0.0	143.5
Product development	57.5	25%	30.4	(34%)	4.8	3%	10.2	6%	82.6	185.6
Other	0.1	6%	(4.4)	270%	0.0	100%	1.6	(315%)	(4.3)	(7.0)
Product marketing	60.0	(48%)	74.0	13%	6.2	26%	8.2	28%	0.0	148.5
Channel mktg controllable	0.0	nm	0.0	nm	0.0	nm	0.0	nm	0.0	0.0
Direct controllable oper expenses	494.9	9%	279.9	7%	36.3	16%	98.1	11%	84.3	993.5
Taxes, insurance, & settlements	0.7	79%	0.4	77%	0.0	77%	0.1	43%	0.0	1.2
Product support services	123.1	3%	144.4	(26%)	0.2	51%	0.0	nm	0.0	267.7
Bad debt expense	19.2	(23%)	18.0	(1%)	0.1	22%	0.0	nm	0.0	37.4
R&D shared resources	71.3	25%	10.9	26%	(1.0)	nm	(0.8)	10%	0.0	80.4
Product-related oper expenses	214.3	11%	173.8	(17%)	(0.7)	217%	(0.7)	19%	0.0	386.6
Total operating expenses	709.2	9%	453.6	(1%)	35.6	19%	97.4	11%	84.3	1,380.1
Responsibility margin	3,083.0	22%	4,165.9	14%	(36.9)	21%	(97.4)	11%	(171.4)	6,943.2
% of net revenue	*79.1%*		*88.7%*		*nm*		*nm*		*201.2%*	*81.6%*
Corporate allocations	600.8	(2%)	461.4	(1%)	26.6	(18%)	18.0	(24%)	0.0	1,106.8
Contribution margin	$2,482.2	29%	$3,704.5	16%	($63.5)	8%	($115.4)	7%	($171.4)	$5,836.4
% of net revenue	*63.7%*		*78.9%*		*nm*		*nm*		*201.2%*	*68.6%*

WINDOWS PLATFORMS RESULTS

- Business and Enterprise Q99-4 net revenue of $1.1 billion was 15% over plan. Primary drivers for the quarter were Windows NT Workstation OEM and Windows NT Server. Including allocations from suites, Windows NT Server gross revenue totaled $403 million, 15% over plan and up 40% from Q98-4. Infrastructure applications, including SMS/Proxy, ended the quarter with $64 million in gross revenue, 13% over plan and up 34% from Q98-4. Windows NT Workstation finished the quarter 15% over plan, with $635 million in gross revenue. The Windows NT Workstation increase was primarily driven by the increase in the NTW OEM mix and corporate licensing in Europe. Windows NT Workstation OEM gross revenue of $402 million was 17% or $58 million over plan.
- Consumer Windows Q99-4 net revenue of $1.1 billion was 9% over plan, yet down 6% from Q99-3 due to cyclical fourth quarter slowness.
- Controllable operating expenses were favorable for the year due to lower than planned hiring plus timing differences in localization, in part due to the delay of Windows 2000.

OUTLOOK

- Business and Enterprise Q00-1 net revenue is expected to be flat at $1.1 billion following a record Q99-4. OEM gross revenue is expected to be approximately $450 million, in line with Q99-4. OEM Windows NT Workstation licenses will again represent approximately 18.1% of total PC shipments. Server revenue is expected to show marginal sequential growth on the continued acceptance of Windows NT Server Enterprise and Terminal Services Edition, offset by market anticipation of Windows 2000 later in the fiscal year.
- Consumer Windows Q00-1 net revenue is expected to decrease 9% to $966 million from Q99-4. This decrease is driven by a slight decrease in both Windows 9x finished goods and OEM gross revenue, compounded by declining annuity business and sales of 16-bit operating systems.

BUSINESS & ENTERPRISE

INVESTMENTS & PRODUCT HIGHLIGHTS

- Release Candidate 1 of Windows 2000 Professional, Server and Advanced Server was made available in early July, following the release of Beta 3 earlier in the year. Final availability of the Windows 2000 family of products is expected to be in Q00-2.
- MS announced the availability of Service Pack 5 for Windows NT Workstation 4.0, Windows NT Server 4.0 and Enterprise Edition. The Service Pack contains improvements to the file management system and cluster services, as well as the latest year 2000 updates.
- MS announced the availability of Active Directory Service Interfaces (ADSI), version 2.5. ADSI 2.5 consists of programming utilities for developers writing directory-enabled client/server tools, and allows independent software vendors (ISVs) to extend ADSI with their own plug-in features.
- MS announced a $40 million worldwide investment to train developers, channel and IT professionals on the Windows 2000 operating system. Through the initiative, more than 15,000 customers will be trained in the deployment and development on Windows 2000.
- Xerox Corp. reached an agreement with MS to incorporate Embedded NT, a version of the Windows NT operating system, in future versions of its high-end copiers. Xerox also announced that its Document Center corporate printing technology would switch to Intel based processors from PowerPC.
- MS and Mission Critical Software entered into an agreement to include Mission Critical's Domain Migrator technologies with the Windows 2000 Server operating system. Domain Migrator consists of tools and utilities that help customers upgrade from Windows NT Server 4.0 to Windows 2000 Server.
- MS announced the acquisition of ZOOMIT Corp., a provider of meta-directory products and technologies. ZOOMIT's technologies will enable customers to use Active Directory in managing heterogeneous identity data across their enterprise.
- Windows NT Workstation momentum continued in Q99-4, with 8.5 million total licenses shipped in the quarter. This places the total number of licensed Windows NT Workstation users at over 37 million; more than 18% of personal computers shipped with the operating system this quarter.
- Since the release of Windows 2000 Professional Beta 3, MS has delivered over 200,000 Corporate Preview licenses. More than 10 OEMs are installing Windows 2000 Professional on their desk and laptop systems, and in excess of 100,000 channel partners have received training.

BUSINESS METRICS

	Business and Enterprise Metrics					
Workstation Finished Goods	Q98-4	Q99-1	Q99-2	Q99-3	Q99-4	FY99
WinNTW Total FG licenses (000s)	2,717	2,065	3,180	4,514	4,715	14,474
Win32 % FG OS Licenses	93%	94%	94%	92%	94%	93%
WinNTW % FG 32 Bit OS Licenses	45%	32%	63%	68%	68%	56%
Workstation shipments						
OEM licenses (000s)	2,551	2,482	3,354	3,378	3,896	13,109
OEM Unit Mix WinNTW of Total OS	12.8%	14.0%	14.6%	15.9%	18.1%	15.7%
WinNTW Installed Base (000s)	16,497	20,285	25,532	31,216	37,623	37,623
Server shipments						
Windows NT Server (000s)	323	319	388	381	438	1,526
BackOffice/SBS (000s)	35	31	32	33	30	125
Enterprise Agreements (000s)	52	15	25	25	31	96
Total Windows NT Server (000s)	411	365	444	439	500	1,748
Server installed base (000s)	2,512	2,807	3,162	3,488	3,851	3,851

Note: Win NTS Server shipments includes Competitive Upgrade licenses.

COMPETITION

- Novell announced ZENworks 2, an update to its network management product based on Novell Directory Services (NDS). New features in this release include software/hardware inventory capabilities, software distribution across the Internet, and enhancements to remote management of desktops.
- Novell announced the acquisition of Ukiah Software, Inc., a privately held developer of policy-based network management software. Novell expects to incorporate Ukiah's traffic monitoring and bandwidth-shaping technology into a future release of its directory based network management product. Financial terms of the acquisition were not disclosed.
- Red Hat Software announced an initial public offering of its stock, initially valued at $100 million, for the week of August 9. Red Hat is a distributor of Linux software and services, and disclosed that CY99 revenues were expected to be $11 million with a projected loss of $130 thousand.
- .eBay experienced three unplanned outages in five days. A corrupted database was blamed for the eBay site outages. eBay pointed a finger at software from Sun Microsystems.

STREAMING MEDIA

INVESTMENTS & PRODUCT HIGHLIGHTS

- MS announced in April the formation of the Streaming Media Division (SMD). The new organization is devoted to developing and marketing technologies and solutions for the consumer and business digital-media applications. The streaming media technology is used for applications ranging from music, radio, news and events to online training and corporate communications.
- Windows Media Technologies 4.0 Beta was released in April. The new version provides content providers, solution providers and software developers with the industry's best audio and video quality, a flexible content rights management system and improved electronic commerce solutions. Features include delivering FM-Stereo-quality audio to modem users and MP3 equivalent music with files half the size.
- MS launched the Windows Media website (www.windowsmedia.com) in April. Through June, windowsmedia.com has 1.4 million page views per day, 3.6 million unique users per month, 357 On-Demand content providers and 435 events.
- Windows Media Player downloads total close to 33 million players worldwide through June.
- RioPort and MS announced a digital audio relationship in June. In the deal, Rio Portable devices would support Windows Media Audio (WMA), a key feature of its Windows Media Technologies. The two companies will also work together to provide easy access to downloadable audio content from their respective portal sites (Windowsmedia.com and RioPort.com).

COMPETITION

- In June, Apple released the final version of QuickTime 4 for both the Macintosh and Windows platforms. QuickTime 4 features "streaming" of live and stored video and audio over the Internet and is the first Internet streaming solution to use non-proprietary industry standard RTP and RTSP protocols. More than 5 million copies of QuickTime 4 beta software have been downloaded from Apple's web site during the first 50 days since its release in April.
- In May, Real Networks Inc. launched RealJuke Box and RealSystem MP. RealJuke Box is used to acquire, play and manage personal music collection. RealJuke Box has more than 100 partners including music artists, electronic commerce partners, and hardware vendors. RealSystem MP is an open and extensible digital music platform enabling integration with Internet music services and hardware devices.
- RealNetworks announced that the RealPlayer, launched in 1995, has over 65 million unique users registered. The average download rate now exceeds 175 thousand per day, which is an increase of more than 270% since the beginning of 1997. Further, RealSystem software is used to deliver content on 85% of all streaming media enabled web pages.

CONSUMER WINDOWS

INVESTMENTS & PRODUCT HIGHLIGHTS

- Windows 98 installed base exceeded 52 million users by the end of Q99-4. During the first full year of sales, Windows 98 out-sold Windows 95 for the corresponding period.
- Windows 98 Second Edition, based on the Windows 9x kernel, launched on June 10. The new product includes a variety of features and improved components such as Internet Explorer 5, NetMeeting 3, Outlook Express 5, Windows Media Player 6.1, Internet Connection Sharing and advanced hardware support.
- The next version of Consumer Windows, code named "Millennium," will be the last version of Consumer Windows to be based on the Windows 9x kernel. It will deliver clear customer value by focusing on feature areas such as digital media and entertainment, home networking and making the home PC more relevant and simpler to use. The Millennium operating system is expected to launch in Q00-4.
- Internet Explorer 5 was released in March, focusing on performance, reliability, simplicity and automation. With this release, IE has garnered the number one market share position among browsing technologies including AOL and Netscape.

BUSINESS METRICS

	Consumer Windows Division Metrics					
	Q98-4	Q99-1	Q99-2	Q99-3	Q99-4	FY99
PC ship growth (trailing 12 months)	23%	17%	18%	20%	21%	21%
Win9x OEM OS license mix	81.4%	82.7%	82.1%	80.6%	78.8%	81.0%
Win95 licenses (000s)	15,451	9,979	8,188	4,882	4,316	27,365
Win98 licenses (000s)	3,638	8,166	12,623	13,765	13,954	48,508
Total Win9x (000s)	19,089	18,146	20,810	18,647	18,270	75,873
IE browser share*	53%	48%	51%	53%	56%	56%

**based on Call-down data +/-3%*

COMPETITION

- AOL 5.0 will include Internet Explorer 5.0, despite AOL's recent acquisition of Netscape Communications. AOL is under contract with Microsoft to provide Internet Explorer and has "no plans to switch over to Netscape at this time," according to Jonathan Sacks, senior vice president and general manager of AOL Interactive Services.
- New versions of Linux from Caldera Systems and Red Hat Software offer improved installation programs, broader hardware support, and new graphical interfaces. While the Caldera and Red Hat bundles list for $50 or less, they include the core program and hundreds of applications. Both companies also make the stand-alone OS available for free from their Web sites.
- This year Compaq, Dell, and IBM have all announced that they'll install and support Red Hat Linux on desktop PCs in addition to servers.
- Be Inc., offering the BeOS operating system for digital media applications and Internet appliances, announced an initial public offering at 6 million shares priced between $8 to $10 a share. The company plans to use the proceeds for increased sales and marketing activities, research and development, working capital and general corporate purposes.
- AST Computer introduced what it called the first high-performance system incorporating BeOS. The new AST Premium 2000Be with BeOS 4.5 and Windows NT Workstation 4.0 starts at $1,912 and contains a 450-MHz Pentium II processor, a 4.5GB hard drive and 64MB of memory. You can easily toggle between operating systems.
- Microworkz.com Corp, the maker of the $299 WEBzter PC, announced its new $200 computer/Internet information appliance, called the iToaster. The iToaster uses a combination of the Linux and Be Inc. operating systems. Microworkz was also in discussions with AOL about a possible AOL-branded PC, giving AOL the chance to connect with consumers without the use of MS Windows.

MS RESEARCH

Microsoft Research

(in millions, variance to plan, except headcount)	Q99-4		FY99	
	Actual	Var %	Actual	Var %
Net revenue	$0.0	-	$0.0	-
Operating expenses:				
People	14.3	24%	55.5	13%
Infrastructure	5.1	(1%)	17.2	5%
Contingent staff	1.5	(2%)	5.3	15%
Product development	0.3	87%	10.2	4%
External localization	0.0	-	0.0	100%
Product marketing	3.3	(7%)	8.2	28%
Other	0.7	nm	1.6	nm
Direct controllable oper expenses	25.1	17%	98.1	11%
Product-related oper expenses	(0.0)	(25%)	(0.7)	19%
Total operating expenses	25.1	17%	97.4	11%
Responsibility margin	(25.1)	17%	(97.4)	11%
Corporate allocations	5.9	(66%)	18.0	(24%)
Contribution margin	($31.0)	8%	($115.4)	7%
Quarter-end regular headcount	451	3%		

FINANCIAL HIGHLIGHTS

- Research Division Q99-4 operating expenses totaled $25 million, under plan by 17% due to savings on people expenses. The $25 million this quarter represented a 30% increase over the prior year due to growth in headcount and University Relations program spending.
- Research Division operating expenses nearly topped $100 million in FY99. The $97 million was 11% favorable to plan due to lower than expected headcount-related expenses and a shortfall in spending on the University Relations program.
- Research Division operating expenses are expected to rise by 108% to $52 million during Q00-1 due to growth in headcount-related and product development expenses.

INVESTMENTS & PRODUCT HIGHLIGHTS

- Research Division employees reached 451 by year-end, representing net growth of 44% over the past year. Key external hires included Laci Lovasz, formerly a Professor of Mathematics and Computer Science at Yale University, and Oded Schramm, formerly a Professor at the Weizmann Institute of Science in Israel. Both joined MS as a Senior Researcher in the Theory Group.
- Jim Blinn, a Researcher in the Graphics Research Group, will receive the 1999 COONS Award, which is the lifetime achievement award for computer graphics that is presented every second year by ACM Siggraph.
- MS has acquired Intrinsa Corporation. Intrinsa's Prefix product uses component simulation technology to statically detect errors in C and C++ code. All the members of the core team have joined MS Research's Programmer Productivity Research Center.

BUSINESS PRODUCTIVITY & DEVELOPERS

Q99-4

(in millions, variance to plan)	Office Actual	Office Var %	Prod. Apps Actual	Prod. Apps Var %	Office Family Actual	Office Family Var %	Mac Actual	Mac Var %
Net revenue	$1,600.1	7%	$5.3	(53%)	$196.6	(12%)	$26.7	108%
Cost of revenue	53.1	(14%)	0.3	(95%)	9.1	4%	0.4	13%
% of net revenue	*3.3%*		*5.2%*		*4.6%*		*1.4%*	
Gross margin	1,547.0	7%	5.0	(55%)	187.5	(12%)	26.3	112%
% of net revenue	*96.7%*		*94.8%*		*95.4%*		*98.6%*	
Operating expenses								
People	39.5	5%	10.2	18%	7.6	14%	4.1	25%
Infrastructure	13.2	(18%)	4.5	(29%)	2.6	(19%)	2.1	(59%)
Contingent staff	7.6	(18%)	5.2	(54%)	1.9	(16%)	0.6	4%
Product development	14.7	(32%)	15.4	(200%)	4.2	(61%)	0.4	83%
Other	0.6	nm	1.9	nm	0.3	nm	0.0	(321%)
Product marketing	23.0	(127%)	11.5	(227%)	30.9	(504%)	1.8	(89%)
Channel mktg controllable	0.0	nm	0.0	nm	0.0	nm	0.0	nm
Direct controllable oper expenses	98.6	(20%)	48.7	(560%)	47.5	(134%)	9.0	17%
Taxes, insurance, & settlements	39.5	nm	0.0	8%	(0.1)	132%	0.0	nm
Product support services	29.5	0%	0.8	(113%)	7.5	(62%)	0.4	nm
Bad debt expense	10.6	(35%)	0.0	33%	1.2	(49%)	0.1	nm
R&D shared resources	0.7	17%	0.4	31%	3.8	44%	0.1	42%
Product-related oper expenses	80.3	(102%)	1.2	(20%)	12.5	(0%)	0.5	(127%)
Total operating expenses	179.6	(47%)	49.9	(495%)	60.0	(83%)	9.6	13%
Responsibility margin	1,368.0	3%	(44.9)	nm	127.5	(30%)	16.8	nm
% of net revenue	*85.5%*		*(844.1%)*		*64.9%*		*62.8%*	
Corporate allocations	169.3	(30%)	10.6	(53%)	22.8	(38%)	3.3	(51%)
Contribution margin	$1,198.7	0%	($54.9)	nm	$104.7	(36%)	$12.5	nm
% of net revenue	*74.9%*		*nm*		*53.3%*		*50.6%*	

(in millions, variance to plan)	Server Apps Actual	Server Apps Var %	Distr. Apps Actual	Distr. Apps Var %	Developer Tools Actual	Developer Tools Var %	eBooks Actual	eBooks Var %	GAAP	Prod. Apps & Dev
Net revenue	$121.9	14%	$185.5	(2%)	$140.5	21%	$0.0	nm	$646.2	$2,924.9
Cost of revenue	5.0	36%	4.3	(34%)	19.7	22%	0.0	nm	6.2	98.0
% of net revenue	*4.1%*		*2.3%*		*14.0%*		*nm*		*1.0%*	*3.4%*
Gross margin	116.9	(2%)	181.2	(3%)	120.8	33%	0.0	nm	640.1	2,826.9
% of net revenue	*95.9%*		*97.7%*		*86.0%*		*nm*		*99.0%*	*96.6%*
Operating expenses										
People	21.1	13%	30.4	(1%)	26.5	22%	2.2	nm	0.0	141.5
Infrastructure	8.4	(33%)	9.0	(19%)	12.2	(27%)	0.6	nm	(5.8)	46.7
Contingent staff	4.4	(25%)	6.8	(51%)	6.8	8%	0.4	nm	0.0	33.6
Product development	3.4	59%	6.6	(217%)	6.9	(26%)	2.0	nm	91.2	145.0
Other	5.9	nm	1.1	(554%)	1.5	(864%)	0.0	nm	(13.8)	(2.3)
Product marketing	6.2	34%	3.9	(210%)	16.0	(199%)	0.1	nm	0.0	51.9
Channel mktg controllable	0.0	nm	0.0	nm	0.0	nm	0.0	nm	0.0	0.0
Direct controllable oper expenses	49.5	5%	57.8	(28%)	69.8	(13%)	5.3	nm	71.6	446.4
Taxes, insurance, & settlements	(0.1)	133%	(0.1)	134%	(0.1)	135%	0.0	nm	0.0	39.3
Product support services	12.4	(36%)	4.8	42%	15.5	16%	0.0	nm	0.0	70.8
Bad debt expense	1.3	(16%)	1.0	(63%)	1.0	(28%)	0.0	nm	2.0	17.1
R&D shared resources	4.2	(283%)	0.7	(105%)	(13.6)	(7%)	0.0	nm	0.0	(3.6)
Product-related oper expenses	17.8	(55%)	6.5	(197%)	2.8	42%	0.0	nm	2.0	123.6
Total operating expenses	67.3	(6%)	64.3	(67%)	72.7	19%	5.3	nm	73.6	570.1
Responsibility margin	49.6	(12%)	116.9	(21%)	48.2	98%	(5.3)	nm	566.5	2,256.8
% of net revenue	*40.7%*		*63.0%*		*34.3%*		*nm*		*87.7%*	*77.2%*
Corporate allocations	111.9	(28%)	53.7	(33%)	48.6	(33%)	0.0	nm	3.9	423.4
Contribution margin	($62.3)	(101%)	$63.2	(41%)	($0.4)	97%	($5.3)	nm	$562.6	$1,833.4
% of net revenue	*(51.1%)*		*34.1%*		*(0.3%)*		*nm*		*87.1%*	*62.7%*

FY99

(in millions, variance to plan)	Office Actual	Office Var %	Prod. Apps Actual	Prod. Apps Var %	Office Family Actual	Office Family Var %	Mac Actual	Mac Var %
Net revenue	$6,115.0	11%	$22.7	(32%)	$637.2	(20%)	$139.5	118%
Cost of revenue	181.3	2%	0.8	(30%)	27.7	20%	2.4	(7%)
% of net revenue	*3.0%*		*3.4%*		*4.3%*		*1.7%*	
Gross margin	5,933.7	12%	21.9	(33%)	609.5	(20%)	137.1	122%
% of net revenue	*97.0%*		*96.6%*		*95.7%*		*98.3%*	
Operating expenses								
People	149.5	6%	38.5	13%	29.2	10%	15.6	21%
Infrastructure	45.9	6%	15.0	(10%)	8.8	11%	5.4	14%
Contingent staff	25.8	16%	18.1	(21%)	6.1	8%	1.8	27%
Product development	44.8	15%	46.5	2%	12.2	5%	0.7	58%
Other	0.9	(503%)	0.2	nm	0.1	nm	(0.2)	nm
Product marketing	36.8	(5%)	26.6	(31%)	45.1	(116%)	3.6	(22%)
Channel mktg controllable	0.0	nm	0.0	nm	0.0	nm	0.0	nm
Direct controllable oper expenses	303.8	7%	144.8	(3%)	101.6	(23%)	26.9	27%
Taxes, insurance, & settlements	41.5	(466%)	0.0	(253%)	0.2	80%	0.0	nm
Product support services	111.6	11%	2.2	(49%)	22.2	(12%)	0.9	(597%)
Bad debt expense	32.9	(10%)	0.1	28%	3.5	(18%)	0.2	nm
R&D shared resources	0.7	71%	1.7	26%	15.0	40%	0.4	47%
Product-related oper expenses	186.6	(13%)	4.0	(3%)	40.9	16%	1.5	(74%)
Total operating expenses	490.4	0%	148.8	(3%)	142.5	(8%)	28.4	25%
Responsibility margin	5,443.3	13%	(126.9)	(14%)	467.0	(26%)	108.8	352%
% of net revenue	*89.0%*		*(559.2%)*		*73.3%*		*78.0%*	
Corporate allocations	531.8	(0%)	31.2	(14%)	71.0	15%	9.8	(15%)
Contribution margin	$4,911.5	15%	($158.1)	(14%)	$396.1	(29%)	$99.0	538%
% of net revenue	*80.3%*		*(696.7%)*		*62.2%*		*70.9%*	

(in millions, variance to plan)	Server Apps Actual	Server Apps Var %	Distr. Apps Actual	Distr. Apps Var %	Developer Tools Actual	Developer Tools Var %	eBooks Actual	eBooks Var %	GAAP	Prod. Apps & Dev
Net revenue	$467.6	0%	$665.3	4%	$638.3	22%	$0.0	nm	$130.2	$5,815.9
Cost of revenue	17.7	45%	15.5	(31%)	94.2	6%	0.0	nm	6.2	345.7
% of net revenue	*3.8%*		*2.3%*		*14.8%*		*nm*		*4.8%*	*5.9%*
Gross margin	449.9	3%	649.8	4%	544.1	28%	0.0	nm	124.0	5,470.1
% of net revenue	*96.2%*		*97.7%*		*85.2%*		*nm*		*95.2%*	*94.1%*
Operating expenses										
People	81.4	6%	116.8	7%	102.1	18%	2.2	nm	0.0	535.3
Infrastructure	29.1	(11%)	35.0	4%	36.7	8%	0.7	nm	10.2	186.7
Contingent staff	14.8	(5%)	22.5	(24%)	21.6	23%	0.4	nm	0.0	111.4
Product development	9.0	70%	15.3	(144%)	18.4	34%	2.0	nm	114.7	263.5
Other	6.1	nm	0.8	(176%)	2.3	(275%)	0.0	nm	(15.4)	(5.2)
Product marketing	19.0	48%	11.0	(120%)	25.7	(9%)	0.1	nm	0.0	141.4
Channel mktg controllable	0.0	nm	0.0	nm	0.0	nm	0.0	nm	0.0	0.0
Direct controllable oper expenses	159.4	18%	201.7	(6%)	206.8	16%	5.3	nm	109.5	1,233.2
Taxes, insurance, & settlements	0.2	50%	0.3	67%	0.2	79%	0.0	nm	0.0	42.4
Product support services	43.6	1%	21.7	41%	63.8	20%	0.0	nm	0.0	266.0
Bad debt expense	4.1	0%	3.3	(34%)	3.5	(21%)	0.0	nm	2.0	49.5
R&D shared resources	12.1	(20%)	(49.1)	(28%)	(47.4)	(12%)	0.0	nm	0.0	(66.6)
Product-related oper expenses	60.0	(1%)	(23.7)	(15%)	20.1	32%	0.0	nm	2.0	291.3
Total operating expenses	219.3	13%	178.0	(9%)	226.9	17%	5.3	nm	111.5	1,524.5
Responsibility margin	230.6	27%	471.8	7%	317.2	113%	(5.3)	nm	12.5	3,945.6
% of net revenue	*49.3%*		*70.9%*		*49.7%*		*nm*		*9.6%*	*67.8%*
Corporate allocations	357.3	0%	175.0	(4%)	162.3	(5%)	0.0	nm	3.9	1,342.3
Contribution margin	($126.7)	28%	$296.5	1%	$154.9	nm	($55.3)	nm	$8.6	$2,603.3
% of net revenue	*(27.1%)*		*44.6%*		*24.3%*		*nm*		*6.6%*	*44.8%*

PRODUCTIVITY APPLICATIONS & DEVELOPER BUSINESS RESULTS

- Office and Office Family Q99-4 net revenue of $1.82 billion was 6% over plan, and exceeded Q98-4 net revenue by 13%. Sequentially, net revenue was flat with the prior quarter. Office and Office Family ended the year at $6.89 billion, up 15% from FY98 and 8% over plan.
- Server Applications (Exchange and the BackOffice Suite SKUs) Q99-4 net revenue of $122 million was 5% under plan, down 13% from Q98-4, and up 3% sequentially from Q99-3. EA revenue from Server Applications grew 28% quarter over quarter to $78 million, representing 26% of the overall revenue mix, up from 21% last quarter. For the year, Server Applications net revenue totaled $468 million, right on plan.
- Productivity Appliances Q99-4 net revenue of $5 million was 53% under plan. On a sequential basis, net revenue was down 13%. Gains in Embedded and Tools sales were offset by declines in Handheld PCs and Palm-sized PCs.
- Distributed Applications (SQL Server) Q99-4 net revenue of $186 million was 2% below plan, down 2% from Q99-3. Net revenue was driven by steady sales of SQL Server following 2 solid growth quarters since the version 7.0 launch. For the year, SQL grew 57% over FY98.
- Developer Tools Q99-4 net revenue of $140 million was 21% above plan, down 14% from Q99-3. Net revenue was driven by strong Visual Studio sales and MSDN subscriptions.
- Q99-4 operating expenses were $106 million, or 38%, greater than planned. This was due to a spike in marketing spend in Q99-4 (approximately 56% of the full year spend occurred in Q4) including the Office 2000 launch and an advertising campaign focusing on business decision-makers. Q99-4 operating expenses were also the result of a timing difference in the reimbursement of product development expenses from semiconductor partners for work done by bSquare. The reimbursement was budgeted in June while actual funds were received throughout the year. Full year operating expenses were $60 million, or 5%, lower than planned driven by unfilled headcount and lower than planned product development and external localization expenses.

OUTLOOK

- Office and Office Family Q00-1 net revenue is expected to be $2.00 billion. The anticipated growth is due to a full quarter of Office 2000 sell-through.
- Server Applications net revenue is expected to be approximately $130 million in Q00-1. Post BackOffice launch slowdown and Y2K customer focus are setting these growth estimates.
- Productivity Appliances Q00-1 net revenue is expected to be $7 million, up 23% over Q99-4 but 41% under budget. Growth is expected to be driven by Palm-sized PC sales, with other markets flat.
- Distributed Applications Q00-1 net revenue is expected to be $200 million, approximately 5% higher than Q99-4, as continued momentum from version 7.0 sales is offset by seasonal slowdown.
- Developer Tools Q00-1 net revenue is expected to be $120 million, approximately 16% lower than Q99-4, as sales of the version 6.0 products continue to slow down post launch. Revenue results are dependent on developers upgrading to the version 6.0 tools and renewing MSDN Universal subscriptions.

OFFICE AND OFFICE FAMILY

INVESTMENTS & PRODUCT HIGHLIGHTS

- Office 2000 was officially launched in the US on June 7 and was on retail shelves on June 10.
- Prior to launch, existing Office customers had already purchased the rights to 15 million licenses for Office 2000 through volume license and Technology Upgrade programs.
- The first 15 days of US Retail/DMR license sales for Office 2000 shows modest growth (31%) relative to the comparable period of the Office 97 launch.
- Office 2000 received many positive reviews (NY Times, LA Times, Philadelphia Inquirer, Chicago Tribune), a great deal of positive news coverage (Wall Street Journal, US Today), and positive product reviews (PC Magazine, PC Computing, PC World, InfoWorld, InformationWeek). Yet there has also been a consistent undercurrent expressing a lack of features for pure end-users not connected to the internet, notably Mossberg's WSJ review and Wildstrom's Business Week Review, where these reviews said there are noteworthy features for "corporate users" and "administrators" but the product is lacking for the individual who is not interested in creating web pages or intranets. We have also received fairly consistent concern over the price of Office 2000 Premium (Word, Excel, PowerPoint, Access, Outlook, Publisher, FrontPage, PhotoDraw, and Small Business Tools, VUP ESP $449 with rebate), though it is selling above expectations as of the first weeks of launch.

- FrontPage 2000 won PC Magazine's Editor's Choice Award.
- Office 2000 Server Extensions (OSE) create new opportunities for small and medium-sized business customers that want to take advantage of Office 2000 collaboration features without having their own Web servers. According to a May CSA Lab report on OSE, "This emphasis on Intranet-style server integration is one of the reasons why Office 2000 is so appealing to corporate customers."
- The Office Registration Wizard introduced with the launch of Office 2000 institutes a new registration process designed to help combat software piracy. Product with ORW is being distributed in five countries: Australia, Brazil, China, Hong Kong and New Zealand, plus U.S. and Canada for academic only.

BUSINESS METRICS

	Office Metrics					
	Q98-4	Q99-1	Q99-2	Q99-3	Q99-4	FY99
Suite licenses (000s)	9,725	7,909	10,663	12,446	14,143	41,989
Growth (trailing 4 quarters)	43%	35%	30%	31%	33%	26%
Suite revenue per license	$ 148	$ 164	$ 155	$ 134	$ 145	$ 150
Office Retail & DMR unit share	75%	77%	80%	78%	85%	
Office Pro/Prem % suite licenses	48%	43%	47%	50%	49%	

COMPETITION

- Corel announced a new agreement with Gobi Inc. to bundle Corel WordPerfect Suite 8 on all of Gobi's computers. Corel also announced bundling agreements with Micro Pro Inc., and Edge Corp. Edge Corp. Corel launched both WordPerfect Office 2000 and CorelDRAW9 in the June quarter.
- Lotus released a version of SmartSuite with updated speech-recognition capabilities, better file filters for Microsoft Office applications, and a new personal information manager. Also included in SmartSuite 9.5 is a tool to ease the posting of word-processing documents to the Web.
- Ichitaro (Japan) has released two new products oriented toward home consumers (Ichitaro Home and Ichitaro Lite2).
- H&C (Korea) has received a significant infusion of cash and is reporting a rise in legitimate licenses due to increased anti-piracy measures by the government and an attractive subscription program.
- Star Office (Germany) continues to push the Linux version of its suite and as such continues to receive mind-share. This does not appear to be impacting the sales of its Windows version.

SERVER APPLICATIONS

INVESTMENTS & PRODUCT HIGHLIGHTS

BackOffice™

- Exchange licensed 4.9 million seats this past quarter, which was a new all time high. The life-to-date total is now almost 33.8 million seats.
- General Electric became the largest single commercial deployment of Exchange at 200,000 seats.
- Dataquest published a study that found that the deployment for Exchange increased faster in 1998 than Lotus Notes or Novell GroupWise. In addition, more companies adopted Exchange as a collaboration application than any other similar product.
- Market Decisions, Inc. conducted a study that showed Exchange Server to be the choice leader in the MORG and LORG space for those who migrated from cc:Mail, within the past 12 months.
- Microsoft Japan and CIS Corporation have agreed that Microsoft Japan will purchase 20% of CIS's outstanding shares. With this tie, CIS plans to ship an Exchange-compatible version of its CNAP Lotus Notes application by the third quarter of 1999 as well as develop its Exchange and BackOffice business.
- For the first time since reviewing the product, PC Week Labs recommended that companies purchase BackOffice for the extra benefits such as easier installation and administration, rather than just for the discounted price.
- Small Business Server 4.5 was officially launched on May 24 with press releases, ads in channel publications and Direct Access events.
- Microsoft offered about $125 million for all outstanding shares of Sendit AB. The Sweden-based company has a product that provides mobile data access via a wireless operator's web site. This technology can be expanded to have unified messaging and mobile content services.

BUSINESS METRICS

	Server Applications Metrics					
	Q98-4	Q99-1	Q99-2	Q99-3	Q99-4	FY99
1. New Exchange clients	2,422,787	2,010,812	2,788,677	2,795,383	3.078,625	10,673,496
2. New BackOffice clients	1,542,823	1,542,823	1,144,160	1,862,323	2,330,113	6.879,419
3. Exchange attach rate to NTS	16%	13%	11%	12%	11%	12%

Notes on Methodology:

1. New Exchange clients include usage-based allocations from BackOffice & Small Business Servers
2. BackOffice CALs include Enterprise Agreements
3. Exchange Attach Rates to NTS include usage-based allocations from BackOffice & Small Business Servers

COMPETITION

- IBM expanded its efforts to allow remote workers to link to corporate networks with handheld devices by announcing a tiny version of its MQSeries business messaging software. The product is called MQSeries Everywhere.
- In an announcement made at PC Expo, IBM said it would offer hosted business applications from Great Plains Inc., SalesLogix, and Ultimate Software.
- IBM is expected to announce a new sales initiative and a massive marketing campaign that will target small businesses with employees of 100 or less, according to CNet. The programs are expected to be tied closely to the Web and current IBM e-commerce offerings.
- Lotus announced a new Independent Software Vendor program to facilitate the development of vertical industry applications for Notes. The new program includes a Web-based catalog and tighter requirements for product certification.
- Lotus announced that it will launch a Linux version of Domino Server by the end of this year, but will not market a version for Novell NetWare.
- Lotus released Sametime 1.0, a server-based collaboration program that allows anyone with a Java-enabled Web browser to share applications, whiteboards, text discussion threads, and chat sessions. The server operates by itself or can tie to Domino servers for the added benefit of the Notes Directory and meeting services.

DISTRIBUTED APPLICATIONS

INVESTMENTS & PRODUCT HIGHLIGHTS

- SQL shipments remained strong for Q99-4, while, total licenses for FY99 grew 86% over FY98. This represents a market share of over 40% of all database licenses sold in FY99.

- SQL Server 7.0 won Editor's choice award in PC Magazine mid-market database roundup.
- SQL Server for the Windows CE operating system was demonstrated at the Windows CE Developers Conference. SQL Server scalability has now been extended from the enterprise to embedded, hand-held and palm-sized devices for mobile and embedded applications.
- MS and Siebel announced a Joint Technology Solution Center in Redmond. As part of the arrangement, SQL Server will be offered in an integrated package with Siebel Systems front-office applications beginning mid-July.
- Two new ads highlighting Business Intelligence through the integration of SQL Server and Office 2000 began running in Q99-4. MS is offering promotional pricing on SQL Server to Access users in an effort to promote the integration between Access 2000 and SQL Server 7.0.

BUSINESS METRICS

	Distributed Applications Metrics					
	Q98-4	Q99-1	Q99-2	Q99-3	Q99-4	FY99
1. New SQL clients (000s)	1,284	1,081	1,715	2,030	2,059	6,884
2. New SQL servers (000s)	68	48	61	68	75	252
3. Client to server ratio	19	23	28	30	27	27
4. SQL attach rate to NTS	17%	14%	15%	17%	16%	16%

Notes on Methodology:

1 & 2. New SQL clients and servers include usage-based allocations from BackOffice & Small Business Servers

4. SQL attach rates to NTS include usage-based allocations from BackOffice & Small Business Servers

COMPETITION

- Oracle emphasized its focus on the Internet and e-business in its latest quarterly results. However, its overall revenue was still dominated by its services business, which continues to grow faster than its licensing revenue.
- Oracle continues to see significantly higher growth rates for its NT based products than for the same products on the UNIX platform according to a Morgan Stanley analysis.
- Oracle announced the availability of Oracle 8i Lite for mobile applications (Windows CE included). Like Sybase's UltraLite, Oracle's small-footprint database features a Java virtual machine.
- Informix CEO Bob Finocchio stepped down as president and named executive VP Jean-Yves Dexmier as his replacement effective July 17. Finocchio will continue as chairman of Informix, but said the company needs new leadership as it enters the second phase of its growth strategy.
- Sybase launched four vertical software packages with prices starting at $100,000. Industry-specific versions of the Warehouse Studios are immediately available for the insurance, health care, telecommunications, and retail banking industries. To follow later this year are packages for the credit card, utility, life insurance, and retailing industries.

TOOLS DIVISION

INVESTMENTS & PRODUCT HIGHLIGHTS

- Office Developer 2000 was launched on June 7. Product was made available on retail shelves on June 10. Office Developer 2000 improves upon the prior version by providing a COM Add-In Designer, Code Librarian and Visual Source Safe for developers targeting the Office platform.
- MS announced a pilot program aimed at changing the delivery of its training curriculum to Certified Technical Education Centers (Microsoft CTECs). Through the Microsoft Official Curriculum (MOC) Licensing Program, MS CTECs can offer more unique training solutions to customers by integrating their own content with MOC, or replicate the curriculum delivered by MS.
- MS paid Inprise Corp. $125 million as part of a broad alliance under which MS will license Inprise's technology patents and will receive $25 million of preferred stock. This investment will settle what Inprise (formerly Borland) described as "longstanding" patent issues between the companies.
- MS Data Engine (MSDE) for Visual Studio 6.0 launched at Tech Ed on 5/24 via the Visual Studio web site. MSDE for Visual Studio contains: MSDE freely redistributable cab file, SQL Server 7.0 Developer Edition, NT4 SP4.

BUSINESS METRICS

	Tools Metrics					
	Q98-4	Q99-1	Q99-2	Q99-3	Q99-4	FY99 Target
1. VB language usage	49%	49%	50%	50%	n/a	51%
2. Tools suite penetration	31%	33%	48%	45%	40%	35%
3. Revenue per license	$ 362	$ 353	$ 488	$ 462	$ 434	$ 340

Note on Methodology:

1. Percentage of U.S. developers using MS Visual Basic language
2. Percentage of Visual Studio & MSDN Universal licenses sold as a % of total Pro and Ent licenses
3. Revenue per license of Visual Studio and its standalone products (excl. academic sales)

COMPETITION

- IBM posted a free Java virtual machine (JVM) for Windows 32-bit platforms. The new JVM can be used in conjunction with Windows 95, Windows 98, and Windows NT to deploy and run Java applications and applets on those platforms, and have them run 30 percent faster on average than with currently available JVMs.
- Sun has delivered an enhanced Java virtual machine for the Solaris platform. The JVM is core to the free Java 2 Software Development Kit (SDK), Standard Edition, Version 1.2.1 for the Solaris operating environment.
- ObjectShare introduced a new suite of development tools for Linux that allows corporate and third-party developers to create applications that will work with Windows, Mac OS, and multiple versions of Unix without modification. Version 3.1 of VisualWorks for Linux, allows programmers to work on lower-cost hardware platforms and to deploy applications in multi-platform enterprise environments more quickly.
- IBM launched the beta test program of its VisualAge for Embedded Systems, Java Technology Edition. By getting the Java development environment into the hands of device manufacturers, chip makers, software developers, and systems integrators, IBM is hoping to foster the development of embedded systems and Internet appliances.
- Lotus has begun shipping a set of Java components and tools that help Domino Web developers build interactive applications for intranets and extranets. Using eSuite DevPack 2.0, application developers can extend the technology of their Domino Web server by adding Web client interactivity to the enterprise data options provided in Domino R5 server platform.

PRODUCTIVITY APPLIANCES

INVESTMENTS & PRODUCT HIGHLIGHTS

- Total Windows CE licenses for FY99 fell just short of the 1 million unit level and were up 68% over FY98. Palm-sized PC (PPC) units sold-in 372 thousand in their first full-year, while Embedded licenses reached 111 thousand. Lifetime Windows CE licenses now exceed 1.7 million.
- Color PPCs shipped this quarter, with units from HP, Compaq, Casio, and Philips hitting the US market. HP and Compaq are new vendors for PPC units. On the Handheld PC side (HPC), IBM and Compaq introduced their first devices.
- MS announced plans to introduce a wireless communications kit this fall. Containing AvantGo client software, a Socket phone card, and a cable; the kit will enable PPC users to access their e-mail, browse the Internet, and synchronize data via a cellular phone.
- Microsoft Mobile Explorer Version 1 was released to manufacturing this quarter. The small footprint browser for mobile phones currently supports text messaging and email browsing.
- Microsoft announced a new data architecture for Microsoft Windows CE that will enable data access based on ActiveX Data Objects (ADO) and OLE DB. The new architecture will allow access to data stores through a set of open interfaces. The MS SQL Server team, Sybase Inc. and Simba Technologies have all announced products to support the new architecture.
- MS launched its SmartCard for Windows OS. Pilots with Merrill Lynch, Arco and the Veterans Administration are schedule to begin this fall. MS and Atmel entered into a joint development effort to port the SmartCard for Windows OS to the Atmel's crypto controller line of integrated circuits.

BUSINESS METRICS

	Productivity Appliances Metrics					
	Q98-4	Q99-1	Q99-2	Q99-3	Q99-4	FY99
Handheld PC Units (HPC/HPC Pro)	208,721	158,159	108,164	128,744	96,618	491,685
Palm-sized PC units	16,027	83,952	105,345	107,745	75,644	372,686
Embedded licenses	nm	1,536	18,530	34,410	56,717	111,193
Share of PC companion (HPC) segment	62%	44%	34%	70%	75%	50%
Share of palm-sized PC segment	3%	20%	15%	19%	15%	16%
Share of total handheld companions	27%	31%	21%	27%	27%	27%
Comparable quarterly growth (HPC Pro/Std)	127%	38%	21%	-14%	-54%	-13%

COMPETITION

- Palm launched an integrated wireless device, the Palm VII. 3Com also launched a wireless ISP service, Palm.Net. Palm.Net uses proprietary "web-clipping" technology to provide small-screen/low data rate browsing. Palm.Net has signed over 50 content and e-commerce providers.
- 3Com and Aether Technologies announced the formation of OpenSky, which will provide wireless access to the Internet and corporate intranets. Scheduled to launch by the end of 1999, OpenSky will provide network operators a single source for a complete wireless data service solution.
- Sun and 3Com announced plans to optimize Java2 Micro Edition for the Palm OS. This marks the first time Sun will optimize Java for a specific platform. The two companies will develop an end-to-end solution for delivering content and Java applications to Palm OS devices.
- AOL and 3Com entered into a strategic alliance to enable AOL users to receive AOL email through Palm devices. Palm VII users will be able to view a scaled down version of AOL's content services via web-clipping.
- Matsushita (Panasonic) has joined Symbian with a 9% stake valued at about $35 million. Symbian partners now account for 65% of worldwide handset shipments. Matsushita is the leading phone manufacturer in Japan.
- Symbian released EPOC version 5. New features include: Internet email, SMS support, full color display, and improved data/PC synchronization. Psion prototyped two new devices based on EPOC R5 and also offering full Java support.

CONSUMER AND COMMERCE & OTHER

Q99-4

(in millions, variance to plan)	LEFD		Web TV		Hardware		Portal		Commerce		ISM		DFD		News		Press		Other		GAAP	CC&O
	Actual	Var %	Actual	Var %	Actual	Var %	Actual	Var %	Actual	Var %	Actual	Var %	Actual	Var %	Actual	Var %	Actual	Var %	Actual	Var %		
Net revenue	$80.7	(33%)	$52.6	(16%)	$71.5	(37%)	$126.5	(3%)	$6.7	(10%)	$31.7	16%	$12.3	(3%)	$0.0	nm	$44.7	(19%)	($111.0)	nm	$277.6	$593.3
Cost of revenue	26.9	7%	62.8	21%	64.6	7%	24.5	63%	0.6	(0%)	4.2	(1%)	3.5	(19%)	0.5	52%	20.7	8%	14.2	(107%)	289.8	512.2
% of net revenue	33.4%		119.4%		90.3%		19.4%		8.8%		13.3%		28.3%		nm		46.3%		(12.8%)		104.4%	86.3%
Gross margin	53.8	(41%)	(10.2)	39%	6.9	(84%)	102.0	57%	6.1	(11%)	27.5	18%	8.8	(10%)	(0.5)	52%	24.0	(27%)	(125.2)	nm	(12.2)	81.1
% of net revenue	66.6%		(19.4%)		9.7%		80.6%		91.2%		86.7%		71.7%		nm		53.7%		112.8%		(4.4%)	13.7%
Operating expenses																						
People	20.0	(17%)	17.9	(4%)	7.0	0%	23.7	4%	5.3	29%	15.1	(25%)	7.7	(10%)	0.1	12%	6.2	(1%)	16.9	0%	229.2	349.0
Infrastructure	6.6	(25%)	12.8	(50%)	2.0	7%	10.9	(77%)	3.3	(35%)	5.1	(21%)	2.1	(21%)	0.0	(44%)	2.0	(10%)	1.9	16%	(2.3)	44.5
Contingent staff	6.3	(29%)	4.7	(37%)	2.3	(4%)	10.2	(90%)	3.2	22%	5.8	(36%)	2.1	(67%)	0.0	nm	2.0	(37%)	0.7	(116%)	(329.4)	(292.0)
Product development	18.2	(1%)	5.2	(49%)	8.4	(33%)	31.8	(526%)	13.9	(492%)	6.3	(23%)	2.7	(0%)	0.0	nm	3.8	(95%)	0.9	44%	120.2	211.6
Other	0.9	nm	4.4	(57%)	0.1	nm	1.5	(154%)	(0.1)	157%	12.0	(33%)	(0.3)	256%	41.1	(184%)	1.1	(141%)	2.3	4%	216.5	279.5
Product marketing	9.2	(26%)	2.2	(131%)	4.5	(158%)	30.1	1%	2.2	(180%)	11.5	(89%)	2.0	(6%)	0.0	nm	0.6	(19%)	2.5	(43%)	0.0	64.9
Channel mktg controllable	0.0	nm	16.2	5%	0.0	nm	5.2	(21%)	0.0	nm	0.0	nm	0.0	nm	0.0	nm	4.4	(62%)	0.0	100%	(14.6)	11.2
Direct controllable oper expenses	61.2	(16%)	63.6	(18%)	24.2	(25%)	113.5	(48%)	27.8	(60%)	55.9	(37%)	16.3	(11%)	41.2	(182%)	20.2	(34%)	25.2	1%	219.6	668.7
Taxes, insurance, & settlements	(0.0)	129%	0.1	nm	(0.0)	129%	1.5	33%	0.0	nm	0.0	96%	0.0	41%	0.0	nm	0.0	(15%)	(2.3)	nm	80.0	79.2
Product support services	3.1	(20%)	5.1	29%	1.8	(38%)	10.9	48%	0.5	nm	0.1	(43%)	1.0	(2%)	0.0	nm	0.0	65%	0.0	nm	(624.7)	(602.0)
Bad debt expense	0.8	(3%)	0.0	85%	0.7	3%	6.3	6%	0.0	88%	0.1	50%	0.1	18%	0.0	nm	0.0	81%	0.0	(339%)	0.0	8.0
R&D shared resources	1.2	22%	0.2	29%	0.5	58%	(1.1)	544%	(3.4)	(39%)	2.6	38%	2.3	17%	2.2	(41%)	0.0	nm	(7.0)	(33%)	0.0	(2.5)
Product-related oper expenses	5.0	(1%)	5.4	30%	2.9	10%	17.6	41%	(2.9)	(47%)	2.8	40%	3.4	12%	2.2	(41%)	0.0	75%	(9.2)	111%	(544.7)	(517.4)
Total operating expenses	66.2	(15%)	69.0	(12%)	27.1	(20%)	131.1	(24%)	24.9	(110%)	58.7	(29%)	19.7	(6%)	43.4	(165%)	20.3	(33%)	16.0	(5%)	(325.1)	151.3
Responsibility margin	(12.4)	(137%)	(79.2)	(1%)	(20.2)	(192%)	(29.1)	29%	(18.8)	(278%)	(31.2)	(40%)	(10.9)	(23%)	(43.9)	(156%)	3.7	(79%)	(141.2)	(451%)	312.9	(70.2)
% of net revenue	(15.3%)		(150.5%)		(28.2%)		(23.0%)		(281.1%)		(98.4%)		(88.3%)		nm		8.3%		127.2%		112.7%	(11.8%)
Corporate allocations	41.7	(42%)	4.3	(66%)	20.0	(31%)	8.3	(61%)	0.0	nm	7.9	(62%)	2.1	(39%)	0.0	(64%)	1.9	(63%)	3.5	50%	155.3	253.0
Contribution margin	($54.1)	nm	($83.5)	(3%)	($40.2)	(708%)	($37.4)	19%	($18.8)	(278%)	($39.1)	(44%)	($15.0)	(29%)	($43.9)	(156%)	$1.8	(89%)	($144.7)	(364%)	$156.6	($323.2)
% of net revenue	(67.0%)		(158.8%)		(56.2%)		(29.5%)		(281.2%)		(123.3%)		(146.1%)		nm		4.0%		130.3%		55.7%	(54.5%)

FY99

(in millions, variance to plan)	LEFD		Web TV		Hardware		Portal		Commerce		ISM		DFD		News		Press		Other		GAAP	CC& Other
	Actual	Var %	Actual	Var %	Actual	Var %	Actual	Var %	Actual	Var %	Actual	Var %	Actual	Var %	Actual	Var %	Actual	Var %	Actual	Var %		
Net revenue	$506.9	(11%)	$158.7	(7%)	$479.9	(14%)	$444.0	9%	$16.9	(22%)	$79.5	5%	$57.7	(18%)	$0.0	nm	$150.6	(22%)	($110.3)	(384%)	$643.1	$2,427.0
Cost of revenue	131.6	(3%)	279.6	11%	303.0	5%	204.5	14%	1.2	1%	15.5	(10%)	13.4	18%	3.3	17%	65.4	19%	34.3	(34%)	1,235.9	2,287.8
% of net revenue	26.0%		176.1%		63.1%		46.0%		7.2%		19.5%		23.3%		nm		43.4%		(31.1%)		192.2%	94.3%
Gross margin	375.3	(15%)	(120.8)	16%	176.9	(26%)	239.6	39%	15.7	(23%)	64.0	4%	44.3	(18%)	(3.3)	17%	85.2	(24%)	(144.7)	(198%)	(592.9)	139.3
% of net revenue	74.0%		(76.1%)		36.9%		54.0%		92.8%		80.5%		76.7%		nm		56.6%		131.1%		(92.2%)	5.7%
Operating expenses																						
People	69.2	(3%)	62.8	6%	26.6	(1%)	87.5	8%	19.6	19%	48.3	(1%)	26.5	4%	0.3	36%	22.9	6%	35.2	44%	324.4	723.2
Infrastructure	21.7	(4%)	33.5	(34%)	7.8	5%	34.2	(19%)	10.3	25%	17.6	(1%)	7.8	(11%)	0.1	(13%)	7.7	7%	17.7	(155%)	3.3	161.7
Contingent staff	22.3	(13%)	14.0	(4%)	8.6	4%	30.5	(36%)	9.4	43%	18.1	(5%)	7.7	(50%)	0.0	nm	6.6	(5%)	2.0	(51%)	(329.4)	(210.1)
Product development	58.8	9%	12.0	30%	29.6	(8%)	56.4	(156%)	25.2	(48%)	13.0	32%	11.9	11%	(0.0)	nm	9.7	9%	2.4	44%	72.1	391.0
Other	1.1	nm	12.1	(15%)	0.5	nm	5.3	(121%)	0.5	10%	35.7	5%	1.3	54%	81.7	(17%)	1.5	17%	6.1	41%	202.0	347.9
Product marketing	30.2	7%	4.6	(15%)	20.4	(36%)	125.0	(0%)	4.9	(57%)	34.6	(13%)	8.3	28%	0.0	nm	2.7	39%	5.4	0%	0.0	236.1
Channel mktg controllable	0.0	nm	59.0	18%	0.0	nm	15.6	16%	0.0	nm	0.0	nm	0.0	nm	0.0	nm	10.1	15%	1.3	5%	0.0	86.0
Direct controllable oper expenses	203.3	1%	198.1	5%	93.3	(9%)	354.4	(13%)	69.9	7%	167.3	1%	63.5	6%	82.1	(17%)	61.2	9%	70.3	24%	272.4	1,635.5
Taxes, insurance, & settlements	0.1	79%	0.1	nm	0.2	80%	5.4	26%	0.0	nm	0.1	92%	0.1	(2%)	0.0	nm	0.1	(181%)	10.6	nm	78.5	95.2
Product support services	11.3	(3%)	20.4	7%	6.1	(9%)	46.9	37%	1.2	nm	0.4	(19%)	3.6	14%	0.0	nm	0.0	70%	0.0	nm	(624.7)	(534.7)
Bad debt expense	3.0	(7%)	0.6	7%	2.8	(5%)	23.0	(7%)	0.0	80%	0.3	59%	0.3	(16%)	0.0	nm	0.1	87%	2.1	nm	0.0	32.2
R&D shared resources	3.0	40%	0.4	51%	1.9	42%	(6.9)	127%	(13.8)	(50%)	10.3	28%	7.9	19%	6.3	1%	0.0	nm	(20.5)	(38%)	0.0	(11.4)
Product-related oper expenses	17.5	10%	21.6	9%	11.0	11%	68.3	32%	(12.6)	(54%)	11.0	31%	11.9	17%	6.3	1%	0.2	73%	(7.8)	(70%)	(546.1)	(418.7)
Total operating expenses	220.7	1%	219.7	6%	104.3	(6%)	422.7	(2%)	57.3	(21%)	178.3	4%	75.4	8%	88.4	(16%)	61.4	10%	62.5	(5%)	(273.7)	1,217.0
Responsibility margin	154.6	(29%)	(340.6)	10%	72.6	(48%)	(183.1)	34%	(41.6)	(54%)	(114.3)	8%	(31.1)	(11%)	(91.7)	(14%)	23.8	(45%)	(207.2)	(92%)	(319.1)	(1,077.9)
% of net revenue	30.5%		(214.6%)		15.1%		(41.2%)		(245.8%)		(143.8%)		(54.0%)		nm		15.8%		187.7%		(49.6%)	(44.4%)
Corporate allocations	132.5	(7%)	13.1	(24%)	63.3	(0%)	26.9	(22%)	0.0	nm	24.7	(22%)	24.0	(8%)	0.1	(23%)	5.8	(23%)	13.1	54%	14.5	318.0
Contribution margin	$22.1	(77%)	($353.7)	9%	$9.3	(88%)	($210.0)	20%	($41.6)	(54%)	($139.0)	4%	($55.1)	(10%)	($91.8)	(14%)	$17.9	(54%)	($220.2)	(61%)	($333.7)	($1,395.8)
% of net revenue	4.4%		(222.8%)		1.9%		(47.3%)		(246.0%)		(174.9%)		(95.5%)		nm		11.9%		199.6%		(51.9%)	(57.5%)

CONSUMER AND COMMERCE BUSINESS RESULTS

- Consumer and Commerce Group (CCG) Q99-4 net revenue of $230 million was under plan by 5% but 41% above the same quarter of the previous year. Online revenue drove the increase of $67 million over the last year due to strong advertising revenue (MSN.com up $21 million), increased subscriber revenue (Internet Access up $16 million) and growth in the ISM properties ($23 million). Compared to plan, weak subscription revenue in WebTV Services ($10 million) and Internet Access ($6 million) drove the unfavorable variance of $12 million due to below plan subscribers. However, MSN.com finished Q99-4 ahead of plan by $3 million due to strong advertising revenue and ISM was over plan by $4 million due to continued growth in transaction revenue. Overall CCG operating expenses were greater than plan by $88 million or 33%. The MSNBC Cable write-off of the cable JV deal ($34 million) and high product development in MSN.com ($24 million, mainly for LookSmart) drove the unfavorable operating expense variance. Additionally, high marketing, contingent staff and vendor costs across the majority of groups also contributed to the unfavorable variance. Continued favorable product support costs ($12 million) in WebTV Services and Internet Access partially offset the negative variance. CCG's responsibility margin loss of $218 million was $42 million behind plan.
- Interactive Service Media Division (ISM) net revenue of $32 million was 16% better than plan for Q99-4 due to continued strong Travel BU transaction volumes and a one-time $6 million CarPoint accounting change reflected in Q99-4, offset by lower Sidewalk revenue due to sales force transition. ISM responsibility margin loss for Q99-4 was 40% worse than plan resulting primarily from Expedia hotel receivable write-offs, excess Expedia marketing spend and Sidewalk product development spend higher than plan.
- The MSNBC Joint Ventures Division includes MSNBC Interactive and MSNBC Cable. For Q99-4, Interactive JV net revenue of $8 million was better than plan by $3 million and Cable net revenue of $40 million was favorable by $10 million. MSNBC Cable advertising revenue continues to grow from strong cable ratings and favorable cable advertising market.
- Net revenue for Desktop Finance Division (DFD) in Q99-4 of $12 million was on plan. Strong online and OEM revenue performance offset weak finished good sales. DFD's Q99-4 responsibility margin loss of $11 million was $2 million unfavorable to plan.
- Web Essentials (MSN access) responsibility margin loss for the quarter was $29 million, 24% better than the planned loss of $37 million. Net revenue of $126 million for Q99-4 was 3% below plan. Subscriber revenue of $100 million was 6% below plan due to fewer than planned subscribers, ending the year at 1.8 million worldwide. Advertising revenue at $25 million was 15% greater than plan for the quarter primarily resulting from distribution deal revenue. Cost of revenue for Q99-4 was 63% favorable to plan due to the change in data center depreciation accounting policy reflected in Q99-4 ($35 million). Operating expenses were $29 million over plan due to a $17 million contract payment to LookSmart, $3 million Jump acquisition, $3 million OmniBrowse acquisition and $2 million for OpenFind product development in Taiwan. Additionally, high marketing and contingent staff costs contributed to the unfavorable variance.
- WebTV Q99-4 net revenue of $53 million was under plan 16% due to fewer net subscribers than expected. There were 828,000 net subscribers at the end of Q99-4, 20% less than plan. Cost of revenue for Q99-4 was 21% favorable to plan due to the change in data center depreciation accounting policy ($10 million) and lower than planned product subsidies. Q99-4 operating expenses were 12% unfavorable to plan due to significant Q99-4 hiring and higher infrastructure and product development spending related to major development projects.

OUTLOOK

- Q00-1 net revenue will increase over Q99-4 levels by approximately 8% due to strong forecasted growth in WebTV, Commerce and Portal. Online businesses should continue to achieve increases in advertising and transaction revenue. For the year, new product versions and new product introductions in the Portal and WebTV will bring higher revenue in second, third and forth quarters of FY00.

INTERACTIVE SERVICE MEDIA

INVESTMENTS & PRODUCT HIGHLIGHTS

- Travel Business Unit had a strong quarter driven by seasonality, World Wide Web growth and leading reach numbers according to Media Metrix. (ranked #1 in April and May ahead of all other travel agency sites). Q99-4 Expedia average monthly unique users was up 36% from Q99-3, 26% for Travel BU tickets sold, 31% for Travel BU retail revenue and 30% for Travel BU cumulative registrants.
- Expedia Germany beta launched in June with final release planned for July. Also, a one-hour, syndicated, weekly travel radio program designed as an audio companion to MSN Expedia, Expedia Radio launched on radio stations in Los Angeles, Chicago, Boston, Philadelphia and Seattle.
- CarPoint had another record sales quarter by enrolling 506 new dealers to the New Car Buying service and 186 UCM dealers. New car purchase requests hit an all time high of 130,844 in June and a single day high of 5,490 on June 21. Q99-4 personal auto page signups (153,000) grew by 21% over Q99-3. Personal auto pages passed 360,000 registered users in June representing 472,000 registered vehicles. Q99-4 DealerPoint usage increased 133% over Q99-3. As of June 30, there are 466 dealers actively using DealerPoint.
- Sidewalk became the #1 City Entertainment/Travel site in the month of May, ranking as the 35 largest Web domain with a 7.3 home/work reach compared to AOL Digital Cities (6.1 reach) and CitySearch (5.7 reach). Sidewalk Q99-4 monthly unique users grew 22% over Q99-3 and has grown by nearly 500% since the October site re-design.
- The "Get a loan. Get a free PC." promotion (close a loan through HomeAdvisor and receive a free PC) proved successful in generating consumer, industry and partner interest. Shortly after announcing this promotion, HomeAdvisor secured seven of the top ten national lenders onto the platform; including Chase, Countrywide and Citibank. Average monthly unique users in Q99-4 increased 17% over Q99-3 and loan leads transmitted to lenders improved by 41%. HomeAdvisor also reached agreement with Sears, Roebuck & Co. for a multi-million dollar marketing campaign, making Sears the largest advertiser on HomeAdvisor. Also, Chase Manhattan Mortgage, the top mortgage lender in the country, selected HomeAdvisor as the technology provider for its online mortgage services. HomeAdvisor's real estate technologies will be deployed at both Chase and GMAC's Better Homes & Garden consumer Web site.

BUSINESS METRICS

	Interactive Service Media Metrics			
	Q99-1	Q99-2	Q99-3	Q99-4
Sidewalk				
Average monthly unique users	1,133,108	2,619,842	4,794,073	5,835,211
Average monthly queries	n/a	1,431,816	2,684,531	3,428,670
# of live advertisers	2,938	4,023	6,049	6,718
Monthly revenue per advertiser	$86	$396	$368	$291
Travel				
Average monthly unique users	2,917,524	3,543,216	5,194,372	7,065,422
# of air tickets sold	312,881	390,647	584,298	739,065
Daily average airline tickets sold	3,438	4,293	6,421	8,122
Retail value of air, car, hotel sales	$ 112,312,202	$ 158,150,393	$ 228,480,714	$ 298,807,007
Cumulative registrants	5,487,937	6,843,910	9,023,867	11,762,855
Expedia.com transaction revenue/ticket	$19	$19	$19	$18
CarPoint				
Average monthly unique users	1,517,577	1,754,746	2,949,721	2,766,781
# of referrals	214,997	197,171	325,397	376,807
# of new franchises/used dealers active	1,697	2,161	2,868	3,209
$ per franchise/dealer per month	$397	$382	$396	$464
Personal auto page accounts	-	81,635	207,520	360,469
DealerPoint active dealers	-	-	308	466
HomeAdvisor				
Average monthly unique users	522,584	718,822	1,015,573	1,185,398
Average # of home listings	124,482	153,703	254,731	311,305
# of loan leads*	2,539	2,719	3,355	4,721

* Loan leads include pre-qualifications and initial loan applications

NEWS AND PUBLISHING DIVISION

INVESTMENTS & PRODUCT HIGHLIGHTS

- Holding on to its #1 news site ranking according to Media Metrix for Q99-4, MSNBC On the Internet continued its growth with quarterly average monthly users to the site increasing from 8.2 million in Q99-3 to a record 8.8 million in Q99-4, reaching a peak of 10 million users in April.
- MSNBC Cable also had a record performance in Q99-4. Channel ratings were heavily influenced by the Kosovo bombing and Littleton shooting. Consequently, MSNBC's average quarterly ratings gained 59% and adult households 25-54 gained 93% from Q98-4, while CNN's average quarterly ratings only gained 33% and adult households 25-54 only gained 52% over the same period.
- Slate achieved record growth in both usage and advertising revenue throughout Q99-4. Surpassing its main competitor Salonmagazine.com in March with 697,000 versus 493,000 unique users, Slate increased its lead to 916,000 versus estimated 743,000 in May. As a result, advertising revenue increased 185% over prior quarter from $73,000 to $208,000.

BUSINESS METRIC

	MSNBC JVs & Slate Business Metrics				
MSNBC On the Internet	Q98-4	Q99-1	Q99-2	Q99-3	Q99-4
Revenue ($000s)	$ 2,252	$ 2,273	$ 3,630	$ 3,958	$ 7,886
Avg monthly page views (000s)	56,357	96,333	94,946	150,367	184,667
Avg monthly unique users (millions)	4.46	6.88	6.94	8.16	8.81
Slate					
Revenue ($000s)	$ 415	$ 91	$ 183	$ 112	$ 231
Avg monthly page views (000s)	5,524	5,948	6,709	5,382	5,092
Avg monthly unique users (millions)	209	318	295	465	663
Ad Impressions sold (millions)	2.8	2.3	4.2	n/a	n/a
MSNBC Cable					
Advertising revenue ($millions)	$ 10.7	$ 9.0	$ 17.9	$ 16.6	$ 24.7
Subscriber revenue ($millions)	$ 10.3	$ 13.0	$ 13.5	$ 14.2	$ 15.0
Carriage (Go-out) (000s)	41,180	43,341	45,603	47,837	49,117
Ratings (average)	0.22	0.33	0.33	0.31	0.35
Households (average) (000s)	90	141	146	144	171

COMPETITION

- MSNBC On the Internet held on to its #1 Media Metrix Site rating with a reach rating of 9.9 for April and 8.9 for May versus CNN's reach of 8.5 and 7.7 for the same periods.
- MSNBC Cable's channel average 24 hour rating for the quarter was a .4 for 171,000 viewing households, up 90% from Q98-4's 90,000. This compares favorably to CNN's 37% growth in households but unfavorably to Fox News Channel's growth of 206%.
- Distribution (number of homes passed) for the News Networks at the end of the quarter was as follows: CNN, 76 million (up 3% from Q98-4), MSNBC, 49 million (up 19% from Q98-4) and FOX News, 41 million (up 29% from Q98-4).
- Although Fox News Channel appears to be growing faster comparatively, MSNBC Cable still has 40% higher ratings and 76% larger household viewing audience for the targeted demographic of adults 25-54.

DESKTOP FINANCE

INVESTMENTS & PRODUCT HIGHLIGHTS

- MS announced a new addition to its personal finance software family: TaxSaver 99. Designed in the U.K. with tax software specialists Digita and KPMG, one of the U.K.'s leading tax advisers, it was released on store shelves in the U. K. on June 16.

- MS announced agreements with four financial institutions - American Express, Bank of America, Charles Schwab and Citigroup Inc. - to provide customized financial content on MSN MoneyCentral.
- MS Money 99 won PC World's 1999 World Class Award for Best Personal Finance Software, an award previously dominated by Intuit's Quicken product.
- MS announced plans to ally with two of the nation's ten largest banks and one of the nation's five largest credit card issuers to offer Active Statement downloads. These new implementations will enable customers of Bank One Corp.; First USA, the credit card subsidiary of Bank One; and Fleet Financial Group to more quickly and efficiently download statement data into MS Money.
- The TransPoint electronic bill presentment system went live at the end of April and ended the quarter with five billers actively presenting bills to their customers.

BUSINESS METRIC

	DFD Business Metrics		
	Q99-2	Q99-3	Q99-4
Money			
Revenue (Smillions)	S 26.5	S 8.9	S 2.6
FG revenue/license	S 33.8	S 35.4	S 38.5
Deluxe mix	43%	46%	60%
Business & personal mix	5%	nm	4%
Money Central			
Revenue (Smillions)	S 4.4	S 4.5	S 5.5
Paying subscribers	45,314	51,306	56,620
Quarterly revenue/subscriber	S 29	S 29	S 27
Monthly unique users (000s)	3,098	4,629	4,501
Churn rate	2%	2%	2%

COMPETITION

- In May, Intuit's Quicken.com became the first Internet financial portal site to deliver electronic bills. Quicken.com is offering bill presentment in a test with a limited number of consumers, and plans to make electronic billing widely available in the third quarter of the calendar year. Users of the site can view bills from seven companies that use Checkfree Holdings Corp.'s E-Bill system.
- In May, Intuit announced earnings for the quarter ended April 30, 1999 of $73 million, or $1.12/share. Revenue rose 69% to $240 million, including sales from Intuit's Lacerte professional tax software. Intuit experienced record usage of TurboTax and MacInTax software programs this year, with more than 4.1 million copies reported sold through April 21. In addition, more than 1.6 million returns were filed electronically using TurboTax/MacInTax and WebTurboTax - compared to 689,000 in tax year 1997. Intuit also reported that 240,000 Federal returns and 148,000 state returns were completed using WebTurboTax. Intuit estimated its tax software has greater than 70% of retail market share in its category and was used in one of every five personal filings to the IRS.
- In June, Chase Manhattan, First Union and Wells Fargo announced they are forming a new company that will serve as a type of high-tech intermediary to route online bills to bank customers. The new company, to be called The Exchange until the naming process is complete, says it could be delivering bills by the end of the calendar year third quarter and expects to sign up other banks as members. The Exchange will use technology from Sun Microsystems, Inc. to build the operating platform.

WEB ESSENTIALS
INVESTMENTS & PRODUCT HIGHLIGHTS

msn Worldwide

- In April, MS acquired Jump Networks Inc., a leading provider of Web-based calendar services. Jump's technology enables consumers to access their e-mail, address books and calendars from any Internet-connected computer. When fully integrated with the MSN network of Internet services, Jump's technology will complement MSN communication services, including the MSN Hotmail Web-based e-mail service and MSN Web Communities.
- In May, MS announced it is investing $250 million in WebMD Inc. As part of the collaboration between MS and WebMD and in exchange for common stock warrants, MS will also provide WebMD with advertising and e-commerce opportunities, professional subscriptions and co-marketing campaigns worth approximately $275 million over the next five years. MS will introduce MSN Health, a new comprehensive source of healthcare information and services. Through a five-year distribution agreement, Healtheon-WebMD will pay MS $162 million to become the premier healthcare content provider for MSN, the MS Web TV Network Service and MSNBC.
- MS announced a two-year licensing and marketing agreement with Centraal Corp. for incorporating the RealNames Web addressing and navigation service into MSN Search and AutoSearch,. As a result, consumers using MSN Search will be able to more easily find the information, brands and companies they are looking for on the Web.
- MS and CareerBuilder formed a strategic arrangement to jointly develop a private-label career center for the MSN network, providing access to employment listings, career advice content and personal search agent technology.
- In June, MS launched MSN Mobile. From MSN.com, consumers can now sign up to receive a host of wireless information services on their interactive pagers and cellular phones. MSN is the first of the major Internet portal sites to provide wireless information services, which includes news, sports, weather, stock quotes, horoscopes and personal alerts. In conjunction with the launch, MS also announced it has acquired OmniBrowse Inc., a wireless data services company specializing in applications for wireless handheld devices. OmniBrowse's suite of wireless content delivery services has been incorporated into MSN Mobile. Nextel Communications and MS announced an agreement that will enable Nextel customers to access a customized set of Internet services offered through a co-branded version of the MSN portal. Internet users will be able to easily access their online information wherever and whenever they want through the wireless MSN portal.
- PC Magazine has awarded MSN LinkExchange its Editors' Choice award for web site enhancement services. The magazine called LinkExchange's services "invaluable" for small businesses that want to increase their online traffic and sales. In addition, Solutions Inc. and MSN LinkExchange announced a strategic marketing agreement to help small businesses on the Web establish, promote, improve and earn money from their web sites more easily.
- Concentric Network and MS announced an expanded relationship consisting of five major initiatives. The initiatives are Concentric's commitment to establish a co-branded version of the MSN portal for its dial-up and broadband DSL Internet subscribers; the development and co-marketing of Microsoft Windows NT Sever-based application hosting services; a $8 million commitment by Concentric to advertise and promote its services via the MSN network of Internet services; a $50 million investment by Microsoft in Concentric; and a two-year extension of Concentric's current contract to supply network services to WebTV Services.

BUSINESS METRICS

- Worldwide subscriber base of MSN Connect was on plan at 2 million paying subscribers for Q99-4. Average revenue per subscriber of $18.92 was up from $16.64 in Q99-3. Churn rate for active accounts was above plan at 5.5% for Q99-4. Support calls at $.20 per subscriber in Q99-4 were better than plan by $.03 per subscriber. Cost per subscriber was down from Q99-3 at $1.70 per subscriber, better than plan by $.66/subscriber. Favorable results were primarily due to fewer customers, shorter average handling times, improved rates and MCI telecom credits.

(000's)	Web Essentials Business Metrics Apr-99	May-99	Jun-99
Average Subscribers	1,819	1,814	1,817
Unique Monthly Visitors			
MSN.com	33,808	34,451	34,544
Hotmail	25,624	26,430	27,420
New Trials	129	121	187
Avg Monthly Pageviews			
MSN.com	1,069,085	1,036,739	989,808
Avg Revenue/Subscriber	$18.83	$17.56	$20.36
Revenue/Unique Visitor			
MSN.com	$0.23	$0.22	$0.28
Hotmail	$0.06	$0.04	$0.07

COMPETITION

- For the quarter ended March 31, 1999, AOL reporting net profit of $117 million on revenue of $1.25 billion, up 66% year over year. Including CompuServe, AOL's paid subscriber base has passed the 19 million mark. AOL did make a number of smaller moves that continued down the path of their stated 'AOL Everywhere' strategy to own the consumer online experience. They include the following:
  - Entering streaming media business via the acquisitions of net radio firm Spinner.com and music technology company Nullsoft (maker of Winamp), for a combined $400 million.
  - Announced partnerships with DirecTV, Hughes Network Systems, Philips Electronics and Network Computer in which the hardware firms will provide advanced set-top boxes and satellite services for AOL TV. Additionally, AOL made a $1.5 billion investment in Hughes Electronics, and will form an alliance with them to offer high-speed Internet via satellite.
  - Signed deal with 3Com to enable PalmPilot owners to access their AOL email.
  - Entered into a technology licensing agreement with Gemstar International Group to develop AOL TV electronic programming guides.
  - Completed the $525 million purchase of MovieFone, a telephone and online movie information and ticketing service.
  - Acquired When.com, a free web-based calendaring firm.
- Yahoo made two moves onto the desktop during the quarter. They acquired Encompass Inc. for $130 million, a company that provides Internet registration software used on the first boot experience of a PC. They also announced a distribution deal with Phoenix Technologies, the maker of the system BIOS for most PCs, to give AOL 'first look' position. The acquisition of Geocities by Yahoo was completed during the quarter, and the company's purchase of Broadcast.com continues to process. For the quarter ending June 30, 1999, Yahoo announced operating income of $37 million on revenue of $115 million (up 24% from the prior quarter).
- CMGI acquired an 83% stake in online portal AltaVista from Compaq Computer for approximately $2.3 billion. CMGI also owns 20% of Lycos, whose proposed merger with USA Networks and Ticketmaster Online/Citysearch was abandoned during the quarter due to shareholder opposition over the terms.
- CNBC will merge many of its Internet assets with Xoom.com and Snap.com to form a new company called NBCi, which they state will be the seventh largest Internet site, and the first publicly traded Internet company integrated with a major broadcaster. MSNBC is not included in the deal.

WEBTV NETWORKS

INVESTMENTS & PRODUCT HIGHLIGHTS

- At the end of Q99-4, WebTV had 828,000 net subscribers, with 340,000 on WebTV Plus, 484,000 on WebTV Classic and 4,000 on WebTV Satellite. During Q99-4, WebTV acquired 183,000 new customers, a 64% increase over Q98-4.
- WebTV introduced the second-generation WebTV Classic and WebTV Plus set-top products. WebTV Classic has a faster processor and modem, a smaller form factor and printing capability. WebTV Plus has more memory and a faster processor.
- WebTV delivered a free network service upgrade providing a new set of features including a shopping guarantee for credit card purchases from WebTV shopping partners, a personal web page building and hosting service, and a design of the WebTV Web Home page.
- Real Networks and WebTV announced that they are upgrading existing RealAudio support for WebTV subscribers to RealAudio G2. WebTV concurrently announced that MS TV will feature MS Windows Media Technology.
- EchoStar announced a special introductory price of $199 for the DISHPlayer WebTV satellite receiver, a savings of $300 from the retail MSRP.
- MS and Wink announced an agreement to promote interactive content and commerce based on the ATVEF specification. MS invested $30 million in Wink for a 10% stake in the company.
- AT&T and MS announced a series of agreements to accelerate the deployment of next-generation broadband and Internet services. MS purchased $5 billion of AT&T securities, AT&T will increase its use of MS's TV software platform and both companies will work together to showcase new digital cable services.
- MS will invest $400 million in Rogers Communications, money that will help accelerate deployment of high-speed Internet access. Rogers will license MS TV client and server software to support at least 1 million advanced set-top boxes.
- WebTV initiated a new platform business, MS TV Platform Adaptation Kit (TVPAK), to develop and license client and server software to enable other networks to deliver new digital services. The first product release occurred in April at the NCTA cable show, over 30 companies announced support for the MS television platform software.

BUSINESS METRICS

	WebTV Business Metrics				
	Q98-4	Q99-1	Q99-2	Q99-3	Q99-4
Subscribers	380,000	447,000	641,000	753,000	828,000
Revenue per subscriber	$ 17.00	$ 18.37	$ 21.58	$ 22.03	$ 21.50
Gross margin per subscriber *	-	$ (1.33)	$ 2.88	$ 4.00	$ 6.54

* Excludes customer acquisition costs and PSS.

COMPETITION

- NBC announced an investment in TiVo Inc. NBC will use TiVo's service to promote its programming, target viewers who record NBC programming and explore additional revenue streams. NBC will take a seat on TiVo's board of directors. DirecTV announced an investment in TiVo. DirecTV and TiVo will jointly market TiVo's service and the required Philips set-top box to new and current DirecTV subscribers.
- AOL announced a technology licensing agreement with Gemstar to develop AOL TV electronic programming guides. AOL announced partnerships with DirecTV, Hughes Network Systems, Philips Electronics and Network Computer to help develop its AOL TV services to bring interactivity to the television experience while extending AOL services through television. AOL and DirecTV announced a strategic alliance to develop and market uniquely integrated digital entertainment and Internet services nationwide. AOL will make a $1.5 billion strategic investment in DirecTV.
- Network Computer raised a $50 million financing round from Comcast, Cox Communications, General Instrument, Sun, Lucent Technologies and Rogers Communications. It changed its name to Liberate Technologies.

HOME AND RETAIL

BUSINESS RESULTS:

- Home & Retail Division (HRD) Net revenue of $152 million in Q99-4 was down 33% sequentially from Q99-3 and down 27% in comparison to Q98-4. The decline from previous quarter was planned based on typical seasonality in the retail business, however the drop was higher than expected due to continued product returns in the international markets, weak OEM sales of Mouse and two major product release slips in the Entertainment Business Unit (Age of Empires II, FlightSim 2000). The decline from prior year was primarily due to heavier than normal sell-in of HRD products during Q98-4 in conjunction with the Windows 98 launch. Operating expenses for Q99-4 included $11 million in costs related to two recent acquisitions; FASA Interactive and Access Software. Excluding costs for FASA and Access, operating expenses were 9% less than Q98-4 but 5% over budget due to higher contingent staff and product marketing costs. Based on lower net revenue and acquisition related costs, responsibility margin for Q99-4 shows a loss of $35 million versus a profit of $25 million in Q98-4.

OUTLOOK:

- Net revenue in Q00-1 is planned to increase 22% to $186 million representing a 3% growth over Q99-1 (after restating to reflect new channel reserve policy). Growth potential is limited as most new product releases are scheduled for late September to be included in the Holiday selling program during Q00-2 and Q00-3. HRD is on schedule to meet all planned releases for the first two quarters of FY00 including all new versions of our Encarta, Works and Home Publishing products, three new Keyboard products with Internet and multi-media features, a solid-state Mouse, and new releases of our franchise game titles (Age of Empires, Flight Simulator). In addition HRD is moving forward to implement a direct to store distribution model in the U.S., which is expected to boost sales of all MS products at these retailers.

LEARNING, ENTERTAINMENT AND PRODUCTIVITY

INVESTMENTS & PRODUCT HIGHLIGHTS

- During Q99-4 the $50 million acquisition of Access Software was finalized. MS will retain the development headcount in Salt Lake City where future versions of Links LS golf title and other games will be developed.

- Entertainment Business Unit released the new titles Baseball 2000 and Midtown Madness Chicago Edition- an extension of the Madness driving series. Entertainment also entered the non-PC platform video game markets with a broad agreement with Konami Co. of Japan to publish selected MS titles on Sony, Sega, Nintendo and other non-Windows platforms. An agreement with Take Two Interactive was signed to publish Monster Truck Madness on game consoles.
- Consumer Productivity released MapPoint 2000 business mapping software, coinciding with the release of Office 2000. MapPoint delivers previously inaccessible functionality to the Office desktop by putting map analysis functionality into the hands of business users.
- In the Learning Business Unit, Encarta Virtual Globe 99 and Encarta Reference Suite 99 were winners in the 1999 EdPress Distinguished Achievement Awards. The annual awards recognize excellence in educational publishing.
- Internet Gaming Zone (www.Zone.com) saw steady usage metrics growth but at a lesser rate than prior quarters due to the larger user base. Memberships increased 39% (2.1 million) since March to 7.4 million, while peak concurrent usage grew 8% to 36,000 simultaneous users. Average games served per day increased 5% from March to 257,000, though it was flat through June.

BUSINESS METRICS

	Learning, Ent. and Productivity Metrics				
	Q98-4	Q99-1	Q99-2	Q99-3	Q99-4
Learning					
FG Revenue (SM)	S 9.8	S29.4	S61.7	S2.9	S8.8
FG Avg Selling Price	S 47.49	S 51.35	S 45.91	S 70.28	S 26.99
% Intl	*65%*	*72%*	*63%*	*41%*	*64%*
Entertainment					
FG Revenue (SM)	S 29.0	S 28.6	S92.2	S14.8	S8.9
FG Avg Selling Price	S 34.17	S 31.65	S 30.94	S 25.43	S 29.35
% Intl	*38%*	*63%*	*53%*	*56%*	*54%*
Consumer Productivity					
FG Revenue (SM)	S 20.3	S 29.2	S51.7	S21.8	S17.1
FG Avg Selling Price	S 32.43	S 36.28	S 43.36	S 35.72	S 29.75
% Intl	*44%*	*31%*	*54%*	*48%*	*41%*
Total LEPD					
FG Revenue (SM)	S 59.2	S 87.3	S205.5	S39.4	S34.9
% Intl	*44%*	*55%*	*56%*	*50%*	*50%*

- Learning, Entertainment & Productivity (LEPD) FG sell-in revenue for the quarter was down 11% from Q99-3 and down 41% from Q98-4. The decline from Q99-3 was driven by expected seasonality as well as the release delays of Flight Simulator 2000 and Age of Empires 2. The decline from Q98-4 was related to a large Games sell-in that accompanied the Windows 98 launch.
- The significant decrease in average selling price in Learning reflects the continued reseller promotional pricing on Encarta Standard and low sell-in of suites during Q99-4. Entertainment's price decrease in relation to Q98-4 reflects life cycle management of older product versions and downward pricing of the Sports titles. Consumer Productivity price decrease was largely driven by a lower mix of Works Suite. The international mix in Q99-4 was up slightly compared to last year's mix that was heavily influenced by the US Windows 98 launch related sell-in.

COMPETITION

- An IPO of Mpath Interactive, owners of the 2.5 million member Mplayer.com game site, generated $70 million in funding and $465 million market value in April.
- Hasbro surged to become the #2 games publisher in June, ahead of Electronic Arts for the first time, on strength of the MechWarrior3 launch (MS will publish future versions of MechWarrior).
- Encyclopedia Britannica announced an exclusive content partnership with Washington Post Newsweek Interactive (WPNI) in which WPNI will be the branded news provider and editor of the Brittanica.com news channel. The move is part of Brittanica's plan to become the premier provider of trusted and reliable information on the web. In an effort to support and launch the new online service, Brittanica also announced a $25-$35 million advertising campaign.

HARDWARE

INVESTMENTS & PRODUCT HIGHLIGHTS

- In May, the Hardware Division won two industrial design awards in competition sponsored by Business Week magazine. The Division won the Silver award for reMemory, using an RF transceiver to easily save, store and retrieve data, and the Bronze award for the design of the Intellimouse Pro mouse.
- At the Electronics Entertainment Expo (E3) in June, the Intellimouse Explorer, the solid state mouse with an optical sensor that replaces the ball technology was nominated for the best new peripheral. Also at E3, the new Sidewinder Dual Strike 3-D character game device, to be released this fall, was nominated as the best new peripheral.

BUSINESS METRICS

	Hardware Business Metrics Average FG Selling Price		
	Q98-4	Q99-4	Var%
Mouse	\$34.86	\$26.77	(23%)
% OEM	52%	51%	
Keyboards	\$44.30	\$38.23	(14%)
% OEM	31%	40%	
Gaming Devices	\$42.19	\$38.63	(8%)
% Intl	49%	93%	

- Hardware Division's Q99-4 sales were down 24% from Q98-4, which was a strong quarter due to the uplift from the Win98 release. By channel, Finished Goods (FG) was down 27% and OEM 18%. For FY99, revenues were 2% below a year ago due to OEM sales, which were down by 19%. OEM units were essentially flat but average selling prices (ASPs) dropped from $10.53 to $8.53. Finished goods sales were 9% above last year due to strong performance in the gaming device business.
- Mouse FG sales were up 2% for the year although down 13% for Q99-4, again, due to the strong 4th quarter a year ago. For the year, mouse FG units increased 34% but the ASPs were down 23%. The price drop is the result of a market shift to lower cost units, boosting the sales of units priced under $20. For the year, 48% of the FG units sold were at prices below $20 compared to only 17% in FY98.
- Gaming device FG sales were up 26% for the year although down 63% for the quarter due to a continuation of channel inventory returns and soft Q99-4 sales in the U.S. International sales were especially strong for the year, growing 54% and representing 66% of the total worldwide sales. Similar to the mouse business, the ASPs dropped 8% during FY99. The decrease was both in the high end where 7% of the units sold were over $100 this year versus 18% last year. At the lower end, 40% of the volume was under $30 in both years, but the ASPs were 7% lower in FY99.
- Keyboard sales in Q99-4 were 31% below last year, and 13% below for the full year. The decline was due to falling ASPs; the unit volume was up 22% for the year. Both the retail and OEM business will get a boost with the introduction of three new keyboards with Internet and multimedia keys. Two of the three new products will be flat keyboards opening the door to new market opportunities and to OEM's who are especially price sensitive.

COMPETITION

- Logitech, the principal competitor in both the mouse and keyboard market, is expected to be aggressive again this fall with new releases of products across their product line. Recently Logitech has moved to the number one keyboard share position with 20% of the market in the U.S. Logitech's fall keyboard line-up is focused on quick and easy Internet access and navigation, as well as continued improvement in user comfort through cordless alternatives. The cordless products use Logitech's digital radio technology, which provides reliable performance within a six-foot range without the line-of-sight requirement inherent in infrared-based cordless devices.
- In July, Logitech will release a cordless wheel mouse with a $60 street price, and will increase their cordless offerings from three to seven by the end of the calendar year. Logitech is committed to the radio-based cordless products as a way of providing freedom and flexibility on the desktop.

LOCALIZATION

Localized Gross Revenue by Language Q99-4

Business Productivity & Dev Group

Top Languages with Localized Product	Revenue (in 000's)	% of Total Revenue
Japanese	$ 334,673	29%
German	201,319	17%
French	112,635	10%
Italian	48,619	4%
Spanish	40,093	3%
Dutch	36,412	3%
Swedish	30,421	3%
Other	330,385	31%
Total	$ 1,134,557	100%

Top Products Localized	Revenue (in 000's)	% of Total Revenue
Office	$ 804,909	69%
Other DAD	168,250	15%
BackOffice	76,058	7%
Visual Tools	30,520	3%
SQL	21,247	2%
Exchange	18,826	2%
Other	38,454	3%
Total	$ 1,158,264	100%

BED Group

Top Languages with Localized Product	Revenue (in 000's)	% of Total Revenue
German	$ 91,865	26%
Japanese	76,157	22%
French	35,739	10%
Spanish	14,385	4%
Italian	9,767	3%
Other	121,153	35%
Total	$ 349,066	100%

Top Products Localized	Revenue (in 000's)	% of Total Revenue
Windows NT Workstation	$ 255,353	73%
Windows NT Server	79,680	23%
Other Platforms	14,033	4%
Total	$ 349,066	100%

CWD Group

Top Languages with Localized Product	Revenue (in 000's)	% of Total Revenue
Japanese	$ 125,827	31%
German	75,593	19%
Korean	41,291	10%
French	28,565	7%
Chinese Trad.	24,152	6%
Other	112,083	27%
Total	$ 407,511	100%

Top Products Localized	Revenue (in 000's)	% of Total Revenue
Windows 9X	$ 397,207	97%
Other	10,304	3%
Total	$ 407,511	100%

KEY PRODUCT RELEASE SCHEDULE

Business Unit/Product	RTM Act/Est (a)	RTM Plan
Desktop Finance		
MSN Money Central (V7)	Jul-99	Jun-99
Money 2000	Aug-99	Aug-99
TaxSaver	Nov-99	Nov-99
Learning, Entertainment and Productivity		
Basketball 2000	Jul-99	Jan-99
Midtown Madness	Apr-99	Mar-99
MapPoint 2000	Apr-99	Aug-98
FlightSim 2000	Sep-99	May-99
Age of Empires 2	Sep-99	Q2-99
Hardware		
OEM Mouse	Jul-99	Jul-99
Solid-state Mouse - retail	Aug-99	Aug-99
Ergo Keyboard w/ internet keys - OEM	Aug-99	Aug-99
Ergo Keyboard w/ internet keys - retail	Jul-99	Jul-99
Flat Keyboard	Jun-99	Jun-99
Flat Keyboard w/ internet keys	Sep-99	Sep-99
Entry level gamepad	May-99	May-99
Rapid motion game controller	Sep-99	Sep-99
Non force feedback steering wheel	Oct-99	Oct-99
Interactive Service Media		
Expedia 4.0	Jul-99	Q99-3
MTT/Airline 4.0	Jul-99	Q99-3
Expedia Germany	Jul-99	Q99-3
MTT/Corporate 4.0	Jul-99	Q99-3
HomeAdvisor 3.0	Q00-2	Q00-2
CarPoint 4.0	Nov-99	Q00-1
WebTV Service		
WebTV Plus-2.5 Platform	Jun-99	Apr-99
WebTV Classic-BPS Platform	May-99	Jun-99
WebTV Service Upgrade (Grunge)	Jun-99	May-99
WebTV Service Upgrade (HipHop)	Oct-99	Oct-99
Thomson eTV (WebTV integrated TV)	Feb-00	Sep-99
Mercury Satellite Platform (DirecTV)	Apr-00	Jan-00
Galaxy Satellite Platform (Echostar)	May-00	May-00
WebTV Plus DVR Platform	Jun-00	Jun-00

Business Unit/Product	RTM Act/Est (a)	RTM Plan
WebTV Platform		
Microsoft TV 1.0	Nov-99	Nov-99
Microsoft TV Server 1.0	Mar-00	Feb-00
Office & Office Family		
Word 98 Special Edition for iMac	Jul-99	Jul-99
Consumer Windows		
Windows 98 Second Edition	May-99	Apr-99
Millenium	Q2-CY00	Q2-CY00
Internet Explorer 5.01	Q4-CY99	Q4-CY99
Internet Explorer 5.02	Q2-CY00	Q2-CY00
Business & Enterprise		
Windows 2000 Server Beta 3	Apr-99	Q4-CY98
Windows 2000 Server	Q4-CY99	Q4-CY99
Windows 2000 Professional Beta 3	Apr-99	Q4-CY98
Windows 2000 Professional	Q4-CY99	Q4-CY99
Embedded NT	Jun-99	Mar-99
Server Appliances	Sep-99	Jun-99
Windows NT Services for Unix 2.0	Dec-99	Dec-99
Streaming Media		
Windows Media Technologies 4.0	Aug-99	Jun-99
Windows Media Technologies 5.0	Q2-CY00	Q2-CY00
Server Applications		
Exchange Server Platinum	Q1-CY00	Q1-CY00
BackOffice 5.0	Q3-CY00	Q3-CY00
Small Business Server 5.0	Q3-CY00	Q3-CY00
Developer Tools		
Visual Studio 7.0	Apr-00	Apr-00
Office Developers Edition	Apr-99	Dec-98
Distributed Applications		
SQL Server 7.5	H1-CY00	H1-CY00
Productivity Appliances		
WinCE Toolkit (VB, VC++, VJ++) 6.x	Jan-00	Jun-99
Auto PC 2.0	Jul-99	Jun-99
WebPhone	Dec-99	Feb-99
Palm Size PC 2.0	Dec-99	Aug-99
Windows CE Services 2.3 (P/PC 2.0)	Aug-99	Aug-99
Windows CE 3.0	Feb-00	Sep-99
Smartphone	Dec-99	Dec-99
Auto PC 3.0	Sep-00	Dec-99

(a) Forecast dates quoted are the current internal projections for the Release to Manufacturing (not the dates that have been quoted externally)

Sales, Marketing &
Product Support

CONSOLIDATED SALES, MARKETING & SUPPORT

Q99-4

(In millions, variance to plan)	SPAR		EMEA		Asia		Total FG		OEM		Other			
	Actual	Var%	Actual	Var%	Actual	Var%	Actual	Var%	Actual	Var%	Actual	Var%	GAAP	Total
Net revenue	$1,592.8	7%	$1,015.1	6%	$439.0	11%	$3,046.9	7%	$1,653.9	6%	$55.1	(76%)	$1,008.2	$5,764.1
Costs of revenue	96.7	10%	76.8	(20%)	33.7	(9%)	207.2	(2%)	44.3	(5%)	119.0	30%	298.4	669.0
Gross margin	1,496.1	8%	938.3	5%	405.3	12%	2,839.6	8%	1,609.6	6%	(63.9)	(211%)	709.8	5,095.1
% of Net revenue	*93.9%*		*92.4%*		*92.3%*		*93.2%*		*97.3%*		*(115.9%)*		*70.4%*	*88.4%*
Controllable expenses														
People	77.4	(5%)	67.3	(6%)	21.2	(19%)	165.9	(7%)	12.7	(9%)	30.8	(12%)	192.2	401.6
Contingent staff	4.8	(28%)	3.2	(63%)	1.1	(77%)	9.1	(44%)	0.3	(5%)	2.9	(9%)	(329.4)	(317.1)
Vendors	7.6	(18%)	7.5	(35%)	1.3	(5%)	16.4	(24%)	0.5	(211%)	9.4	(334%)	(18.7)	7.6
Infrastructure	24.5	(5%)	18.6	(14%)	7.8	(11%)	50.9	(9%)	3.0	(15%)	18.0	(289%)	(19.3)	52.7
Other misc expenses	23.7	(81%)	2.4	59%	4.9	(76%)	30.9	(43%)	48.7	(66%)	11.1	16%	234.9	325.7
Sales expense	137.9	(15%)	99.0	(7%)	36.4	(23%)	273.3	(13%)	65.2	(48%)	72.2	(44%)	59.8	470.5
Marketing	302.2	(58%)	101.6	(15%)	54.3	(82%)	458.1	(48%)	21.7	(47%)	104.3	(31%)	(169.0)	415.1
Product support svs (net)	100.1	(32%)	29.4	(4%)	14.2	(35%)	143.7	(25%)	0.4	84%	16.3	22%	(161.7)	(1.3)
MCS (net)	(5.4)	(48%)	(1.3)	(81%)	0.6	80%	(6.0)	(64%)	0.0	nm	0.0	nm	6.4	0.4
General & admin costs	3.2	(0%)	10.4	(6%)	3.3	(30%)	16.8	(9%)	0.5	(19%)	(3.7)	(13%)	0.0	13.6
Total controllable expenses	538.1	(41%)	239.0	(13%)	108.8	(50%)	885.9	(33%)	87.8	(43%)	189.2	(28%)	(264.5)	898.4
Responsibility margin	958.0	(5%)	699.2	3%	296.5	2%	1,953.7	(1%)	1,521.9	5%	(253.1)	183%	974.3	4,196.8
% of Net revenue	*60.1%*		*68.9%*		*67.5%*		*64.1%*		*92.0%*		*nm*		*96.6%*	*72.8%*
Shared resources	37.3	(14%)	12.0	5%	4.5	5%	53.7	(7%)	1.3	(23%)	(45.8)	(26%)	0.0	9.2
Corporate allocations	314.1	(31%)	215.6	(32%)	83.5	(31%)	613.1	(31%)	246.2	(24%)	210.4	(53%)	270.0	1,339.8
Contribution margin	$606.6	(17%)	$471.7	(6%)	$208.6	(6%)	$1,286.9	(12%)	$1,274.3	2%	($417.7)	119%	$704.3	$2,847.8
% of Net revenue	*38.1%*		*46.5%*		*47.5%*		*42.2%*		*77.1%*		*nm*		*69.9%*	*49.4%*

FY99

(In millions, variance to plan)	SPAR		EMEA		Asia		Total FG		OEM		Other			
	Actual	Var%	Actual	Var%	Actual	Var%	Actual	Var%	Actual	Var%	Actual	Var%	GAAP	Total
Net revenue	$6,000.9	5%	$4,458.5	12%	$1,696.5	20%	$12,155.9	9%	$6,527.0	11%	$375.8	(43%)	$688.1	$19,746.8
Costs of revenue	405.7	14%	316.5	(10%)	122.8	(5%)	845.0	3%	148.5	3%	576.6	11%	1,244.0	2,814.0
Gross margin	5,595.2	7%	4,142.0	12%	1,573.8	21%	11,310.9	10%	6,378.5	12%	(200.7)	nm	(556.0)	16,932.7
% of Net revenue	*93.2%*		*92.9%*		*92.8%*		*93.0%*		*97.7%*		*(53.4%)*		*(80.8%)*	*85.7%*
Controllable expenses														
People	297.4	6%	256.6	0%	73.8	(3%)	627.8	3%	43.1	1%	78.7	23%	287.4	1,037.0
Contingent staff	14.9	5%	10.2	(12%)	3.2	(24%)	28.3	(3%)	1.0	7%	10.3	1%	(329.4)	(289.7)
Vendors	22.6	17%	25.7	(13%)	4.4	10%	52.8	4%	1.0	(54%)	26.8	(124%)	9.9	90.5
Infrastructure	87.5	12%	69.2	2%	29.5	(1%)	186.2	7%	10.5	8%	53.7	(223%)	19.6	270.0
Other misc expenses	30.4	44%	15.7	34%	12.6	(19%)	58.8	33%	114.9	2%	55.1	(20%)	190.9	419.7
Sales expense	452.9	12%	377.4	2%	123.5	(4%)	953.8	6%	170.5	2%	224.8	(20%)	178.3	1,527.5
Marketing	724.6	1%	347.6	(6%)	148.5	(9%)	1,220.7	(2%)	59.3	(2%)	364.6	(1%)	18.4	1,663.1
Product support svs (net)	365.6	(7%)	114.3	10%	47.7	(12%)	527.6	(4%)	7.3	7%	67.9	8%	(624.7)	(21.8)
MCS (net)	(10.6)	1%	(3.3)	(39%)	1.8	(22%)	(12.1)	(11%)	0.0	nm	0.0	nm	331.4	319.3
General & admin costs	11.8	9%	39.5	1%	10.7	(5%)	62.0	2%	1.7	(3%)	(13.1)	(10%)	0.0	50.6
Total controllable expenses	1,544.3	3%	875.5	(0%)	332.3	(7%)	2,752.1	1%	238.8	1%	644.2	(6%)	(96.5)	3,538.6
Responsibility margin	4,050.9	11%	3,266.4	16%	1,241.5	26%	8,558.9	15%	6,139.7	12%	(844.9)	40%	(459.5)	13,394.1
% of Net revenue	*67.5%*		*73.3%*		*73.2%*		*70.4%*		*94.1%*		*nm*		*(66.8%)*	*67.8%*
Shared resources	141.1	10%	37.0	29%	13.9	29%	192.0	16%	3.6	14%	(163.4)	2%	0.0	32.3
Corporate allocations	995.0	1%	682.8	1%	264.4	1%	1,942.3	1%	788.8	6%	587.0	(6%)	0.0	3,318.1
Contribution margin	$2,914.8	17%	$2,546.6	23%	$963.2	38%	$6,424.6	22%	$5,347.2	16%	($1,268.5)	28%	($459.5)	$10,043.7
% of Net revenue	*48.6%*		*57.1%*		*56.8%*		*52.9%*		*81.9%*		*nm*		*(66.8%)*	*50.9%*

FINISHED GOODS P&L SUMMARY

- Q99-4 finished goods (FG) net revenue exceeded $3 billion, a 20% increase over Q98-4 (19% in constant dollars), but down from the 25% growth rate posted through the first half of the year. Growth in the quarter was attributed primarily to strong business in Japan and Latin America, partially offset by slower sales in Western Europe. Foreign currency fluctuations versus budgeted rates added an additional $40 million (1%) to revenue, down from the positive $132 million variance in the prior quarter. For the year, FG net revenue was $12.16 billion and increased 22% over the prior year.
- Among the top 10 subsidiaries, the Netherlands and Australia beat net revenue plans for the quarter by 43% and 29% respectively, the largest variances among the major subsidiaries. In constant dollars, the Netherlands net revenue increased 25% sequentially and 67% over the same quarter last year due to continued strong volume licensing of desktop applications. Australian net revenue increased 37% over Q99-3, in local currency, and 13% over the same quarter last year due to end of fiscal year government sales. Germany and France missed plan for the quarter by 5% and 2% respectively, and were the only top 10 subs below plan in the quarter. For the year, Swedish net revenue increased 43% versus last year (48% in constant dollars). Canadian net revenue missed plan by 3%, but was up 13% over Q98-4, slowly recovering from a stagnant economy.
- Q99-4 revenue adjustments were $542 million, versus a plan of $142 million. The majority of the increased adjustments were for excess Office 2000 inventory. The amount of the Office 2000 reserve

(in millions)	Q99-4 Office 2000		
	Sell-in	Reserve	Sell-thru
SPAR FG	$ 447.0	$ 260.0	$ 187.0
EMEA FG	126.7	73.0	53.7
Asia FG	106.3	103.0	3.3
Total FG	$ 680.1	$ 436.0	$ 244.1

by area is as follows.

- There were $138 million of channel reserves reflected as a non-specific geography (outside of FG), in order to isolate the impact of certain accounting policy changes from the channel management P&L statements. $77 million was related to home and retail products and another $61 million related to Office 2000. If these reserves were included within the geography P&Ls, FG net revenue would have grown by 20%, instead of the 22% reported above.
- Q99-4 gross margin from the FG channel was 93%, 0.3 percentage points ahead of plan and 0.2 points better than the same quarter last year. This was due to the shift toward volume licensing offset by the cost of revenue associated with the Office 2000 launch. Additional product costs stemming from compliance with the Java lawsuit added $14 million in the quarter. For the year, gross margin from FG was 0.4 points better than last year.
- Q99-4 sales expense was 13% above plan and increased 17% over the prior quarter. Headcount remained 3% below planned levels. On a per head basis, people costs were 10% over plan, and up 5% sequentially, due primarily to higher recruiting and travel expenses. Per head infrastructure expenses were 12% above plan, due principally to higher computer expense.
- Q99-4 net marketing expense was $458 million or 15% of net revenue compared to a plan of 11%. Net marketing expense increased 22% over the same quarter last year primarily in the SPAR and Asia regions, 31% and 55% respectively. Spend in the EMEA region decreased 7% over the same quarter last year. EMEA spend exceeded plan due to accelerated spending in Germany, France and Italy. Asia spend exceeded plan primarily due to Japan, as well as unfavorable exchange rates. Marketing recovery was $79 million in the quarter, 57% over plan and up 44% sequentially due to continued effective recovery from the Microsoft Certified Program. FY99 net marketing expense was 2% below budget and up 16% over last year.
- Q99-4 net product support services (PSS) costs were 5% of net revenue, 25% above plan and 12% over Q99-3 due primarily to the Office 2000 launch. Q99-4 PSS revenue was $61 million, up $4 million from last quarter, but 4% below plan due primarily to lower than planned Premier sales in the United States. PSS expenses in the quarter were 15% above plan, the result of the Office 2000 launch and higher than planned headcount.
- Microsoft Consulting Service (MCS) posted a responsibility margin of $6 million in the quarter versus a plan of $16 million. FY99 MCS's responsibility margin was $12 million, versus $4 million last year, due to higher utilization and improved subcontractor margins.
- Q99-4 FG responsibility margin was 64%, 5 points lower than plan and in line with the same quarter last year. Asia profitability was 68%, a 2-point decrease over the same quarter last year. For the year, both Asia and EMEA were equally profitable at 73%. Worldwide, fiscal 1999 profitability was 70%, a 2-point improvement from a year ago.

REVSUM/NET REVENUE SUMMARY

Subsidiary FG Net Revenue Ranking

(including Retail OEM revenue)

(in millions)	Q99-4 Actuals	Q99-4 Plan	Q99-4 Var %	Q98-4	% Growth	% of Total	Fiscal 1999 Actuals	Fiscal 1999 Plan	Fiscal 1999 Var %	Fiscal 1998	% Growth	% of Total
1 United States	$1,255.4	$1,184.9	6%	$1,081.9	16%	41.2%	$4,874.3	$4,562.3	7%	$3,987.9	22%	40.1%
2 Japan	303.7	295.7	3%	251.9	21%	10.0%	1,297.9	1,063.1	22%	1,173.4	11%	10.7%
3 United Kingdom	238.5	229.7	4%	211.1	13%	7.8%	976.0	913.9	7%	773.6	26%	8.0%
4 Germany	177.5	186.4	(5%)	153.9	15%	5.8%	832.9	729.7	14%	667.0	25%	6.9%
5 France	105.8	107.9	(2%)	89.8	18%	3.5%	549.7	493.4	11%	442.2	24%	4.5%
6 Canada	94.7	86.0	10%	83.4	13%	3.1%	340.2	349.9	(3%)	300.1	13%	2.8%
7 Italy	61.0	59.1	3%	52.9	15%	2.0%	287.8	242.4	19%	224.6	28%	2.4%
8 Sweden	42.0	37.8	11%	47.6	(12%)	1.4%	245.8	181.5	35%	172.1	43%	2.0%
9 Netherlands	76.6	53.7	43%	46.4	65%	2.5%	264.1	203.4	30%	184.3	43%	2.2%
10 Australia	68.0	52.9	29%	60.5	12%	2.2%	229.6	201.3	14%	198.6	16%	1.9%
11 Switzerland	35.8	31.7	13%	30.5	17%	1.2%	172.1	154.7	11%	135.6	27%	1.4%
12 Brazil	50.5	51.7	(2%)	44.1	15%	1.7%	171.6	190.8	(10%)	154.2	11%	1.4%
13 Spain	32.4	24.8	31%	20.7	57%	1.1%	134.8	108.0	25%	94.7	42%	1.1%
14 Belgium	31.4	29.2	8%	21.4	47%	1.0%	129.0	114.9	12%	103.6	25%	1.1%
15 Denmark	24.5	25.5	(4%)	20.5	20%	0.8%	106.8	99.2	8%	87.8	22%	0.9%
Others	449.0	385.3	17%	332.2	35%	14.7%	1,543.2	1,504.3	3%	1,293.7	19%	12.7%
FG Total	$3,046.9	$2,841.9	7%	$2,548.7	20%	100.0%	$12,155.9	$11,112.6	9%	$9,993.6	22%	100.0%

Q99-4 FG RevSum Revenue

(including Retail OEM revenue)

(in millions)	South Pacific & Americas Actual	Plan	% Var	Growth vs. Q98-4	Europe, Middle East & Africa Actual	Plan	% Var	Growth vs. Q98-4	Asia Actual	Plan	% Var	Growth vs. Q98-4	W.W. Finished Goods Actual	Plan	% Var	Growth vs. Q98-4
Desktop Applications	$1,120.6	$819.5	37%	57%	$691.3	$575.7	20%	28%	$373.2	$272.3	37%	52%	$2,185.1	$1,667.5	31%	46%
Tools	79.1	68.8	15%	31%	39.4	34.8	13%	29%	33.7	23.7	42%	64%	152.2	127.3	19%	36%
Business Systems	424.2	391.4	8%	37%	273.4	237.5	16%	41%	76.9	84.4	(9%)	25%	776.5	713.3	9%	37%
Platforms - Desktop	214.8	187.7	14%	(44%)	113.7	102.1	11%	(29%)	36.0	20.6	75%	33%	364.5	310.4	17%	(36%)
Consumer Platforms	0.3	0.5	(36%)	(27%)	0.0	0.0	nm	n/m	0.3	0.0	nm	nm	0.6	0.5	28%	(21%)
Total Platforms & Applications	1,838.9	1,367.8	25%	25%	1,119.9	950.2	18%	21%	520.1	401.0	30%	47%	3,478.9	2,819.0	23%	27%
LEPD	21.6	44.6	(52%)	(46%)	8.9	30.6	(71%)	(44%)	5.8	3.8	55%	21%	36.3	78.9	(54%)	(40%)
Hardware	22.9	42.0	(45%)	(48%)	12.0	12.4	(3%)	(14%)	8.1	4.8	69%	100%	43.0	59.1	(27%)	(31%)
Desktop Finance	(3.6)	1.3	n/m	n/m	0.8	1.1	(24%)	(226%)	0.3	0.1	163%	nm	(2.5)	2.5	(199%)	(398%)
Other IMG	1.1	0.5	135%	67%	0.6	0.7	(20%)	11%	0.5	1.7	(70%)	(66%)	2.2	2.9	(25%)	(19%)
Total Interactive Media Group	41.9	88.3	(53%)	(51%)	22.3	44.8	(50%)	(25%)	14.7	10.4	42%	42%	79.0	143.4	(45%)	(38%)
Other	20.2	16.3	24%	39%	4.5	4.7	(5%)	(10%)	0.3	0.1	nm	(222%)	25.0	21.1	18%	29%
Total FG Gross Revenue	$1,901.1	$1,572.4	21%	21%	$1,146.7	$999.7	15%	19%	$535.1	$411.4	30%	47%	$3,582.9	$2,983.5	20%	24%

Fiscal 1999 FG RevSum Revenue

(including Retail OEM revenue)

(in millions)	South Pacific & Americas Actual	Plan	% Var	Growth vs. YTD98	Europe, Middle East & Africa Actual	Plan	% Var	Growth vs. YTD98	Asia Actual	Plan	% Var	Growth vs. YTD98	W.W. Finished Goods Actual	Plan	% Var	Growth vs. YTD98
Desktop Applications	$3,263.9	$2,987.9	9%	21%	$2,651.8	$2,263.7	17%	24%	$1,177.7	$900.6	31%	18%	$7,093.4	$6,152.1	15%	22%
Tools	355.2	302.2	18%	35%	183.7	156.2	18%	34%	136.3	110.1	24%	11%	675.2	568.6	19%	29%
Business Systems	1,474.8	1,378.0	7%	34%	1,063.3	963.6	10%	42%	264.7	290.6	(9%)	(4%)	2,802.9	2,632.2	6%	32%
Platforms - Desktop	793.2	639.2	24%	(14%)	483.4	426.2	13%	4%	192.6	117.9	63%	56%	1,469.2	1,183.4	24%	(3%)
Consumer Platforms	1.4	2.1	(33%)	(1%)	0.4	0.0	nm	nm	0.6	0.0	nm	nm	2.3	2.1	10%	11%
Total Platforms & Applications	5,888.6	5,309.4	11%	18%	4,382.5	3,809.8	15%	25%	1,771.9	1,419.2	25%	17%	12,043.0	10,538.4	14%	20%
LEPD	204.3	231.2	(12%)	(3%)	148.4	169.9	(13%)	(9%)	28.1	25.3	11%	1%	380.8	426.4	(11%)	(5%)
Hardware	193.9	251.3	(23%)	(10%)	122.5	96.1	27%	57%	33.5	21.6	55%	36%	349.8	369.0	(5%)	10%
Desktop Finance	17.2	27.7	(38%)	22%	8.0	8.0	1%	15%	4.2	2.6	64%	4775%	29.4	38.3	(23%)	39%
Other IMG	2.8	5.2	(47%)	(39%)	1.9	2.6	(25%)	66%	5.3	6.1	(13%)	(28%)	10.0	13.9	(28%)	(24%)
Total Interactive Media Group	418.2	515.4	(19%)	(6%)	280.9	276.6	2%	13%	71.0	55.5	28%	19%	770.1	847.5	(9%)	2%
Other	68.3	64.9	5%	13%	19.0	22.4	(15%)	(20%)	0.2	(0.2)	(171%)	(95%)	87.4	87.1	0%	0%
Total FG Gross Revenue	$6,375.0	$5,889.7	8%	16%	$4,682.4	$4,108.7	14%	24%	$1,843.1	$1,474.6	25%	17%	$12,900.5	$11,473.0	12%	19%

- Q99-4 FG revsum revenue was $3.6 billion, 20% above plan and up 24% over the same quarter last year. Key drivers include strong volume licensing of Office suites worldwide, and wide acceptance of the Word/Excel bundle in Japan. Volume licensing, including Select, Open and earned revenue from Enterprise Agreements (EA), amounted to $1.9 billion in the quarter, up 8% sequentially and 30% over the same quarter in the prior year. Open license growth was solid, growing 15% sequentially and 44% over the same quarter last year. Select revenue growth slowed considerably in the quarter, up 4% over the same quarter last year compared to a first half growth rate of 21%, as organizations continued to shift to the EA annuity model for purchases.

(in millions)	Q99-4 Gross revenue	Q99-4 Unearned	Q99-4 Earned	Year-to-date Gross revenue	Year-to-date Unearned	Year-to-date Earned
SPAR	$21.6	$11.0	$10.6	$43.7	$18.5	$25.2
EMEA	$218.6	$74.4	$144.2	$620.9	$227.3	$393.6
Asia	$396.5	$160.4	$236.2	$1,004.3	$322.2	$682.0
FG Total	$636.8	$245.7	$391.0	$1,668.9	$568.1	$1,100.8

- EA activity continued its torrid pace, as Q99-4 ranked as the best quarter to date in terms of EA signings. New EAs billed totaled 393 and covered 1.4 million desktops. This mark surpassed the prior record quarter (Q99-3) when 300 agreements were billed covering 1.3 million desktops. Billed revenue increased to $637 million in Q99-4, including $255 million from new agreements, with both figures surpassing the prior quarter record amounts of $490 million and $249 million, respectively. EA revenue of $391 million was recognized in the quarter, a 30% increase from the prior quarter. Significant new EAs during Q99-4 were signed with Deutche Telecom (127,000 desktops, 3 yrs, $99 million total revenue to MS), Lucent (90,000 desktops, 3 yrs, $45 million total revenue to MS) and Coca-Cola (49,000 desktops, 3 yrs, $25 million total revenue to MS).
- Q99-4 net revenue in SPAR was $1.6 billion, 7% above plan, an increase of 16% over Q98-4. Revenue in the U.S. was 7% over plan and up 16% over the same quarter last year, augmented by strong results in Canada, Latin America and the South Pacific. Canadian net revenue was $95 million in the quarter, a 13% increase from Q98-4. Latin America had a very strong quarter with $164 million in net revenue, a 21% increase from Q98-4. Ecuador highlighted the quarter, growing 158% from Q98-4 due to anti-piracy successes. Revenue in Brazil and Mexico was up 15% and 30%, respectively from Q98-4. For the year, Brazilian revenue was up 11% and Mexican revenue was up 4%, due to strong end of year sales. Revenue in the South Pacific beat plan by 13% in the quarter and was also 13% higher than Q98-4. In constant dollars, fiscal year revenue grew 29% and 27% in Australia and New Zealand, respectively. Select revenue growth slowed in the quarter due to customer adoption of EAs. This mix shift to EAs slows growth in the near term as revenue is recognized ratably, compared with Select, which is recognized 100% when billed. For the year, SPAR net revenue was $6 billion, 5% over plan and up 21% over fiscal year 1998.
- EMEA revenue remained strong in the quarter, but was adversely affected by the strengthening Dollar versus European currencies. Q99-4 net revenue was 6% above plan and grew 21% over Q98-4 (23% in constant dollars). Volume licenensing slowed compared to prior quarters, a 3% decrease over Q99-3. Open growth increased 7%, while Select licensing decreased 17%. Enterprise Agreements reached the highest level ever this quarter representing $218M or 35% of the full year. Growth in Western Europe slowed in the quarter, due to a strong first half of the year and a slowing economy. While the U.K. became the first EMEA subsidiary to top $1 billion of gross FG revenue for the year, growth for the quarter slowed to 13% over Q98-4. Growth over Q98-4 also slowed in France and Germany to 18% and 15%, respectively. Revenue in Sweden decreased 12% over the comparable quarter as a result of Sweden's Home PC program ending. For the year, Sweden and the Netherlands tied as the fastest growing subs, both growing at 43%. EMEA net revenue was $4.5 billion for fiscal 1999, 12% over plan and up 27% from FY98.
- Q99-4 net revenue in Asia was $439 million, 11% over plan and 29% over Q98-4 (17% in constant dollars). Revenue in Japan improved 21% over the comparable quarter (7% in constant dollars) due to continued strength of PIPC Word/Excel bundle sales. The worst of the economic recession in Japan appears to be in the past. Korea had a very strong quarter, as revenue was 319% higher than the quarter a year ago. Revenue in Korea was driven by government supported software anti-piracy initiatives. Results in China were 31% below plan due to the poor political situation. For the year, Asia net revenue was $1.7 billion, 20% over plan and 14% over fiscal year 1998.

- During Q99-4, a broad reorganization of the customer units was announced. The former Organization CU, Enterprise CU, Education CU, and the Microsoft Consulting Services HQ were combined into the Worldwide Enterprise Group (WEG) led by John Connors. WEG now incorporates the Small and Medium Enterprise Group (SME), the large Enterprise Group (EG), the Education Group (EdG), Corporate Account Technical Marketing (CATM), MCS HQ, and the Training and Certification organization. In addition, the Application Developer Customer Unit was renamed the Business Solutions Group (BSG), reflecting the core mission of the entity.
- In April, the Enterprise Group hosted the Government Leaders Conference in Seattle for more than 300 key officials who make technology decisions. In May., EG hosted the third annual CEO Summit, entitled "Getting Ahead of the Curve". Over 100 of the world's top CEOs explored how new technology can help them gain competitive advantages.
- The Enterprise Group signed a strategic alliance with EDS. Under the alliance, EDS will design, deploy, manage, and support MS based server and desktop solutions. MS and EDS will also partner in the financial services industry, delivering a range of solutions, such as branch automation and credit union systems. EDS will expand its services offerings on MS technologies, and train and certify 7,000 consultants as MCSEs and MCSDs.
- In April, the Network Solutions Group (NSG) announced alliances with Concentric Network, NorthPoint Communications, and Nextel to spur the availability of broadband communication services. Under the alliance, MS will develop co-branded versions of the MSN portal that will be offered to broadband and wireless Internet access customers.
- In April, the Small and Medium Enterprise Group announced Direct Access Business Critical Phone Support, free phone support available to more than 325,000 independent resellers and consultants in North America.
- The Education Group launched the School Agreement licensing program in May and sold 24 agreements worldwide. The program provides annual, non-perpetual licenses for MS applications, development tools, and operating systems for the K-12 market.
- The Education Group hosted 60 university CIO's at the Higher Education CIO Summit in June. The summit is a bi-annual meeting to present MS product directions, develop relationships with university executives, and collect feedback on IT issues in education.
- In April, MS announced that it is investing $40 million to train more than 150,000 developers, channel, and IT professionals worldwide on the Microsoft Windows 2000 operating system.
- In April, Inacom and MS announced an alliance where Inacom will invest in people, services and programs to design and manage solutions that incorporate MS technology. They will develop service offerings around MS Office 2000 and the Windows 2000 operating system. In addition, Inacom will increase its number of MS Certified Systems Engineers to more than 1,000.
- The FY99 SQL Server training initiative ended with 78,174 students trained worldwide, 50% over the original goal of 52,000 students. The objective was to create customer demand, ensure the SQL support channel was trained, and engage competitive DB administrators.
- In May, over 10,000 developers and IT professionals attended TechEd 99 in Dallas. The event provided attendees with information on how to architect, build and manage business applications based on MS platforms.
- MS and AT&T announced an agreement to deliver the next generation of broadband and Internet services. The deal calls for MS to invest $5.0B in AT&T securities, AT&T to expand their use of Windows CE in up to 10 million set-top boxes, and AT&T to license MS client and server software for interactive television. The two companies will work together to showcase digital cable service in the U.S. Additionally, MS agreed to purchase AT&T's 29.9% interest in Telewest Communications, a British cable TV operator.
- In Q99-4, the MS online marketing database surpassed 27 million individuals. Over 70% of them receive at least one electronic newsletter, with a total circulation of over 125 million newsletters during the quarter.

SOUTH PACIFIC AND THE AMERICAS (SPAR)

- SPAR closed 651 Enterprise Agreements in FY99, 97 units above the target of 554. Large deals this quarter included a Lucent renewal agreement worth $45 million and 90,000 PCs, and a Coca Cola agreement worth $25.3M and 49,000 PC's.
- The U.S. economy grew at a healthy pace with +2.5% GDP growth reported during Q99-4. Consumer spending grew 0.6% and remains the main driver of economic growth. Low inflation, high personal income (+0.4%), and a falling savings rate (-1.2%) support a favorable year-end outlook.
- The U.S. South Central district split into two districts to increase geographic focus. Northern Texas, Oklahoma and Arkansas are now the Red River District, and Southern Texas and Louisiana are now the Gulf States District.
- MS is developing a direct shipping relationship with retail partners to increase speed to market, improve supply chain flexibility and responsiveness, and enable customized promotions. Initially, there will be six retail partners, however, negotiations have begun with four additional partners with the goal of establishing a total of twelve direct partners by the end of FY00.
- Version 2 of Shop.com will launch in August with 600 MS SKUs and improved online functionality. Shop.com will capitalize on the shift in consumer purchasing behavior ($650 million in 1998 total retail market software web purchasing, $2.8 billion by 2002) and leverage the volume of microsoft.com visits. Version 3 and localized international versions are expected in Q00-4.
- The U.S. retail channel launched Office 2000 in June. The launch had excellent execution of in-store merchandising and the top retail account partners showed enthusiasm through nationwide advertising and promotions. Sales results from the first three weeks exceeded Office '97 results, but were not as strong as forecasted due to weaker than expected end user demand and lagging performance of the largest two retailers.
- In Canada, TransPoint signed a 10-year deal with E-Route, Inc. to use technologies from TransPoint and BCE Emergis for an electronic bill presentment solution worth $685 million. The solution will use Windows NT, SQL Server, Internet Information Server, and Site Server software.
- The Australia economy continues to grow rapidly with GDP growth of 4% in Q99-4. Consumer spending is main driver of growth, with retail sales up 9% over the same period last year. Unemployment figures continue to decline with rates falling to 7.5%. The economy was boosted further by the Standard & Poor's foreign currency upgrade from AA to AA+. The 12-18 month outlook remains very positive for the region.
- The Australia government will push ahead on tax reform, with existing indirect taxes being abolished and replaced with a 10% goods and services tax beginning July 2000. Although the overall impact of the change remains unclear, computer hardware sales are expected to be delayed in the lead up to July 2000 as they currently attract a 22% indirect sales tax. Conversely, software sales, which do not currently attract a sales tax, may be brought forward to take advantage of lower taxes under the current policy.
- Brazil's economy continues to show signs of stability after the January maxi devaluation. Inflation is under control and interest rates have steadily decreased, although without a material impact on re-igniting the economy. After a substantial recovery, the Brazilian Real has given up ground again, but remains within the range expected under the IMF agreement.
- Brazil closed 28 Enterprise Agreements in Q99-4, including agreements with Petrobras for $6.4 million covering 15,000 PCs and Telemar for $5.2 million covering 10,000 PCs.
- In Argentina, the MS platform won out against competitors in the largest virtual shopping project in Latin America. One of the region's largest telecommunications groups will implement the project in 10,000 stores over a 24-month period.
- Chile announced a multimillion-dollar public works program and offered financial aid to indebted businessmen to boost the economy and create jobs. Earlier, the Central Bank announced a drop in interest rates from 5.75 percent to 5 percent, a move President Frei called "an invitation to bet on our country and dismiss pessimism."

EUROPE, MIDDLE EAST, AND AFRICA (EMEA)

- Despite the conflict in the Balkans, Q99-4 EMEA FG channel performance was solid, with net revenue finishing the period 6% above plan and 21% over Q98-4 (4% and 23% in constant dollars). Responsibility margin of 69% was 3% above plan and increased 5 points over Q98-4. Licensing mix continued to improve, led by strong sales of Enterprise Agreements and Select. Select/EA and Open licensing grew by 41% and 36% (43% and 37% in constant dollars) respectively over Q98-4, while earned revenue from EAs increased to $143 million. A total of 123 new EAs were signed during the quarter, the largest one with Deutsche Telekom AG in Germany covering 127 thousand desktops, for a total amount of $99 million over a three-year period.
- The United Kingdom became the first EMEA subsidiary ever to top one billion US dollars of gross sales. In FY99, the UK grew FG revenue by 25% (26% in constant dollars) to end the year at $1.04 billion dollars.
- During Q99-4 the Euro continued to weaken, and the US dollar was also able to gain additional ground against most of the leading European currencies. The recent Euro weakness is not necessarily a sign of structural flaws in the currency itself, but is simply due to differences in the relative performance of the US and Euro economies against a backdrop of the war in Kosovo.
- During the quarter, MS opened two new offices in the EMEA region. In June, the MS Lebanon Representative Office was launched and celebrated with a large showing of partners and customers from Lebanon, Jordan & Cyprus. The event was held in Beirut with 90 guests including the Minister of Economy & Trade, the US Ambassador, press and government officials. On April 1, a new Microsoft entity SIA Microsoft Latvia was formed.
- Microsoft Morocco, a 28-person subsidiary based in Casablanca, dazzled 40,000 customers at Sit'Expo '99, a four-day event held every 2 years. With representatives from MS solution providers and technical education centers on hand, company representatives demonstrated the Windows NT, Office and BackOffice family of products. Microsoft received 3 awards including the top prize for its presentation space.
- In Greece on June 9, it was announced that Yannis Rondiris had been selected General Manager of MS Hellas SA. Rondiris succeeds Leonidas Panzaris who had served as General Manager of the Greek subsidiary since 1992. Panzaris will leave the company in August 1999 after transitioning responsibilities to Rondiris.
- Despite recent improvements in global economic conditions, unemployment in Europe remains high and continues to be a drag on growth. Unemployment of 10.8% is expected for the EU in 1999, down only 0.5% from 1998. European nations with greater than 10% unemployment for 1999 are expected to include France, Germany, Italy, Spain, Greece and Finland.
- According to the most recent IDC analysis released in May, the European market for collaborative software grew by 2 million new users in Q99-1. Lotus Notes added 864 thousand new users (42% of total) versus 709 thousand new users for Exchange (35% of total). It was also reported that Lotus Notes total users market share increased one point to 52% while Microsoft Exchange share remained at 30%.
- According to the June 1999 combined Netcraft/Compass surveys, Internet Explorer browser share increased to an all time high of 74.6%. Internet Information Server on the other hand saw market share decline one point to 20.8% in the EMEA region.
- In a much-publicized humanitarian effort, MS volunteers from the EMEA region worked with HP and Compaq to develop a refugee registration system for the UN High Commissioner for Refugees in Albania and Macedonia. With the recent signing of the peace agreement, emphasis has shifted to using the database for families returning to Kosovo and ongoing tracing of lost family members. Longer-term plans include the development of a software development kit which will be used by UNHCR to address future refugee registration needs worldwide.
- In early April, Microsoft opened a Y2K call center in the EMEA region in response to growing demand from customers for information on how to prepare their computer systems for the millennium milestone. This center compliments Technical Support Services by providing information fulfillment and answers to common non-technical inquiries.

Asia

- Historically, the Japanese yen has been extremely volatile relative to the U.S. dollar (USD). Between August 1998 and January 1999, the exchange rate dropped from 147 yen for each USD to 109 yen. For the last two quarters, the yen has been relatively stable with an average rate of 117 yen. The average rate for both FY99 and the FY00 forecasted rate is 123 yen.
- An improving economy in Japan has helped improve MS business in Japan and the Asian region. Japan's real GNP was estimated to have decreased by 3% in CY98 and 1% in CY99. The forecast for CY00 is 1% growth. Real GNP decline for the ten ASEAN countries was an estimated 5% in CY98 while it is forecasted to be flat in CY99.
- Management estimates that PC shipments in Japan for Q99-4 were 1.9 million units, down substantially from the 2.7 million shipments in Q99-3. For FY99, management estimates 8.6 million units were shipped, representing 21% growth over FY98. Q4 shipments have historically been lower than Q3 shipments, because of increased purchases in March, prior to the close of corporate and government fiscal year-end.
- Over 40% of the PCs shipped in Japan have a word processing program and a spreadsheet program preinstalled ("PIPC business"). MS Japan has increased its market share of this segment from 69% in FY98 to a forecasted share of over 87% for FY99. With the sell-in of Office 2000 products in June, Word/Excel bundle revenue in MS Japan was $98 million in Q99-4 (18% of the total revenue for the region). This represents a reduction from Q99-3, when the revenue from the Word/Excel bundle was $132 million, 25% of the total revenue for the region.
- PC consumption for the Asia region is forecasted to grow at 14% in FY00 compared with 16% for FY99. Japan's consumption is forecasted to grow 10% in FY00, down from 21% in FY99. Korea's consumption is forecasted to be 5% in FY00 compared with 10% growth in FY99. PC consumption in the Greater China region is expected to grow at 21% in FY00 compared with 17% in FY99. South Asia consumption is forecasted to grow 20% in FY00 compared with 2% growth in FY99.
- The English version of Office 2000 was launched with a street date of June 10, and the Japanese version of Office 2000 was sold into the channel. The street date of the Japanese version was July 9. Sell-in revenue in June was $76 million, which $71 million was product sold into the channel in Japan. Total Office standard and upgrade revenue in Q99-4 was $243 million, up substantially from $177 million of Office revenue in Q99-3. In the management P&L, a $102 million reserve was set up for all FPP Office 2000 and Word/Excel 2000 product in the channel at the end of June.
- In January 1999, the Asia Pacific Operations Center (APOC) was opened in Singapore. Beginning in May, the manufacturing and billing of products for the Japan market were moved from Tokyo to APOC. In connection with the establishment of APOC, two new legal entities were formed in Japan, MS Asia Ltd. and MS Product Development.
- In FY99, lagging economies have adversely impacted our FG business in the South Asia region. Gross FG revenue in Q99-4 and in FY99 was on plan, but FY99 revenue was 5% below the prior year.
- MS China's gross FG revenue in Q99-4 was $10 million, down slightly from the $11 million of revenue in Q99-3. The boycotting of American businesses in China as a result of the unintentional bombing of the Chinese embassy in Yugoslavia on May 7, adversely impacted business in the quarter. Throughout FY99, other factors resulted in revenue setbacks including the crackdown by the Chinese government on the gray market for PCs; foreign currency controls temporarily preventing distributors from importing MS English products; and increased piracy of software.
- Several management changes in the region were announced during the quarter. Effective July 1, Allen Fan, the GM of MS Taiwan, was named President of MS Taiwan, and has been succeeded by Alexander Huang, the former director of the ECG in Taiwan. Jimmy Wong, the GM of MS Hong Kong, and Juliet Wu, the GM of MS China, resigned effective August 1, 1999. Jaemin Kim resigned as the GM of MS Korea and is seeking employment at Redmond. Christophe Aulnette has recently been promoted to GM of the Asia HQ staff. He will continue to report to Pieter Knook, vice president of the region.

OEM

(In millions, variance to plan)	Q99-4			FY99		
	Actual	Plan	Var%	Actual	Plan	Var%
Net revenue	$1,653.9	$1,554.9	6%	$6,527.0	$5,865.9	11%
Costs of revenue	44.3	42.0	(5%)	148.5	153.6	3%
Gross margin	1,609.6	1,512.9	6%	6,378.5	5,712.3	12%
% of Net revenue	*97.3%*	*97.3%*		*97.7%*	*97.4%*	
Controllable expenses						
People	12.7	11.6	(9%)	43.1	43.6	1%
Contingent staff	0.3	0.2	(5%)	1.0	1.1	7%
Vendors	0.5	0.2	(211%)	1.0	0.6	(54%)
Infrastructure	3.0	2.6	(15%)	10.5	11.4	8%
Other misc expenses	48.7	29.4	(66%)	114.9	117.0	2%
Sales expense:	65.2	44.0	(48%)	170.5	173.7	2%
Marketing	21.7	14.7	(47%)	59.3	58.1	(2%)
Product support services (net)	0.4	2.4	84%	7.3	7.9	7%
MCS (net)	0.0	0.0	nm	0.0	0.0	nm
General and administrative costs	0.5	0.4	(19%)	1.7	1.7	(3%)
Total controllable expenses	87.8	61.5	(43%)	238.8	241.4	1%
Responsibility margin	1,521.9	1,451.4	5%	6,139.7	5,470.9	12%
% of Net revenue	*92.0%*	*93.3%*		*94.1%*	*93.3%*	
Shared resources	1.3	1.0	(23%)	3.6	4.2	14%
Corporate allocations	246.2	198.1	(24%)	788.8	839.2	6%
Contribution margin	$1,274.3	$1,252.2	2%	$5,347.2	$4,627.5	16%
% of Net revenue	*77.1%*	*80.5%*		*81.9%*	*78.9%*	

BUSINESS HIGHLIGHTS

- OEM net revenue of $1.7 billion in the quarter was 24% over the comparable quarter in the prior year and 6% over plan. The $6.5 billion net revenue for the year was 30% higher than FY98.
- Asia, with $283 million in revenue, experienced the strongest growth, increasing 51% over Q98-4. All regions, except China, exceeded plan, with Korea continuing to post the largest favorable variance. Trigem, the manufacturer of eMachines, accounted for over half of Korea's favorable variance.
- The system builder channel was the fastest growing channel for both the quarter and the year. Revenue of $331 million was up 24% over Q98-4 and 39% greater than prior year.
- OEMs reported 3.9 million units of Windows NT Workstation in Q99-4, up 53% over Q98-4. NTW penetration on business machines shipped by multinationals is estimated at 39%.
- Hardware revenue of $35 million for the quarter was 41% below budget. Sales continued to fall short due to increased price competition from low-end mice.
- People expenses were 9% over plan due to increased recruiting costs and headcount being slightly above plan. 40 additional heads were approved at mid-year, most which were hired in Q99-4.
- Other miscellaneous expenses includes customer (reseller) marketing. OEM marketing expense, including reseller and product marketing, was 3.8% of net revenue for the quarter, compared to a plan of 2.4%. For the year, marketing was 2% below plan.
- Q99-4 responsibility margin was 92%, 1 point lower than plan and equal to Q98-4. For the year, profitability was 94%, a percentage point increase over last year.

SIGNIFICANT OEM CUSTOMERS

OEM Revenue by Customer

($ in millions)	Q99-4			FYTD99			FY98	FY Growth
	Actual	Plan	Variance	Actual	Plan	Variance	Actual	%
Dell	$216.3	$198.4	$17.8	$829.6	$692.2	$137.4	$561.1	48%
Compaq	189.4	173.3	16.1	710.6	666.7	43.8	477.3	49%
IBM	140.7	97.0	43.7	569.3	386.3	183.0	336.1	69%
Hewlett Packard	108.7	115.5	(6.9)	360.8	397.5	(36.7)	309.6	17%
Gateway 2000	93.1	99.3	(6.2)	425.7	409.1	16.6	367.4	16%
Toshiba	42.6	36.6	6.0	166.0	147.0	19.0	141.6	17%
NEC	41.9	41.7	0.2	146.2	141.1	5.1	111.7	31%
Fujitsu	39.8	41.8	(2.0)	146.9	135.3	11.6	128.1	15%
Packard Bell NEC	34.9	42.3	(7.4)	154.8	177.7	(23.0)	158.0	(2%)
Siemens Nixdorf	34.3	30.2	4.1	133.4	110.8	22.6	93.6	43%
Other multinationals	53.9	52.2	(1.6)	198.8	192.9	9.0	148.3	34%
Total Multinationals	995.6	928.3	67.3	3,841.9	3,456.6	385.3	2,832.9	36%
Named accounts	349.7	340.2	9.5	1,394.0	1,296.5	97.5	1,221.5	14%
System Builders	331.1	296.8	34.2	1,358.7	1,151.8	207.0	976.1	39%
Total OEM Gross revenue	1,676.4	1,565.3	111.0	6,594.6	5,904.9	689.7	5,030.6	31%
Revenue adjustments	(22.5)	(10.4)	(12.1)	(67.6)	(39.0)	(28.7)	(17.8)	
Total OEM Net revenue	$1,653.9	$1,554.9	$98.9	$6,527.0	$5,865.9	$661.1	$5,012.8	30%

- Dell was the top revenue producer for the second year in a row. Significant contributions to this growth include strong PC and Windows NT Server shipments (up 55% and 73%, respectively over FY98) and a high application attach rate.
- Though Compaq continues to be the worldwide market leader with a 14.9% share, it is growing at a slower rate than the direct OEMs. In response, Compaq introduced the new Prosignia line for small and medium sized businesses, and made these products available via the Internet, telesales and the channel.
- IBM experienced high growth as a result of competitive pricing and the faster release of new products. Unit shipments were up 27% over Q98-4. IBM continues to have a strong focus on Window NT Workstation. NT penetration on business PCs exceeded 35%.
- Gateway had the highest revenue per PC of all multinationals due to extensive application pre-installations. Under a new contract being finalized, Gateway will ship Office SBE or Works Suite on all non-corporate PCs. With the introduction of the new low-priced line of mice, MS will also be the sole supplier of mice to Gateway for the next year.
- Hewlett-Packard unit shipments remained under budget due to their shift in focus from market share to profit margin. H-P began shipping Office SBE or Word on their small business line.
- Using a subsidy model similar to that found on cell phones, several OEMs are offering free PCs with an Internet subscription. Microcenter, for example, offers a $400 rebate on a $399 PC for a three-year subscription to MSN.

MARKETING EXPENSE

Marketing Spend Quarterly Trend

(in millions)	Q97-4	Q98-1	Q98-2	Q98-3	Q98-4	Q99-1	Q99-2	Q99-3	Q99-4
SPAR	$161.4	$118.1	$139.0	$135.7	$231.4	$100.5	$179.3	$142.5	$302.2
EMEA	82.1	40.0	88.9	68.8	109.4	60.0	100.2	85.8	101.6
Asia	43.7	22.6	37.5	26.3	34.9	26.1	41.5	26.6	54.3
FG Total	$287.2	$180.7	$265.4	$230.8	$375.7	$186.6	$321.0	$254.9	$458.1
Growth over same quarter, prior year	11%	28%	14%	(0%)	31%	3%	21%	10%	22%
Spend as a percentage of net revenue	14%	8%	10%	9%	15%	7%	10%	8%	15%
Broad Reach	$32.2	$19.4	$43.1	$41.8	$23.6	$6.2	$29.7	$28.6	$15.1

- Net finished goods marketing expense for Q99-4 was $458 million, 15% of net revenue compared to plan of $309 million, 10.9% of net revenue. Q99-4 spend increased $203 million over Q99-3. It is estimated that approximately $141 million or 31% of Q99-4 spend was to support the launch of Office 2000. Q99-4 spend includes approximately $100 million of year end accounting accruals for estimated expenses incurred but not yet paid by accounts payable. Q98-4 was high due to the launch of Windows 98 and the launch of Office 2000 contributed to the high Q99-4 percentage.

Marketing percentage spend by quarter

	Q1	Q2	Q3	Q4
FY96	21%	27%	18%	34%
FY97	16%	26%	26%	32%
FY98	17%	25%	22%	36%
FY99	15%	26%	21%	38%

FY99 FG Marketing Spend

(in millions)	FY99 Marketing spend			
	SPAR	EMEA	Asia	Total
Prod marketing & other	$521.2	$166.3	$83.1	$770.6
OCU	69.3	96.7	$24.2	190.2
CCU	59.0	30.1	12.0	101.1
ADCU	32.6	32.3	14.7	79.6
ECU	36.2	17.6	9.1	62.9
ICU	6.3	4.4	5.4	16.1
	$724.6	$347.4	$148.5	$1,220.5
% of YTD Net revenue	12.1%	7.8%	8.8%	10.0%
Advertising	$160.7	$74.5	$37.3	$272.5
Events	128.7	65.7	17.5	211.9
Reseller marketing	124.6	41.7	11.6	177.9
Program delivery costs	163.1	21.3	10.9	195.3
Seminars	70.7	36.5	29.0	136.2
Marketing materials	69.6	41.7	16.5	127.8
Public relations	56.2	23.6	3.8	83.6
All other	171.1	94.2	37.6	302.9
Marketing recovery	(220.2)	(51.6)	(15.7)	(287.5)
	$724.5	$347.6	$148.5	$1,220.6
FY99 Plan	$733.9	$329.3	$135.7	$1,198.9
% FY99 Plan spent	98.7%	105.6%	109.4%	101.8%

- FY99 FG marketing spend was $1.22 billion, 10% of net revenue compared to plan of $1.20 billion, 10.8% of net revenue. EMEA and Asia spend approximated plan after adjusting for incremental funding at mid year reviews.
- Product marketing focuses on broad demand generation marketing activities and represents the bulk of advertising, events, public relations and direct marketing spend.
- Customer Unit channel marketing focuses on marketing activities with channels of distribution (e.g., resellers, solution providers, direct sales to corporate accounts, etc.) This marketing accounts for the majority of reseller marketing and program delivery costs.

MICROSOFT CONSULTING SERVICES (MCS)

Q99-4 and FY99 P&L Summary

(in millions, except cost per head)	Q99-4 Actual	Q99-4 Plan	Q99-4 Var %	Year to date Actual	Year to date Plan	Year to date Var %
Consultant	$71.1	$80.8	(12%)	$246.4	$269.9	(9%)
Subcontractors	20.0	16.6	20%	84.4	64.4	31%
Revenue	91.1	97.4	(6%)	330.8	334.3	(1%)
People	63.1	64.3	2%	226.7	244.4	7%
Contingent staff/Vendors	20.3	14.1	(44%)	76.9	55.3	(39%)
Infrastructure	12.0	11.8	(2%)	41.8	50.5	17%
Other/Marketing/G&A	(10.3)	(9.3)	11%	(26.8)	(29.5)	(9%)
Total operating expenses	85.0	80.8	(5%)	318.6	320.7	1%
Responsibility margin	6.1	16.6	(63%)	12.1	13.6	(11%)
Headquarters allocations	3.2	2.5	(29%)	10.4	11.5	9%
Estimated general and administrative	2.7	2.7	(0%)	10.6	10.6	(0%)
Contribution margin	$0.1	$11.4	(99%)	$(8.9)	$(8.5)	(4%)
MCS Practice average headcount	2,307	2,442	6%	2,080	2,236	7%
MCS Headquarters average headcount	50	52	4%	47	52	11%
Subcontractor margin	$1.5	$3.2	(54%)	$14.4	$12.7	13%
Consultant revenue per head	$ 142.37	$ 148.29	(4%)	$ 132.2	$ 134.6	(2%)
People costs per head	$ 109,428	$ 105,272	(4%)	$ 108,999	$ 109,274	0%
Infrastructure expenses per head	$ 20,776	$ 19,252	(8%)	$ 20,093	$ 22,567	11%

MCS Highlights

- In Q99-4, the MCS business delivered a breakeven contribution margin against a budgeted profit of $11.4 million. For the year, MCS finished with a contribution margin loss of $8.9 million compared to a planned loss of $8.5 million and FY98 loss of $16.4 million. SPAR delivered a contribution margin loss of $0.9 million against planned loss of $1.7 million; EMEA closed at a loss of $5.1 million against a planned loss of $3.4 million; and Asia finished at a loss of $2.9 million against a planned loss of $3.5 million and MYR forecast loss of $3.6 million. Germany was the main driver of EMEA variances to plan; 70 additional heads were approved at mid-year to bring them to 292 at year-end. In June, they closed with 252 heads on board, and consultant revenue per head at 7.6% below plan. In addition, they carried out a major PC refresh program for Win/Office 2000.
- Year over year, SPAR and Asia improved their contribution margins by $5 million and $3 million respectively, while EMEA lost an additional $0.8 million. Worldwide consultant revenue per head decreased by 4% (notably Asia improved by 36%) and people cost per head grew by 2%, offset by the reduction in infrastructure costs per head of 27%, an increase in subcontractor margins of 22%, and reduction in bad debt expenses of $6 million.
- Worldwide average headcount grew 38% year over year. FY99 ended with 2,380 heads versus a plan of 2,464 (3% below plan, and growth of 625 heads over June 1998).
- In France, MCS and CAP GEMINI (a subcontractor) were engaged to develop a new architecture for the SNCF (French National Railways) reservation system. The key priority was to organize a strong risk management process, with 3-5 MCS consultants engaged on this project for the next 2-3 years.
- In Germany, a $2.5 million contract was signed with the Federal Labor Office (Bundesanstalt für Arbeit), where MCS will support the rollout of 70,000 Windows NTW and 1,000 Windows NTS seats.
- In the first attempt to create a virtual mall in Argentina, Telecom agreed to develop a 7000+ store online mall. 15 pilot stores were launched in June. This development was the first step in the MS-Telecom strategic agreement, signed during the recent Enterprise Solutions Conference.

PRODUCT SUPPORT SERVICES (PSS)

Product Support Cost and Revenue

(in millions)	Q99-4 Actual				Q99-4 Budget			
	Costs	Revenue	Net PSS	Recovery %	Costs	Revenue	Net PSS	Recovery %
SPAR	$144.3	$40.1	$104.2	27.8%	$126.4	$43.4	$83.0	34.3%
EMEA	$47.3	$16.6	$30.7	35.0%	$48.1	$16.1	$32.0	33.4%
Asia	$18.9	$4.1	$14.8	21.8%	$15.7	$3.8	$11.9	24.2%
FG Total	210.5	60.8	149.7	28.9%	190.2	63.3	126.9	33.3%
OEM	2.1	1.7	0.4	81.4%	3.0	0.6	2.4	21.2%
Total Business	$212.6	$62.5	$150.1	29.4%	$193.2	$63.9	$129.3	33.1%
	FY99 YTD Actual				FY99 YTD Budget			
	Costs	Revenue	Net PSS	Recovery %	Costs	Revenue	Net PSS	Recovery %
SPAR	$526.9	$146.6	$380.3	27.8%	$528.3	$156.7	$371.6	29.7%
EMEA	$177.7	$58.5	$119.2	32.9%	$198.9	$57.0	$141.9	28.6%
Asia	$63.9	$14.0	$49.9	22.0%	$61.7	$13.2	$48.5	21.3%
FG Total	768.5	219.1	549.4	28.5%	788.9	226.9	562.0	28.8%
OEM	10.6	3.3	7.3	30.9%	12.8	4.9	7.9	38.6%
Total Business	$779.1	$222.4	$556.7	28.5%	$801.7	$231.9	$569.9	28.9%

BUSINESS HIGHLIGHTS

- Q99-4 support costs totaled $213 million and were $19 million above plan due to expense timing differences related to IT networking, computers, travel and entertainment, recruiting, and the delayed Office 2000 launch. Support revenue increased $6 million from Q99-3, but was $1.4 million under plan. The earned revenue variance is driven by a slow start in Premier for Developer cash sales earlier in the year, and the delayed renewals of Premier contracts.
- FY99 net support costs were 4.5% of FG revenue compared to a plan of 5.1%. Support costs increased 20% over FY98 and totaled $779 million, compared to a plan of $802 million. The favorable variance is driven by below plan headcount and delayed ramp-up of VAP support. The 20% growth from FY98 is the driven by the Windows 98 launch and increases in BackOffice, Developer, and TAM support headcount related expenses.
- Project Ascent, a three-year strategic plan, is focused on making dramatic improvements in customer satisfaction. Its five core strategies are to align service offerings by customer segment, reengineer the service delivery process by offering, build skills and develop people, drive integration with the business divisions, and leverage PSS' global delivery capability. In conjunction with Project Ascent, the U.S. announced new support offerings effective July 1, which are divided into four families: Alliance, Premier, Professional, and Personal. Alliance Support is aimed at corporate customers in the most demanding environments. Thirty Premier customers were migrated to the Alliance offering, including Siebel and AT&T Solutions. U.S. Premier for Developer sales increased in Q99-4 with addition of 43 new contracts.
- Online Support usage continues to grow with a 24% increase in customers using the U.S. online support sites, and an 11% increase in subscribers from Q99-3. Online support was enhanced with a new automated service that enables Personal customers to get help on Windows 98 by asking questions in their own words.
- PSS initiated the worldwide deployment of Annapurna; a contact management, incident tracking, and contract management application from Clarify. In Q99-4, successful deployments occurred in the UK, Canada, Germany, and France, with the U.S. and several other subsidiaries converting in FY00. The project consolidates 6 incident tracking tools onto a single application, which will pave the road for the Ascent global support system infrastructure.
- U.S. incident customer satisfaction reached 67% very satisfied in Q99-4, up from 61% a year ago. The most notable progress this quarter came from the Office team. They reached 70% very satisfied in June, up from 65% last quarter. PSS was awarded the Technical Support Alliance Network's "Best of the Best" award.

PRESS

(in millions, variance to plan)	Q99-4			FY99		
	Actuals	% Net rev	Var %	Actuals	% Net rev	Var %
Net revenue	$44.7	100.0%	(19.3%)	$150.6	100.0%	(21.9%)
Costs of revenue	20.7	46.3%	8.2%	65.4	43.4%	19.4%
Gross margin	24.0	53.7%	(27.0%)	85.2	56.6%	(23.7%)
Controllable expenses:						
People	6.2	13.9%	(1.1%)	22.9	15.2%	5.5%
Contingent staff	2.1	4.6%	(38.5%)	6.6	4.4%	(7.7%)
Infrastructure	2.0	4.5%	(10.1%)	7.7	5.1%	7.4%
Product development	3.8	8.5%	(93.6%)	9.7	6.4%	9.1%
Other misc expenses	1.2	2.7%	(81.8%)	2.0	1.3%	25.5%
Marketing	5.0	11.3%	(55.0%)	12.8	8.5%	21.2%
G&A costs	0.1	0.2%	(21.1%)	0.4	0.2%	(12.3%)
Total controllable expens	20.4	45.6%	(32.6%)	61.7	41.0%	9.6%
Responsibility margin	3.6	8.1%	(79.3%)	23.4	15.6%	(45.8%)
Corporate allocations	1.8	4.0%	(65.9%)	5.5	3.6%	(24.1%)
Contribution margin	$ 1.8	4.0%	(89.0%)	$ 17.9	11.9%	(53.8%)

- Net revenue for Q99-4 was $45 million, $11 million (19%) below plan and $42 million (22%) below plan for the year driven by higher than expected Windows 98 returns and product delays of Office 2000 and Windows 2000. Cost of revenue, as a percent of net revenue, was over plan for the year by 1%. Controllable expenses were over plan for Q99-4 due to the launch of Office 2000 and year-end accruals. However, full-year controllable expenses were 10% under budget.
- The top ten English language titles for Q99-4 were responsible for 26% of the total English language revenue. Two of the top ten titles are related to the Office 2000 release and two titles are for the SQL 7.0 release. Our top selling titles continue to be our more technical server related titles. Revenue per unit for the top ten titles in Q99-4 is $43.69 versus our FY99 revenue per unit of $53.28 due to the mix of less expensive titles in Q99-4.

Top 10 English Language Titles

Revenue in millions

Rank	Title	SM	Revenue	% Rev	Rev per unit
1	Networking Essentials, Second Edition	20	$1.5	4.3%	$47.82
2	MCSE Core Requirements Training Kit	16	1.4	4.1%	$126.62
3	MS Office 2000 Resource Kit	2	0.9	2.7%	$26.82
4	MS SQL Server 7.0 System Administration Training Kit	2	0.9	2.5%	$46.21
5	MS Internet Information Server Training Kit	15	0.8	2.3%	$43.92
6	MS Windows NT Technical Support Training	26	0.8	2.3%	$44.80
7	MS SQL Server 7.0 Database Implementation Training Kit	3	0.8	2.2%	$45.91
8	MS Windows NT Server 4.0 Resource Kit	32	0.8	2.2%	$66.23
9	MS TCP/IP Training	23	0.6	1.9%	$44.67
10	Running Office 2000 Professional Edition Special Product Build	2	0.6	1.7%	$18.06
	Q99-4 Top 10 English Titles		$9.1	26.1%	$43.69

Rank	Title	SM	revenue	% Rev	Rev per Unit
1	Networking Essentials, Second Edition	20	$ 6.3	6.3%	$46.67
2	MCSE Core Requirements Training Kit	16	5.6	5.6%	$135.49
3	MS Windows NT Server 4.0 Resource Kit	32	4.0	4.0%	$69.36
4	MS Windows NT Technical Support Training	26	3.0	3.0%	$46.01
5	MS TCP/IP Training	23	2.4	2.4%	$45.71
6	MS Windows NT Network Administration Training	26	2.2	2.2%	$35.86
7	MS Internet Information Server Training Kit	15	2.2	2.1%	$45.06
8	MS Visual Basic 6.0 Deluxe Learning Edition	11	1.7	1.7%	$64.54
9	MS Windows NT Workstation 4.0 Resource Kit	33	1.6	1.6%	$31.28
10	MS Exchange Server Training Kit	12	1.3	1.3%	$44.97
	FY99 Top 10 English Titles		$30.4	30.2%	$53.28

General &
Administrative

GENERAL AND ADMINISTRATIVE

(in millions, variance to plan)	Q99-4				FY99			
			Variance				Variance	
	Actual	Plan	$	%	Actual	Plan	$	%
Gross expenses								
Human Resources	$77.5	$79.4	$1.9	2%	$289.8	$310.6	$20.8	7%
IT	70.8	59.0	(11.8)	(20%)	237.7	247.5	9.7	4%
Legal & Corporate Affairs	82.6	44.6	(38.0)	(85%)	262.5	179.7	(82.8)	(46%)
Finance & Administrative Services	111.5	99.1	(12.4)	(12%)	375.7	388.8	13.2	3%
Other	2.9	3.1	0.2	7%	5.6	12.6	7.0	56%
	345.3	285.3	(60.0)	(21%)	1,171.4	1,139.3	(32.1)	(3%)
Distributed expenses								
Benefits	46.1	47.5	1.4	3%	172.0	181.6	9.7	5%
Services	16.0	13.1	(2.9)	(22%)	54.7	56.2	1.5	3%
Recruiting	14.0	15.8	1.9	12%	52.7	60.1	7.4	12%
Facilities	61.0	58.8	(2.1)	(4%)	207.1	219.5	12.5	6%
IT	34.8	32.1	(2.7)	(9%)	118.5	129.5	11.0	8%
	171.8	167.3	(4.5)	(3%)	604.9	646.9	42.0	6%
Allocated expenses								
Other Human Resources	12.4	12.2	(0.2)	(2%)	48.2	52.7	4.5	9%
Other IT	36.0	27.3	(8.6)	(31%)	119.6	119.6	0.0	0%
Legal & Corporate Affairs	82.6	44.6	(38.0)	(85%)	262.5	179.7	(82.8)	(46%)
Finance & Administrative Services	39.6	30.7	(8.9)	(29%)	130.6	127.7	(2.8)	(2%)
Other	2.9	3.1	0.2	7%	5.6	12.6	7.0	56%
	173.5	118.0	(55.5)	(47%)	566.5	492.4	(74.1)	(15%)
Under/(over) distributed expenses	14.3	(2.7)	(16.9)	nm	(0.2)	(24.4)	(24.2)	99%
Net General & Administrative	$187.8	$115.3	($72.5)	(63%)	$566.2	$468.0	($98.2)	(21%)

See Appendix for G&A definitions

- Q99-4: Total gross G&A costs were $60 million over plan in Q99-4 due primarily to $38 million over spending in Legal and Corporate Affairs. This negative variance in Legal was primarily due to the costs incurred for the DOJ, Caldera, Sun, and Bristol litigations ($14 million over plan) and other Legal fees, including fees for piracy, patents, and policy ($23 million over plan). Information technology expenses were $12 million over budget primarily due to the timing of capital purchases for network infrastructure. Finance and administrative services costs were over plan by $12 million in Q99-4 due primarily to the timing of invoices for services (food & beverage, mail, and copy costs), maintenance and repair, and professional fees.

- FY99: Total gross G&A costs were $32 million over plan in FY99 due to an $83 million negative variance in Legal and Corporate Affairs. This variance in Legal is primarily due to a $60 million over spend in litigation expenses and other legal fees, including fees for piracy, patents, and policy (over plan by $37 million). Human resources expenses were $21 million below plan for FY99 due to reduced spend in employee fringes and employee recruiting. Finance and administrative services costs were $13 million below FY99 plan due primarily to lower facilities costs than planned. Information technology was $10 million below plan due primarily to lower infrastructure expenses. Other expenses were $7 million below plan for FY99 due largely to settlement payments received from MS insurance carriers.

BENEFITS

- Costs of employee benefits, including health coverage, 401(k) plan and health club dues are captured centrally and allocated monthly to domestic departments.
- The MS Healthcare plan is self-insured through a tax-exempt trust and administered through several healthcare providers. Healthcare costs were above plan due to costs associated with the transition to Aetna, our new third party administrator.
- The employer match for 401(K) was below plan on a per-participant basis during Q99-4 due to lower than planned compensation and participation rates.
- Health club fees represent costs for employee memberships at the Pro Club and Columbia Athletic centers in the Puget Sound area and were at plan on a per-participant basis during Q99-4.

Employee Benefits Rates	Q99-4				
	Basis	Actual	Plan	Var	Var %
Healthcare Pmts and Fees	Per enrollee	$ 652	$ 618	($34)	(6%)
401(k) Employer Match	Per participant	475	498	23	5%
Health Club Fees	Per participant	240	241	1	0%

RECRUITING

(in millions, except new hires, variance to plan)	Q99-4											
	G&A/Ops			S&M			R&D			Total		
	Actual	Plan	Var %	Actual	Plan	Var %	Actual	Plan	Var %	Actual	Plan	Var %
Recruiting costs	$ 2.1	$ 1.4	(46%)	$ 4.6	$ 3.6	(30%)	$ 7.4	$ 11.1	33%	$ 14.2	$ 16.0	12%
New hires (salaried)	209	155	(35%)	323	354	9%	499	683	27%	1,031	1,192	14%

- Recruiting costs are distributed to customer divisions based on number of new hires. Costs include employment advertising, agency fees, candidate travel, and recruiting staff's people and infrastructure expenses.
- Overall, salaried hires and total recruiting costs were under plan for Q99-4. For G&A/Ops the hires and costs are over plan due mostly to the incremental hires for ITG, but remain on plan on a cost per hire basis. S&M costs are above Plan for the quarter, but are on plan on a full year per hire basis. For the full year, the number of salaried hires was achieved with recruiting costs 12% below plan on a cost per hire basis.

FACILITIES & CAPITAL SPENDING

($ in millions, square feet in thousands)	FYE99 Capital Spend				
	Square Feet	Mix	Actual	Plan	Variance
Puget Sound	6,026	56%	$230.7	$299.2	$68.5
Other domestic	2,345	22%	81.2	100.3	19.1
International	2,467	22%	5.0	8.1	3.1
Total	10,838	100%	$316.9	$407.6	$90.7

- Construction of the Pinehurst project, located on the Redmond campus, continued during Q99-4. By Q00-2, this $91 million project will add 145,000 square feet to the portfolio. Pinehurst will be the new site of the Executive Briefing Center and the New Home of the Future. After Pinehurst is placed in service, Buildings 12-15 will be demolished and the, 490,000 square foot St. Andrews project will be constructed.
- The first land option payment that will apply to the eventual purchase of the Issaquah Highlands property was made during the quarter. Also master planning for potential future development for this property started during the quarter for this potential 3 million square foot campus.
- Sale and lease back of the France building in Les Ulis was completed during Q99-4. The same efforts continue on the Ireland properties.
- The plan to relocate the Munich, Germany properties to one campus continued during Q99-4. When this project is complete, 300,000 square feet will be added to the portfolio and the remaining sites in Germany will terminate their leases or sub-leases.

PUGET SOUND CAPITAL SPENDING

($ in millions)	FY99		
	Actual	Plan	Variance
New Space	$172.3	$202.2	$29.9
Tenant improvements	58.0	96.4	38.4
All other	0.4	0.6	0.2
Total	$230.7	$299.2	$68.5

- New space includes Troon, Pinehurst, St. Andrews and various new leased sites. The variance in spending for new space was primarily due to delayed starts on Pinehurst and Red West parking garage. The variance in tenant improvements was primarily due to the timing of retrofits on Buildings 9-10 and Buildings 16-18.

CORPORATE PROCUREMENT

Metric	Q98-4	Q99-4
Number of Transactions	372,477	473,754
Cost Per Transaction	$ 4.75	$ 3.28
Transactions Paid within Standard Terms	87%	78%

Standard Terms = payment within 30 days of invoice

- Corporate Procurement weekly average transaction volumes increased 27% in Q99-4 over Q98-4 due primarily to the growth rate of MS and expansion into new businesses.
- Q99-4 cost per transaction decreased 31% to $3.28 from Q98-4 and normalized gross expenses decreased 12%. Additionally, the number of weekly average transactions processed by electronic invoicing increased 18% year-over-year to 98% of all supplier invoices.
- On average, 94% of all non EI/ERS invoice transactions used MS Invoice during Q99-4.
- Year to date in North America, there were 7,610 new vendor set-ups, an average of 146 per week. Of these, over 31% were contractors and consultants.

INFORMATION TECHNOLOGY

- Ninety-five percent of the mission critical internal applications are year 2000 ready. Ninety-eight percent of the production data and voice networks are Year 2000 ready. One hundred percent of such systems are scheduled for year 2000 readiness by the end of September 1999.
- ITG and Windows 2000 Development successfully upgraded the Redmond Domain to Windows 2000. There are currently 42,000 users authenticating against Windows 2000. Windows 2000 has been deployed to more than 23,000 desktops.
- Worldwide IT costs were 96% of plan, primarily driven by an under spend in capital purchases.

BUSINESS UNIT IT (BUIT) – SIGNIFICANT PROJECT UPDATES

OPERATIONS IT

- In Q99-4, SAP was successfully implemented for the Japanese subsidiary. This was the seventh rollout of the fiscal year and allowed for the retirement of the final Mac-Pac AS/400 legacy system and also brought the KK business processes in line with the APOC business model.
- In Q99-4, the Euro implementation process was completed and all Eurozone channel partners were moved to Euro ordering and billing. The critical cutover of July 4, 1999 was met and FY00 was started with pick, ship and bill transactions in Euro currency for all vendors and partners. As a result, MS is live billing in Euros to all channel partners within the 11 Eurozone countries and to some additional non-Eurozone based channel partners who also requested to be billed in Euros.

Treasury &
Investor Relations

INVESTMENT INCOME SUMMARY

- Q99-4 investment income totaled $485 million, including portfolio interest income of $280 million and realized gains and losses for CMGI, Real Networks, WorldCom, Citrix, Wang and WebMD.

($ millions)	Investment income				
	Q99-1	Q99-2	Q99-3	Q99-4	FY 99
Portfolio	$ 226	$ 286	$ 287	$ 230	$ 1,029
CMGI			186		186
Real Networks		24	133	94	251
WorldCom			62		62
Citrix				36	36
Wang				50	50
WebMD				25	25
Other misc.	35	27	52	50	164
Investment income	$ 261	$ 337	$ 720	$ 485	$ 1,803

CAPITAL MARKET ACTIVITIES

INVESTMENT PORTFOLIO MANAGEMENT

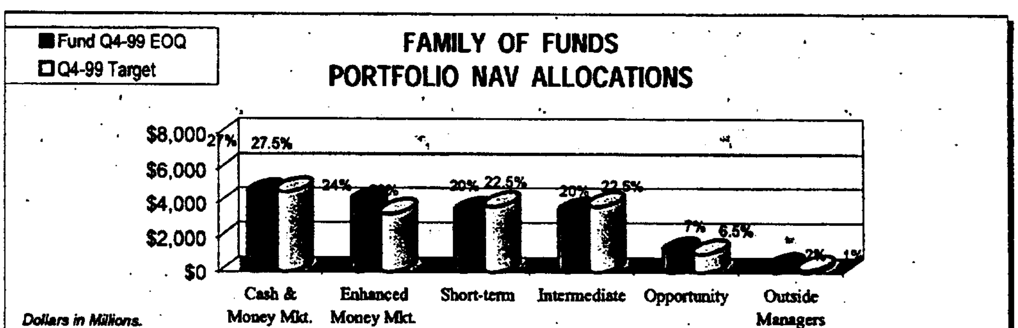
FAMILY OF FUNDS (FOF): PORTFOLIO ALLOCATIONS & ABSOLUTE RETURNS

($ in millions)	Cash & Money Mkt	Enhanced Money Market	Short Term	Intermediate	Opportunity	Outside Managers	Total
Fund allocation	#1	#2	#3	#4	#5	#6	
Q99-3 Avg	30%	20%	22%	22%	5%	1%	100%
Q99-4 EOQ	27%	24%	20%	20%	7%	2%	100%
Q99-4 Avg	32%	18%	21%	22%	6%	1%	100%
Cash balances *							
Q99-3	$ 6,092	$ 3,927	$ 4,851	$ 5,116	$ 1,256	$ 265	$ 21,507
Q99-4**	$ 4,485	$ 4,017	$ 3,441	$ 3,433	$ 1,214	$ 347	$ 16,937
Annualized rate of return (pre-tax)							
Q99-3	5.2%	6.5%	3.5%	1.2%	3.0%	35.0%	4.4%
Q99-4	5.0%	5.9%	2.4%	-1.2%	-2.4%	31.7%	4.0%

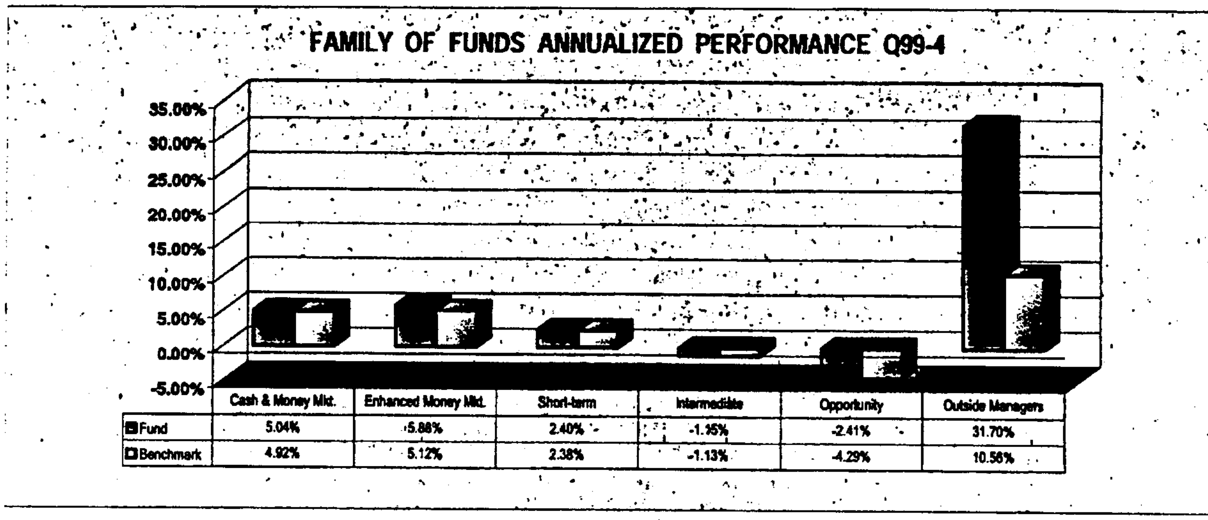
* Net Asset Value at market of Treasury-managed portfolio, includes certain assets classified as other assets on the balance sheet, but excludes certain foreign currency operating balances
**Q99-4 Outside Managers Cash Balance includes additional AOG funds

- Throughout the quarter, corporate liquidity needs drove Fund allocations. The accumulation of liquid assets in Fund 1 funded the AT&T deal in addition to other Corporate Development investments. Q99-4 average monthly balances exceeded end of quarter cash figures in Fund 1, reflecting intra-quarter uncertainty surrounding the timing of the AT&T funding.
- During the quarter, economic data supported the continuation of strong US GDP and fueled concerns that a change in Fed Monetary Policy might lead to a series of tightenings. Prior to the June 30 FOMC meeting, interest rates rose and corporate spreads widened in tandem with the perceived probability of the Fed's action, pushing the 30-year Treasury yields to a 19-month high. In the weak interest rate environment, Q99-4 FoF performance, at a 4.0% annualized rate of return, was lower than that achieved in Q99-3. Annualized out-performance compared to benchmarks is depicted in the performance chart on the next page and reviewed in the accompanying text.

FAMILY OF FUNDS (FOF): PORTFOLIO NET ASSET VALUE (NAV) ALLOCATIONS



FAMILY OF FUNDS: RELATIVE PERFORMANCE VS. BENCHMARKS



**Q99-4 Outside Managers Cash Balance includes additional AOG funds

PORTFOLIO PERFORMANCE

- Q99-4 economic conditions and the Fed expectations translated into a fixed income bear market. Global stability shifted investor focus to strong domestic growth and hints of increasing inflation, warranting the Fed to take back 25 bpts or more of easing afforded by Asian crisis. The expectation of impending higher costs of capital and upcoming Y2K concerns drove Corporate Treasurers to increase issuance of corporate debt pushing spreads wider.
- The upward trend in interest rates during Q99-4 detailed below, produced lackluster fixed income asset class performance. The intermediate sector of the yield curve was hit the hardest with the 2-year, 5-year, and 10-year T-notes each widening in excess of 50 bpts.

	Yield	Increase
3-month T-bill	4.76%	29 bps
1-year T-note	5.05%	35 bps
2-year T-note	5.52%	54 bps
5-year T-note	5.65%	55 bps
10-year T-note	5.79%	56 bps
30-year T-bond	5.97%	35 bps

- MS international equity portfolios gained 8.9% on the quarter compared to 2.5% for the EAFE Index. Strength in Japanese equities and strong performance from stocks held in the basic materials, energy, and financial sectors contributed to the positive results.
- Portfolio durations were held short versus benchmark duration in Fund 1 with limited deviations from benchmark durations in the remaining Funds during the quarter. While Fund 1 duration of 73% appears significant, the strategic bet equates only to an eight day delta. All other Fund durations ranged between 99% and 101% of their benchmarks respectively, on average in Q99-4.
- For Q99-4, the FoF aggregate portfolio returns outperformed their respective benchmarks by 57 bps ($30 million) and under-performed the risk-free rate of return (measured by the Salomon Brothers 3 Month T-Bill Index) by 143 bps ($76 million). All numbers are on an annualized weighted average basis.
- Beginning early in Q99-4, assets in the fixed income portfolios were shifted from Funds 3, 4 & 5 to Fund 1 to provide needed corporate liquidity. This asset allocation resulted in nearly $4 million of higher returns to the FoF versus the FoF Policy Allocation. There is minimal return differential due to Q99-4 allocation versus Q99-3.

PORTFOLIO "CATASTROPHE" HEDGE PROGRAM

- Under the Family of Funds "Catastrophe" Hedge Program, the Portfolio Management Group hedges against a quarterly pretax Mark-to-Market (MTM) loss exceeding the lower of 10% of forecasted quarterly net income or the expected pretax MTM loss (for Funds 3, 4 and 5) resulting from a 2 standard deviation rise in interest rates. In Q99-4, MS purchased payer swaptions for approximately $3 million and sold receiver swaptions for $1 million for a net cost of $2 million, hedging against a pretax MTM loss above $263 million. This risk-limiting program is designed to cap the negative valuation impacts on the portfolio that would be expected in an environment of rapid and significant increases in U.S. interest rates.

- Rather than letting the payer swaptions expire worthless at the end of the quarter, we executed the following strategy: Two swaptions were sold one day prior to expiration for $2 million (These swaptions would have expired worthless). One swaption was exercised for $150 thousand. Fifty percent of the swaptions were rolled to expire on 9/30/99. This strategy monetized approximately $20 million in value and purchased protection for Q00-1 at very attractive interest rate levels. The 9/30/99 payer swaptions will hedge against a pretax MTM loss of $64 million for two-thirds of the exposure for Funds 3, 4, and 5.

RISK MANAGEMENT & HEDGING ACTIVITIES

STOCK REPURCHASES

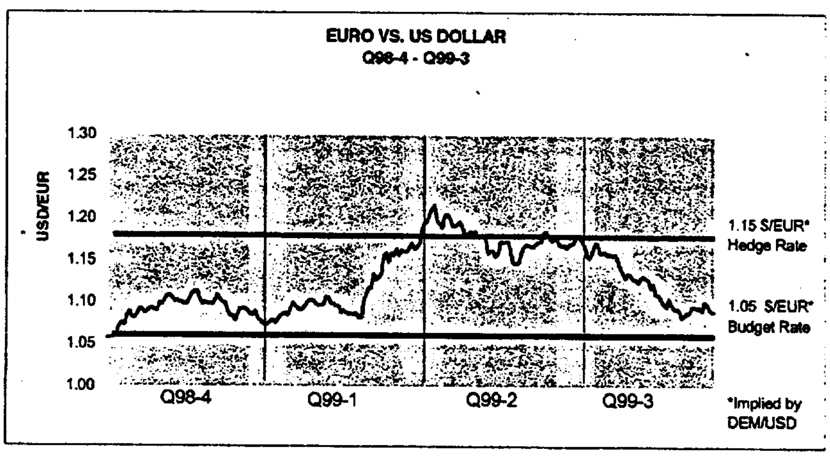
	Shares Adjusted For all Splits	Amount (millions)	Average Cost
FY90	28,566,000	$47	$1.63
FY91	87,516,000	$197	$2.25
FY92	31,677,240	$135	$4.26
FY93	50,056,000	$250	$5.00
FY94	69,112,000	$348	$5.03
FY95	93,352,000	$698	$7.47
FY96	108,000,000	$1,384	$12.81
FY97	148,100,000	$3,101	$20.94
FY98	77,658,706	$2,469	$31.79
FY99	43,759,670	$2,950	$67.40
Deferred Repurchase	-28,025,414		
LTD	709,772,202	$11,577	$16.31

- MS repurchased 18.1 million shares during Q99-4, spending a total of $1,421 million (average price of $78.39). A total of 710 million shares have been repurchased life-to-date at an average price of $16.31.

PUT WARRANTS

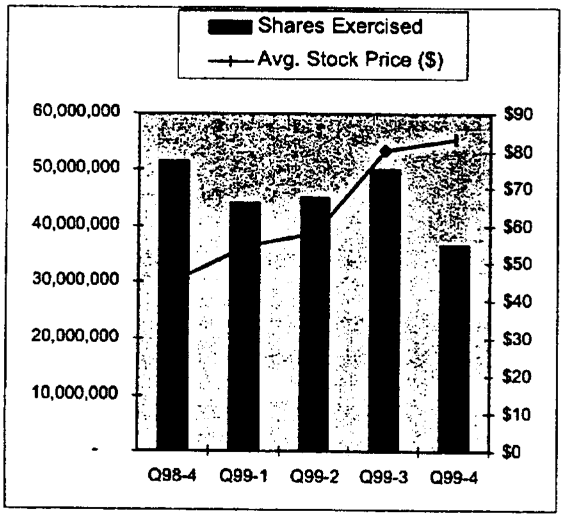
- At quarter end, 163 million put options were outstanding, with strikes ranging from $58.50 to $64.50 and maturities from three months to thirty-three months. The weighted average strike price is $61.52. During Q99-4, MS took in additional premiums of $9 million. Life-to-date program proceeds are now $1,578 million, of which $366 million represents put options that have expired or been closed out. Total put warrant authorization is 200 million puts, with a maximum maturity of three years. This program has enhanced the buyback program by reducing the life-to-date stock buyback cost per share by $2.22, or 13.6%, from $16.31 to $14.09.

FOREIGN EXCHANGE HEDGING



- The U.S. dollar continued to gain versus the euro during Q99-4, supported by the strong economic performance of the U.S. and continuing weak growth in Europe. The U.S. Dollar also maintained stable levels around 120 versus the Japanese yen.
- The Q99-4 foreign exchange net revenue hedges delivered a net gain of $8 million. ($22 million in net premium spent versus $30 million in payouts from the banks).
- The decision to roll down the hedge strikes in Europe and Japan during Q99-2 from 1.85 and 135 to 1.70 and 117 respectively has continued to pay off as the dollar appreciated during the second half of the year. At year-end, the realized incremental gain on the rolled hedges was $41 million.
- Treasury has a continuing program of actively hedging MS's exposure to foreign currency denominated accounts receivable on a short-term rolling 30-day basis. This program is measured against a 50/50 benchmark of completely hedged (via forwards) and completely unhedged positions. The Q99-4 gain/loss versus this benchmark was negative, at -$2 million due to the strong dollar trend.

STOCK OPTION GRANTS AND EXERCISES



- Q99-4, the number of stock option exercises was 14,275, an increase of 7% over the same period in FY98. The number of shares exercised was 36.4 million, a 29% decrease from Q98-4.
- During Q99-4, 1,626 stock option grants were issued, totaling 3.69 million shares. Of this total, 2.5 million shares were dated in Q99-4, with the balance dated in prior quarters due to overlapping window periods.
- Cumulative outstanding options on 6/30/99, were 765.5 million with an average strike price of $17.28. Authorized but unissued options totaled 1.76 billion.

EMPLOYEE STOCK PURCHASE PLAN

- Under the ESPP program, a total of 933,858 shares for the period ending 6/30/99 were issued to 17,273 domestic employees at a purchase price of $59.93 per share. International ESPP is reported in odd numbered quarters.

ACCOUNTS RECEIVABLE

- Worldwide gross accounts receivable increased from $2.4 billion at the end of Q99-3 to $2.7 billion. The majority of the increase came from the U.S. and EMEA. The U.S. accounts receivable balance increased 54% sequentially and EMEA increased 23% sequentially. The increase was due to the shipment of "Office 2000 products. Aging improved with "current" increasing from 88% to 94% and over 60-day delinquency improved from 5% to 2%.
- Worldwide days sales outstanding (DSO) increased slightly from 43 days in Q99-3 to 44 days in the current quarter, with improvement coming from the South Pacific and Latin America.
- The reserve for sales returns and concessions at June 30, 1999 decreased to $559 million. This balance is composed primarily of probable returns of channel inventory of packaged products, prepaid OEM minimum commitments, and OEM and organizational licensing credits and pricing concessions. The decrease reflects the lower risk associated with packaged product channel inventory due to the shift from FPP to licenses and the move to more of a direct model for certain resellers and other customers.
- The allowance for doubtful accounts decreased to $204 million at June 30, 1999. The decrease reflects a change in classification for certain doubtful accounts. These customer balances had been reflected as gross accounts receivable but fully or substantially reserved. Because of their operating history, financial difficulties, undercapitalization, and dependence on reselling their inventory before paying MS, it was determined that transactions with these specific customers did not qualify for initial revenue recognition. Revenue from these customers is on the cash basis, thus there is no gross-up of accounts receivable and the allowance for doubtful accounts. See the following page for a discussion of two of these customers.

($ in millions)	DSO				Aging Summary				
	Q99-1	Q99-2	Q99-3	Q99-4	Total	Current	1-30	31-60	60-
Finished goods									
EMEA	38	42	36	35	$ 490	$ 478	$ 6	$ 2	$ 4
Asia	61	59	53	57	356	327	18	7	5
United States	36	47	40	42	923	900	(1)	12	11
Canada	29	49	41	40	47	45	2	(0)	0
South Pacific	69	79	78	69	73	72	(3)	0	4
Latin America	96	93	102	97	180	168	8	1	4
Total finished goods	44	49	44	44	2,069	1,989	29	23	28
OEM	44	40	43	46	722	620	54	17	31
Other					(102)	(94)	(4)	(2)	(2)
Total accounts receivable	44	46	43	44	$2,688	$2,515	$79	$37	$57
						94%	3%	1%	2%
Clearing accounts					(68)				
Reserves for sales returns					(559)				
Allowance for doubtful accounts					(204)				
Customer deposits					(12)				
Rebates & other					(166)				
Earned but unbilled revenue					571				
Accounts receivable-net					$2,249				

ACCOUNTS RECEIVABLE OF THE TEN LARGEST CUSTOMERS WORLDWIDE

- Total accounts receivable for the top ten worldwide customers accounted for 50% of the total accounts receivable at the end of Q99-4, up from 43% at the end of Q99-3.
- During the quarter, CHS continued to deteriorate financially. As mentioned in last quarter's report, the company had to restate its second and third quarter financials due to fraudulent activity. The company essentially had a "break even" profit for its first quarter and is expected to lose money in its second quarter due to restructuring charges. We are monitoring the segment daily and have them on strict regional credit lines. For revenue recognition, this customer is on the cash basis accounting method.
- As a result of our "Retail Direct to Store" program, we have terminated our distributor agreement with GTIS. The company owes MS $29 million and is past due $21 million. They are presently on a payment plan, but have missed the last two payments due in June and July. We are presently negotiating with their chief financial officer for resolution.
- Q*Soft, a terminated distributor in Australia has petitioned the courts for administrative relief (a form of liquidation). This customer had been on a long-term payment plan, but stopped paying several months ago. As a result of the liquidation, we have turned the matter over to our local counsel in Australia and write off $3.7 million.
- KTX Edge, one of our largest OEM customers in the South Pacific is having cash flow problems and has been on payment plans for the last 12 months. As of quarter end, the customer has stopped making payments and negotiations to resolve the issue have failed. We are presently considering bringing legal action against all Edge entities and enforcing the personal guaranty we have from the principal, Johnson Wang.

($ in millions)	Total		Aging Summary			
	Balance	Percent	Current	1-30	31-60	Over 60
Ingram	$ 411	15%	$ 404	$ 6	$ 0	$ 0
Compaq Computer	172	6%	167	4	1	(0)
Dell Computer	156	6%	153	1	0	2
Tech Data	129	5%	133	(3)	(0)	(1)
R.R. Donnelley & Sons	111	4%	107	0	0	4
Softbank	87	3%	84	3	1	(0)
CHS	81	3%	78	1	1	2
Software Spectrum	73	3%	68	2	2	1
Fujitsu	71	3%	68	2	0	0
Merisel	49	2%	49	0	0	0
Total ten largest	1,341	50%	1,310	17	5	8
Other	1,347	50%	1,205	62	32	49
Total Q99-4	$2,688	100%	$2,515	$ 79	$37	$ 57
Total Q99-3	$2,425		$2,130	$148	$26	$121
Aging mix:						
Q99-4 Top ten largest			98%	1%	0%	1%
Q99-4 Total			94%	3%	1%	2%
Q99-3 Total			88%	6%	1%	5%

NEW DEALS

- Intrinsa – On June 28th, MS completed the acquisition of Intrinsa. The purchase price was $59.5 million, $56 million in stock and $3.5 million in cash payments to employees.
- Intrinsa is a Mountain View, CA-based developer of a software defect detection product called PREfix. The core engineering team of 8, including the recognized expert in this field, has relocated to Redmond and is currently working with the Programmer Productivity Research Center in MS Research to optimize PREfix for use on MS's internal code base. MS does not currently plan to continue the commercial availability of PREfix.
- Wink Communications, Inc. – On June 3, MS invested $15,000,000 into Wink Communications Inc. for 1,250,000 shares of Series D Preferred Stock. MS was also granted a warrant to purchase an additional 500,000 shares. MS is also committed to an additional 1,250,000 shares of Series D Preferred Stock, subject to clearing an HSR review which has been filed. The combined investment will total $30,000,000, and MS will hold approximately 9.4% of Wink. Along with the investment, MS has entered into partnership with Wink whereby Wink evangelizes our TV platform products with its cable and satellite customers; Wink will also be the transaction processing agent for MS.
- AT&T – On May 6, MS and AT&T announced an investment by MS of $5 billion in a combination of convertible preferred securities and warrants. The convertible securities are convertible into 66,700,000 shares of AT&T common stock at a price of $75 per share, and yield 5% payable quarterly. The warrants are for 40,000,000 shares of common stock exercisable at $75 per share.
- The partnership also includes an extension of the TCI's commitment to using MS Windows CE TV client from 5 million to 7.5 million units (with an option on an additional 2.5 million), an updated agreement on client and upgrade pricing, and an agreement to use a broader set of technologies. Further, the partnership defines the deployment of broadband TV services based on MS TV client and server software in two Showcase cities, and one showcase city using MS TV client and a third party server solution.
- At Home Solutions, Inc. – On May 7th, 1999 MS invested $5 million into At Home Solutions, a provider of high speed cable modem services for small and medium sized Cable Companies. MS invested in 5,000,000 of zero coupon debt which carries a 7.53% annual interest rate and a 3 year term.
- As the preferred provider of software to At Home Solutions, MS will provide infrastructure software at the companies headends and regional data centers. MS will commit co-marketing funds to @Home Solutions as well as $1,500,000 in technology support.
- Jump – On April 30, MS acquired Jump, an online calendaring and eventing company in a stock for stock merger for $35 million. MS hired 10 employees, with the technical employees relocating to Don Bradford's team in MS's San Jose office.
- 144Centelec – On May 19, MS purchased 240,000 shares for 3,600,000 Euros (US$3,943,449) for a 30% ownership of the entity. Thomson Multimedia holds the remaining 70%, and invested a proportional amount coincident with MS. 144Centelec intends on developing and operating an interactive free analog television service in Europe based on MS technologies. The venture intends on launching its service in the year 2000 in France, UK and Germany.
- Superior Consultant – On May 6, MS and Superior formed a strategic relationship to deliver end-to-end enterprise solutions for the health care industry. As part of the alliance, MS committed $9 million to invest in Superior over a period of 2.5 years. In addition, MS will contribute $1.84 million in marketing funds over the same period. In return, Superior will train 500 MCSE/D's, develop four healthcare solution centers and move one million seats to Office2000, Exchange and Windows2000.
- Superior offers a full array of strategic, operational, IT and outsourcing consulting services through more than 1,200 professionals in 16 offices. It trades under the ticker SUPC.
- Concentric Networks – On June 21, MS made a $50 million investment in Concentric Networks under which Concentric made a broad set of commitments to the MSN services and MS hosting platforms. The strategic commitments include: (i) MSN consumer and small business portal will be the default narrow and broadband portal for Concentric's consumer and small business access subscribers; (ii) Concentric will launch 3 ASP hosting services on NT/BackOffice; (iii) a renegotiation of the WebTV network supply agreement which extended the term 2 years and

reduced port costs by approximately 30% (WebTV is Concentric's largest customer).

- The investment took the form of a 7% convertible preferred, convertible into 1,252,380 common shares, or $39 (a 20% premium above market). MS also received 500,000 4-year warrants exercisable at $33.27. MS's fully diluted ownership position is 3.2%.
- Sidewalk. - On July 19, Ticketmaster Online-CitySearch, Inc. (TMCS) agreed to purchase the arts and entertainment assets of Sidewalk and enter an MSN distribution deal in consideration for TMCS securities worth approximately $331 million. Specifically, MS received 7 million common shares of TMCS; 1.5 million warrants to purchase TMCS shares at $60 and 3.0 million warrants with a variable exercise price equal to $30 less the amount by which the then current stock price exceeds $30. As of July 27, the shares traded at $34.00, unchanged from the closing price immediately prior to the announcement of the deal.
- The purpose of the transaction was to discontinue an unprofitable line of business while at the same time retaining the ability to distribute city guides on MSN and enabling MSN to offer tickets via Ticketmaster. The deal impacts 10 Sidewalk sites, with 100 employees and 90 contractors.
- Navisite. - On June 7, MS invested $7.35 million in Navisite, Inc., for a 4.9% ownership interest. Navisite is a majority owned CMGI company that operates as an Internet application service provider. Concurrently with the investment, MS also entered an agreement whereby Navisite will standardize on Windows Media Technologies. On July 22, the company filed its IPO.
- Sendit. - On July 8, MS completed its $127.5 million acquisition by tender offer of Sendit AB. Sendit, based in Stockholm, Sweden, employs approximately 100 people and is a provider of mobile Internet solutions to GSM carriers, enabling the carriers to become mobile ISPs. The Sendit team, headed by CEO and founder Hjalmar Winbladh, will remain in Sweden and will become a business unit within Server Applications. Sendit is intended to provide a presence for MS in the Scandinavian "Wireless Valley" for R&D, sales and marketing, and partnering activities.
- AvantGo. On June 18, MS invested $5 million in AvantGo, Inc. as part of a $14.7 million round with 3Com and several financial investors. AvantGo converts Internet content to a format for small form factor devices. Prior to our investment the company was 100% Palm, but as part of the transaction Avantgo has agreed to develop and distribute software that supports Windows CE devices simultaneously or prior to other handheld operating systems.

HIGHLIGHTS OF CURRENT INVESTMENTS

- WebMD - Concurrent with our investment and strategic alliance, WebMD was acquired by Healtheon in an $8 billion merger of equals transaction. As part of this transaction, MS agreed to invest $100 million upon merger announce and $150 million upon merger close. These investment are in addition to the $120 million investment made pursuant to the tender offer which was outstanding prior to the merger. MS owns approximately 14% of Healtheon on a fully-diluted basis and was granted a board seat as part of the merger. As part of the merger, Healtheon has made certain technology commitments to MS technologies.
- Navitel. On April 9, Navitel Communications Inc. was sold to Spyglass, Inc. On the same day Spyglass entered into an agreement with MS to assume the Navitel's development obligation's relating to Hermes, the WinCE based screen phone. As a result of the transaction we received 277,000 shares of Spyglass, which are worth $4 million as of July 28, as compared to our $4 million investment in Navitel.
- Elemental. - On July 24, Macromedia is acquiring Elemental Software for $24 million. Elemental develops and markets tools for the creation of dynamic web pages, principally using ASP. Proceeds to MS were $2 million on a $1.9 million investment.
- Zoomit. - On June 30, MS acquired Zoomit, a leading developer of meta-directory technology for bi-directional synchronization of information stored in heterogeneous directories and database systems. The cost was $21 million including the assumption of debt and conversion of employee ownership to MS options. Zoomit, based in Toronto, will be dissolved and an engineering team of 11 people will be relocated to Redmond to join the Windows NT team.
- OmniBrowse - On May 21, MS acquired OmniBrowse, an operator of a wireless information service for users of mobile devices. The service has been re-launched as the first offering of MSN Mobile. The cost was $3 million including the assumption of debt. Three principal

employees of OmniBrowse joined the MSN Mobile team as part of the transaction.

- Vadem. On May 21st, MS made an investment of $5 million in Vadem, Inc Series F Preferred Stock, a system designer and OEM of Windows CE devices. The investment was the first phase of a transaction that will involve acquiring the intellectual property of Vadem's Paragraph handwriting recognition division. The second phase of the transaction is expected to close in August and involves a further investment in Vadem of $4 million, a payment for the technology of $10 million, and a maintenance and development agreement of $1 million. Because of the difficulties Vadem's core business faces, we should view the entire $20 million as payment for the technology we are acquiring.
- Digital Entertainment Network. On May 21st, MS made an investment of $4.5 million in Digital Entertainment Network's Series B Preferred stock. As part of the transaction, DEN signed a strategic agreement with MS to use and promote Windows Media Technologies on its streaming media entertainment network.
- Dialogic. On July 2, Dialogic was acquired by Intel for $44 / share paid in cash. Intel bought MS's stake and MS made a gain of $16 million before tax within 4 months of our original $24.5 million investment. The strategic business agreement that MS had with Dialogic was assigned to Intel to the satisfaction of the NT business group.

EQUITY INVESTMENTS & OTHER ASSETS

- Sixteen new equity investments for $6.24 billion were funded in Q99-4: AT&T for $5 billion, WebMD for $444 million, Nextel Communications for $600 million, Concentric Network for $50 million, NorthPoint Communications for $30 million, Wink Communications for $30 million, Inprise for $25 million, CareerBuilder for $18 million, High Speed Access for $10 million, Navisite for $7 million, AvantaGo.com for $5 million, Vadem for $5 million, Digital Entertainment Networks for $5 million, Starburst for $3 million, VentureSoft for $3 million, and Kiwi Ventura Sercivos S.A. for $2 million.
- Additional equity investments totaling $35 million also took place during Q99-4, including Dialogic for $10 million through exercise of warrants and Digital Anvil for $5 million. Stock dividends were received from Comcast for $7 million and NTLI for $6 million.
- Reductions of original investment interest, totaling $76 million, include 25% of Citrix (pretax gain $36 million), 100% tender of Wang (pretax gain $50 million), and the remaining Real Networks holdings (pretax gain $94 million).
- Total market value of investments in public companies increased $7.28 billion, mainly due to new investments and the increased share prices for Comcast, United Pan-Europe Communications, CMG Info Service, and Initial Public Offerings by Rhythms NetConnections and Tut Systems.
- Joint ventures increased by a total of $18 million consisting of funding net of operations. Other investments decreased $225 million: "Tracers" matured for $200 million (tax-free security based on derivatives of MS stock) and $25 million from the sale of Boston Financial and Boston Capital Affordable housing investments (pretax gain of $4 million).
- Intellectual property rights increased $196 million primarily from $100 million for Inprise patent license along with the acquisition of Jump Networks for $35 million, Intrinsa for $56 million and Zoomit for $20 million, less an additional $15 million amortized for Q99-4.
- LT loans and other assets increased $117 million. The Apple equity hedge was reclassified from equity investments and increased in value $90 million. There was an increase in Alliance marketing deals of $21 million, due primarily to funding to International Network Services for $11 million and Wang for $10 million. Goodwill decreased net $22 million, primarily from $73 million in amortization for WebTV, CompareNet, LinkExchange, FASA and Access offset by $51 million in acquired goodwill for Access.

(in millions)	Cost			Market Value (if public)		
Equity Investments & Other Assets	Q99-4	Q99-3	Change	Q99-4	Q99-3	Change
AT&T	$ 5,000	$ -	$ 5,000	$ 5,380	$ -	5,380
Comcast	1,055	1,048	7	3,283	2,708	575
Nextel Communications	600	-	600	836	-	836
NTL, Inc	511	504	7	629	601	28
United Pan-Europe Communications	332	332	-	629	432	197
WorldCom (hedged)	14	14	-	477	531	(54)
Qwest	200	200	-	294	320	(26)
Rhythms NetConnections	30	30	-	250	-	250
CMGI	3	3	-	209	157	52
Apple (hedged)	150	150	-	190	185	5
Lemout & Hauspie	60	60	-	133	113	20
Citrix Systems (hedged)	1	2	(1)	103	133	(30)
Verisign (hedged)	7	7	-	101	97	4
Other equity investments	1,330	747	583	521	477	44
	9,293	3,097	6,196	$ 13,035	$ 5,754	$ 7,281
Joint ventures	67	49	18			
Other investments	1,852	2,077	(225)			
Mark-to-market*	3,160	2,208	952			
Total	14,372	7,431	6,941			
Other assets						
Intellectual property rights	589	378	211			
Accumulated amortization	(381)	(366)	(15)			
L/T Loans & Other	732	615	117			
Total other assets	940	627	313			
Total Equity Investment & Other Assets	$ 15,312	$ 8,058	$ 7,254			

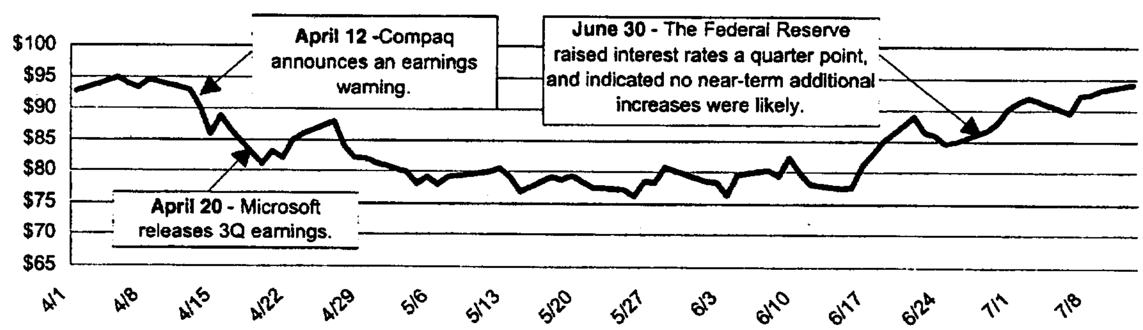
* Privately held securities and certain preferred stocks redeemable into common stock or cash (Comcast, NTL) cannot be marked-to-market.

INVESTOR RELATIONS

MARKET OVERVIEW

- Early in the quarter, the DJIA surged past the 10,000 mark on its way to 11,000. However, in the last two weeks in May, economic indicators fueled a decline and the DJIA fell 650 points. Interest rate concerns kept investors on the sidelines until the Federal Reserve announced it was increasing the Fed Funds Rate only 0.25% in the near-term. Investors jumped back into the market, closing the June 30th session within 37 points of it's all-time high.
- For the year ended June, MSFT outperformed major indices but lagged behind several competitors including AOL, Sun, Oracle, IBM, and Novell who all demonstrated stock price growth between 100% and 320%. The DJIA gained 21%, NASDAQ Composite 40%, S&P 500 20%, and MSFT 67% for the year.
- Major indices moved higher during the June quarter, breaking records on the strength of the broadening market. The DJIA gained 12%, NASDAQ Composite 9%, S&P 500 7%, and MSFT 1%.
- In April, technology stocks weakened following Compaq's earnings warning until it became clear that the problem was not endemic to the entire PC industry. IBM's strong first quarter results drove buying, while Dell's earnings raised fears once again about the sustainability of profits in the PC market.
- MSFT endured a rough ride during the June quarter, ending only 1% above where it started. Rising interest rates, news that the DOJ attracted an IBM executive to testify in the antitrust case, and lingering concern over MS's CY99 financial prospects, contributed to the stock's fall to $75 ½ 21% off the quarter's earlier high. MSFT began its trek back up following the release of favorable economic data and the Fed interest rate actions, closing out the quarter at $90 1/8.

MICROSOFT COMMON STOCK



WALL STREET ANALYST COVERAGE

Rating	Analysts
Strong Buy	13
Buy	10
Hold	3

Source: First Call

- Four analysts initiated MS coverage: George Godfrey - Raymond James & Associates, and Dawn Simon - Brown Brothers Harriman, both with a Strong Buy rating. Chris Shilakes - Merrill Lynch, initiated with an intermediate-term Buy and a long-term Strong Buy, and Jonathan Geurkink - Ragen MacKenzie initiated with a Buy rating.
- Mike Stanek added MSFT to Lehman Brothers 10 Uncommon Values list on July 1, 1999, simultaneously raising their price target from $110 to $130 per share to reflect growing optimism on a successful Windows 2000 product cycle.
- Doug Crook - Prudential Securities downgraded MSFT from Buy to Hold following Microsoft's Q3 earnings release, on valuation and Y2K concerns.
- Top analyst ratings: Rick Sherlund, Goldman Sachs - Recommended List/Strong Buy; Mary Meeker, Morgan Stanley - Buy; and Michael Kwatinetz, CS First Boston - Strong Buy.

SHAREHOLDER ACTIVITY

	Institution (March Rank)	Investment Style	Turnover Rate	Change Since March 99	June 99 Position
1	Fidelity Management & Research Co. (1)	Growth	Medium	(18,900,000)	151,500,000
2	Barclays Global Investors, N.A. (2)	Index	Low	440,000	145,000,000
3	Deutsche Asset Management (3)	Index	Low	1,788,400	75,000,000
4	The Vanguard Group (6)	Index	Low	5,550,000	71,500,000
5	State Street Bank and Tr. Co. Boston (4)	Index	Low	2,110,600	70,900,000
6	Janus Capital Corporation (5)	Growth	High	(6,400,000)	62,200,000
7	Alliance Capital Management L.P. (7)	Growth	Medium	(8,227,600)	42,100,000
8	TIAA-CREF Investment Management Inc. (8)	Index	Low	534,400	38,648,000
9	Massachusetts Financial Services Co. (11)	Growth	Medium	757,400	34,723,000
10	American Century Investment Mgmt. (10)	Growth	High	504,000	34,641,000
11	Putnam Investment Management (9)	Value	Medium	(1,400,000)	32,800,000
12	Mellon Bank, N.A. (13)	Index	Low	-	30,000,000
13	California Public Employees Rtmnt. (14)	Index	Low	(1,612,000)	26,188,000
14	American Express Financial Advisors (16)	Growth	Medium	2,888,000	25,888,000
15	Smith Barney Investment Advisers (18)	Value	Low	2,790,000	25,590,000

- Institutional ownership in MSFT fell 3% in the quarter to 42% overall ownership.
- Three of our top institutional holders continued their rotation out of tech stocks during the quarter with Fidelity selling 11%, Alliance 16%, and Janus 9%. The Vanguard Group added 8% to their position during the quarter.
- Retail shareholders continued to compensate for institutional selling by purchasing 53 million shares during the quarter, now owning 27% of MSFT outstanding shares.

INVESTOR RELATIONS SIGNIFICANT EVENTS

- Microsoft executives presented at five Wall Street investor conferences in the June quarter. Steve Ballmer keynoted the PaineWebber Growth & Technology Conference, Craig Mundie presented at the Hambrecht & Quist 27th Annual Technology Conference, Craig Fiebig spoke at the Bear Stearns 10th Annual Technology Conference, while Greg Maffei presented at both the Thomas Weisel Internet Conference and the Ragen MacKenzie Technology Conference.
- Carla Lewis completed a European Tour in May, presenting to several hundred investors in five cities including Amsterdam, The Hague, Zurich, Geneva, and London.
- Microsoft Investor Relations was recently named a finalist in the 1999 CFO Excellence Awards Program sponsored by CFO Magazine.
- The 1998 Microsoft annual report was accepted for the Mead Annual Report Show. Each year only 25 annual reports are selected for touring around 50 cities in the U.S. and Canada.
- The IR annual satisfaction survey conducted among 150 top Wall Street analysts and investors concluded that over 95% of the respondents are satisfied (very with the level of service and information they receive from Microsoft IR. The percentage "very satisified" (68%), is among the highest ever recorded among Microsoft's audiences. Over 80% believe Microsoft's IR program is better than other companies they follow.

Industry Watch

INDUSTRY HIGHLIGHTS

(Prices as of July 30, 1999)

ORACLE ($38 1/16)

- Oracle reported net income of $527 million, or 36 cents a share, up from $403 million, or 27 cents a share, in the same quarter last year. Analyst expectations were 32 cents. Revenue grew 22% to $2.9 billion, with licensing revenue up 22% over last year's quarter, database revenue increased 25%, applications software increased 28%, and services increased 22%.
- Oracle plans to triple its ad budget to $150 million, in attempt to compete with IBM e-business theme. Oracle is talking of potential initial public stock offerings to several Oracle units, including the e-Travel business that provides travel management services. Oracle acquired eTravel in March for $35 million. Business Online, Oracle's application outsourcing business to rent Oracle software to customers, is another IPO candidate.
- Oracle announced Oracle Exchange, an open business-to-business online marketplace. Oracle Exchange provides an e-business procurement community where a company can buy business goods and services using any purchasing technique. Unlike competitive offerings that can only link customers with those suppliers who use the same proprietary software, Oracle Exchange is available to any company and does not require Oracle software. In support of Oracle Exchange, more than 260 companies currently will make available their purchasing-related content and services to Exchange participants via the Oracle Supplier Network.
- Oracle's Internet Sourcing is slated to be available by year-end 1999. This new Internet bid management software package will support buyer auctions conducted through Oracle Exchange, and will be able to create and distribute requisition forms, and supplier bids over the Web.
- After Oracle's analyst day, many analysts believe the company is undergoing dramatic changes in its business and strategy. Evidence continues to build that Oracle is in the midst of a major business transition, with ERP-related business weighing in at 50% of DBMS business, but facing low growth rates, and the booming Internet/e-commerce still too small to accelerate license revenue growth. In addition, Oracle's plans to slow its consulting growth and improve relations with the "big five" consulting firms to help its emerging CRM applications business represents another significant shift. Finally, the company's plans to extract substantial costs from the business, while positive longer term, will also contribute to a short-term period of low growth.
- Some analysts believe Oracle's shift to server-based pricing introduces some risk into Oracle forecasts. The problem centers around user-based licensing models when users can not be identified by the organization owning the database application, because more and more of the users are external to the organization. This has resulted in tiered user pricing (i.e., lower prices based on access profiles) and server-based pricing for situations like extranets and intranets, where user counts are impossible to predict or even count with accuracy. One solution is to license databases based on server capacity or use (IBM has already adopted this pricing model). Server-based pricing is likely to proliferate, while Oracle's seat-based pricing models will become unmanageable by 2001/02.
- Oracle signed a 3-year, multi-million dollar deal with ISG Software to license software based on OLE DB that will become a key part of its Oracle 8i server. Oracle has in past years opposed using OLE DB, a data access specification, in favor of its own technology. The product, ISG Navigator, is a bundle of software that is used to link dissimilar applications, databases, and other data sources. ISG was one of the first companies to endorse OLE DB, a universal data access specification, several years ago.

SUN MICROSYSTEMS ($67 7/8)

- The Sun-Netscape Alliance will release new server software designed to help companies build e-commerce sites. The new version of

Netscape Application Server should offer Java support, reliability, and faster performance. The software helps companies create e-commerce web sites by processing transactions and running the business logic--or rules--of applications, and linking browser-based clients to databases and other software.

- Motorola and Sun announced a technology pact through which Sun will help Motorola build a wireless IP based network. The deal is initially valued at $1 billion over 10 years. Motorola will run Solaris on back-end application servers and Sun's real-time Chorus OS on the front-end Controllers and Base stations for its network. This agreement allows Sun to provide a part of wireless switching infrastructures. Sun wants to eventually leverage this into other switch manufactures such as Lucent, Alcatel, or Nortel.
- Sun unveiled a new Java technology, Java Server Pages, or JSP, which was designed to make it easier to send out custom-built web pages with changing content. The technology runs on Web servers using special tags in the web page description to invoke specific operations in the web server. Sun said the technology will be used for both simple web servers and more complex web-based applications.
- Sun reorganized management of its three software-related groups. About 1,000 Sun employees were reassigned from Sun's three software-related divisions to the Sun-Netscape alliance, which calls for Sun to resell and help develop Netscape server software. Among those committed to the effort was Mark Tolliver, the former head of the consumer and embedded division and now the leader of the joint venture.
- Sun revised its plan to gain recognition for its Java programming language as an international software standard from the International Standards Organization (ISO). Sun had been working with the ISO's Joint Technical Committee, but was unhappy with the degree of control the committee would have over the Java specification, and is considering other routes to getting Java adopted by ISO. One alternate is to go through the European Computer Manufacturers Association (ECMA). Sun struggles to balance Java's promotion with the ability to maintain control over the technology. Alan Baratz, president of Sun's software division, blamed Microsoft, H-P, and the so-called Wintel world in general for creating an environment he described as unfavorable to gaining ISO recognition. JTC1 is a joint committee of ISO and the International Electrotechnical Commission, which created the JTC1's "evolving" Publicly Available Specifications process.

IBM ($125 11/16)

- IBM posted June quarter net income of $2.4 billion, including a tax benefit of $687 million, as revenue rose by 16 percent. Beating analyst estimates by three cents per share, earnings were 91 cents per share, excluding a tax-related gain of 37 cents per share. Revenue grew to $21.9 billion from $18.8 billion in the June quarter of 1998. Hardware grew to $9.4 billion in the June quarter, an increase of 22 percent. Revenue from computer services business grew 15 percent to $8.0 billion. Excluding maintenance, IBM Global Services, which now amounts to the mainstay of IBM's business, rose 19 percent to $6.7 billion. During the quarter, IBM signed $9.5 billion in new services contracts and had a total services backlog of future contracts of about $55.2 billion at the end of June.
- IBM announced WebSphere Application Server Enterprise Edition, delivers computing power by leveraging Enterprise JavaBeans (EJB) technology, which enables customers to easily integrate disparate business systems -- such as databases and transaction processing systems -- and extend them to the Web.
- IBM's Gerstner said $20 billion, a quarter of IBM's revenue, is related to "e-business," including sales over the Internet, computer consulting and installation and software products that manage data and transactions. IBM expects its 1999 Internet sales to be between $10 billion and $15 billion.

NOVELL ($25 3/4)

- Novell's net income for the April quarter rose to $39 million, or 11 cents a share, from $19 million, or 5 cents, a year ago. The results were one cent greater than analyst expectations. Revenue for the quarter rose 20 percent to $316 million from $262 million. EMEA grew by 35% to $105 million. Asia PAC grew by 23% to $26 million, and the US grew by 13% to $169 million. The revenue upside was driven by stronger than expected growth of 41% in the company's directory enabled NetWare products (NetWare 4 & 5). NetWare 5, which shipped late last fall with Internet standards, contributed $91 million in the quarter, a sequential increase of 68%. NetWare 5 adoption appears particularly strong in the low to mid markets and in Europe. The overall server operating systems business grew 26% to $188 million, as the declines in NetWare 3 revenue continue to cause a drag on overall growth. Novell increased its consulting personnel - growing from 190 to 260 during the quarter. Novell plans to field 300 consultants by October 1999.

- Novell will ship the Novell Internet Messaging System (NIMS), formerly code-named Liberty, a messaging server tailored to ISPs. The server uses the Novell Directory Service (NDS) software to offer ISPs a messaging server for deploying Web email, and programmability options that allow ISPs to create custom message applications, as well as implementing mail ad insertions.
- Since the beginning of the year, Novell has introduced several new products and betas including NDS for Sun Solaris, NDS v.8, Novell Net Publisher, Novell Small Business Suite 5, Novell Cluster Services, Novell WebPublisher, Novell Branch Manager, and GroupWise 5.5. NDS 8.0 aspires to tackle the needs of telecommunications carriers and service providers. Novell says it has a 50-million user base for NDS.
- Novell acquired Ukiah Software, Inc., a privately held developer of policy-based network management software. Novell expects to incorporate Ukiah's policy-based traffic monitoring and bandwidth-shaping technology into a new directory-enabled network management product to be available by the end of 1999.
- Novell announced the acquisition of Netoria, a maker of software for computer network administrators. Novell plans to integrate Netoria products and technology into its NDS product line. Novell plans by the end of the year to ship a version of NDS that runs on the Linux operating system. The new version will allow companies to integrate NDS-based Linux servers with servers running Windows NT, NetWare, and Solaris operating systems.
- Novell plans to extend its NDS technology through a product effort named internally Virtual Replica. Novell plans to serve as a so-called over-arching software layer that can connect and synchronize different databases and directories of information housed on a network. The technology would build on a basic interoperability method called LDAP, Lightweight Directory Access Protocol.

AOL ($97 1/8)

- AOL reported a June quarter operating profit of $226 million. Including taxes but excluding special charges, AOL earned $156 million, or 13 cents a share, beating analysts expectations by 2 cents. For the full fiscal year, AOL generated net income of $396 million on sales of $4.8 billion. The number of new subscribers grew to 755,000, better than the 670,000 new subs added in the same period a year ago. The additional membership, however, fell below the highest analyst estimate of 800,000. Weakness in Europe dampened overall growth, which analysts had expected.
- AOL is rumored to be in talks with Microworkz Inc., a manufacturer of inexpensive computers, to produce AOL-branded PCs. At the PCExpo, Microworkz announced its new $200 computer/Internet appliance, called the iToaster.
- AOL and 3Com announced an arrangement that lets AOL users get their e-mail in Palm Pilot devices; the deal also calls for the two companies to explore distribution of an AOL-branded wireless handheld organizers based on the Palm Computing platform, 3Com's Palm VII organizer and Web clipping technologies, and Sun Microsystems Inc.'s Java II technology for the United States and international markets.
- AOL said it would make a $1.5 billion investment in Hughes Electronics, the owner of DirecTV and DirectPC, and the two will form an alliance to offer high-speed Internet service via satellite nationwide.
- Free Internet providers have grabbed market share in Europe, slowing AOL's growth. Most free ISPs make their money by selling onscreen advertising, but it is uncertain whether advertisers will spend enough on the free services to make them profitable. In Europe, Internet users pay the telephone company for the time they spend online. The phone company then pays the ISP a portion of its revenue from those calls. In the U.S. however, most free ISPs require users to submit to a permanent advertising banner and have limited customer service and technical support.
- Some of the key takeaways from AOL's analyst day include: AOL is seeing 98% renewal rates in their big deals. AOL 5.0, the next version of the client software, should be out by the end of the

year. On the broadband side, no new news was announced, though AOL did comment that it considers broadband an add-on to narrowband, not a replacement cycle. Some analysts believe the Netscape/Sun/AOL alliance may pay off for AOL, however several still feel the integration of Netscape enterprise software business is still a large risk due to the challenges of the non-core business-to-business sector. It is being marketed as a one stop solution for Internet traffic and the alliance has a 700 person sales force, a large Sun sales force, and a possible 35,000 consulting/service sales force (e.g. EDS, Andersen, Price Waterhouse Coopers) pushing the all-in-one solution of traffic, software, and hardware.

- AOL announced SHOP@AOL, a platform that will attempt to make the shopping experience on AOL more convenient, while incorporating new initiatives that are designed to drive sales for retail partners. AOL will try and capture the 'brand shopper' as well as offer promotions for the 'impulse buyer'. AOL will also offer the option to aggregate their entire shopping into one credit card transaction through AOL's 'Quick Checkout'.
- Subscriber growth rate for the June quarter will most likely meet the low-end of estimates. The guidance range was between 750,000 and 850,000 new subscribers and management has indicated that the growth rate will fall on the low end of this range. AOL's subscriber growth performance in past quarters has consistently surpassed expectations. International subscriber growth rate is weak compared to overall strength in North America. The "free access" movement in the U.K., in which Dixon's Freeserve holds the No. 1 ISP position, significantly slowed AOL's growth. AOL has reacted to this threat by dropping its prices in the U.K. market. All of AOL's international operations are joint-ventures and the revenue consolidates with the ventures until profitable, therefore the shortfall in international subscribers will not affect AOL's current quarter revenue. However, AOL's international presence is crucial to its overall growth story.
- AOL was upgraded to a Strong Buy from an Outperform by Morgan Stanley Dean Witter in May.

OTHER

- Red Hat, the number one seller of the Linux operating system, filed for an initial public offering. The company plans to raise $97 million and will trade on the Nasdaq under the ticker symbol "RHAT." It is tentatively scheduled to begin trading the week of August 9. For the February fiscal year end, Red Hat earned $11 million in revenue, compared to $5 million for the same period a year ago. About 7 percent of its yearly revenue came from services and the remainder from sales of software and related products. The company posted a net loss of $130 thousand for fiscal 1999. Red Hat plans to use the funds for working capital and other purposes, such as geographic expansion or acquiring businesses, products, and technologies.
- VA Linux Systems unveiled its Linux.com discussion and information web site. The new site will let users chat on the site in a model based on the discussion site Slashdot. In addition, it will offer information on tuning Linux to work as fast as possible, technical and general information on Linux, and a list of Linux user groups.
- The inventors of the PalmPilot are setting up a new hand-held company, Handspring, along with their PalmPilot OS, which 3Com is licensing to potential competitors in hopes of making it ubiquitous.
- Be (Nasdaq: BEOS), an Internet appliance software developer, went public on Tuesday, July 20. Be had planned to price between $8 and $10. Instead, it went out at $6, raising $36 million, some $33 million less than it had hoped. It most recently traded at $6 13/16. Some analysts say the market didn't believe the Be story. After originally positioning itself as an operating system alternative to Microsoft, it moved into the Internet appliance space in hopes of attracting investor interest. With hardware prices dropping sharply, the market for inexpensive devices focused on Net access could rise. However, the Internet appliance market is still immature. The price of devices such as Internet telephones must come down substantially or be subsidized by the likes of phone companies for the market to really take off.

Appendix

NOTES TO CONSOLIDATED MANAGEMENT REPORTS

- The consolidated management P&L is based on functional responsibility and prepared in accordance with Microsoft accounting policies (MAP). These results exclude the impact of certain adjustments and reclassifications required by generally accepted accounting principles (GAAP) for external reporting, non-operating items, and income taxes. Significant differences between MAP and GAAP results are described in the bullets following.
- Revenue under MAP is generally recognized "as billed". Under GAAP, net revenue includes adjustments for certain billed, but unearned revenue, such as a portion of operating system revenue that will be recognized over the product life cycle. Conversely, certain revenue that is earned but not yet billed, such as unreported OEM and select revenue, is also recognized for external purposes.
- Interactive Media Joint Venture expenses represent Microsoft's share of joint venture operating loss. These product development costs are reflected as non-operating expenses for GAAP purposes.
- For external reporting purposes, all product marketing related activities are classified as a sales and marketing expense. For internal reporting purposes, product marketing departments and related marketing expenses are included in product development.
- For external reporting, the amounts received from customers for the product support services (PSS), consulting (MSC), and MCP/MCSP certification and training are reclassified as revenue. Direct costs of these activities are reclassified to cost of revenue from sales and marketing.

GENERAL & ADMINISTRATIVE

REPORTING DEFINITIONS

- General and administrative (G&A) costs include functional corporate cost centers that support MS on a worldwide basis such as general human resources, facilities, finance, legal services, IT project development and infrastructure. Costs such as recruiting, employee benefits, employee services, IT infrastructure and facilities costs are distributed to domestic product, sales, and administrative groups.
- For internal management reports, net G&A costs are allocated to the channels and product groups as part of corporate allocations.
- Distributions are costs where typically a G&A group controls the unit cost and the receiving business unit drives unit consumption. For example, human resources and administrative services manages the benefit costs per person, but employees and their covered dependents drive total benefit costs. Distributions are based on a standard rate per domestic headcount, except recruiting costs which are distributed to product sales and administrative groups based on the number of new hires.

COST CATEGORIES

- ITG costs include application development, regional support, and distributed infrastructure costs. These costs are driven primarily by demand from supported organizations for new technology and tools, support of existing systems, and sales increased demands on the corporate WAN and telecommunications network.
- Human resources costs are driven primarily by employee headcount. Allocated expenses include employee development, payroll, and stock administration. Distributed HR costs include recruiting and domestic employee benefits such as health insurance, 401(k) match, and health club dues.
- Employee services group provides administrative support including building services, library services, mail, food and beverage, administrative procurement, travel services, and copy centers. These costs are driven by user demand and are indirectly correlated to headcount growth.
- Real estate and facilities costs include allocated functional costs related to facilities planning and development that are driven primarily by growth in domestic headcount and distributed infra-structure costs such as depreciation, rent, utilities, and maintenance which are driven by the number of employees and contingent staff using MS facilities.
- Finance, legal, and executive costs are corporate functional groups supporting MS on a worldwide basis.

COST OF REVENUE - DEFINITIONS

- Cost of revenue includes product costs, royalties, pipe and channel costs, and the cost of obsolete and scrapped inventory as described below. The cost of product engineering, configuration and testing prior to release are included as well as the activities of purchasing, manufacturing, and assembling finished goods. In addition, the activities of supply chain management, customer operations, licensing/contract administration, program management, and all the associated costs of IT systems and support are part of cost of revenue.

PRODUCT COSTS

- Standard product costs represent both the standard material cost for media, manuals, packaging, hardware and collateral per a bill of materials (BOM) for each product as well as labor and overhead expenses incurred in the procurement and assembly of physical product.
- Other costs include expenses for hardware tooling, prep charges incurred to establish the manufacturing process for a product, cancellation fees, blueline scrap, and recost impacts.
- Purchasing variances include material purchase price variances (PPV), turnkey PPV, purchase discounts, expediting or change order charges with turnkey vendors, and freight-in and duty/customs expenses incurred to ship raw materials to the location of final assembly or packaging.
- Manufacturing variances represent manufacturing costs incurred in the internal or external assembly of product which are not included in the standard product cost. This includes operating expenses to manage turnkey vendors, manufacturing absorption variances, material usage variances, BOM variances and variances related to outsourcing packaged product.
- Program costs and variances represent the material costs of Select Welcome and Upgrade kits as well as any product costs incurred for programs such as MSDN, TechNet or Courseware not included in Standard Product Cost. Cost recovery programs such as MSP (Solution Provider) are charged to marketing operations.

ROYALTIES

- Royalties include payments to third parties for the right to use intellectual property in MS products.
- The Royalty P&L line item includes both third party royalty payments and the payment or amortization of license fees.

BUSINESS OPERATIONS

- Business operations represent all of the operating expenses incurred by an individual organization or by a worldwide organization in direct support of the various revenue-generating business streams of MS. These operations include primarily customer operations (order processing, billing, and collection), supply chain management, program management, worldwide licensing, and project management.
- Distribution represents internal and external costs of picking and packing MS products, including operating expenses of the distribution department, storage costs of finished goods and shipping supplies.
- Central services represent all of the operating expenses incurred by centralized organizations that provide supporting functions across all pipes and business streams. These include OBS expenses, hardware operating expenses, operations management and planning, supply base management, and product information and release services.
- Online telecom consists of network costs for Internet connectivity and network access for MSN Subscribers as well as internal expenses for the MSN Network and online operations groups.
- Online data center captures all facilities, maintenance, operational support and staffing of the online data center including MS internal data center operations people and infrastructure costs, and external contracts for facilities and maintenance costs.
- Online processing is comprised of credit card processing fees, Internet advertising tracking and reporting costs, and financial operations people and infrastructure expenses for the MSN and online operations groups.

OBSOLETE & SCRAPPED INVENTORY

- Damaged and obsolete inventory includes charges for in-house scrap, provision for inventory obsolescence, and cycle count adjustments. Costs included in damaged and obsolete inventory are primarily results of actions by the regional operation service centers (ROSCs).
- Returns scrap and rework includes the material, labor, and overhead of product scrapped and/or reworked and the operating expenses of the returns department and outsourced labor.

CHANNEL COSTS

- Local customer operations primarily includes all costs related to fulfillment including programs at both the MS international sales locations and ROSCs. Additionally, this line item includes all customer operations activities (order processing, billing and collection activities) incurred by MS international sales locations.
- Freight includes freight out on finished goods product shipped to customers or subsidiary locations and any related duty and customs charges on importing/exporting of finished product into international subsidiary locations. Freight is net of any reimbursements from customers or distributors.

BUSINESS STREAM DEFINITIONS

- Channel full packaged product (FPP) includes Software FPP, MLPs and hardware sales. Hardware sales include both OEM and retail activity.
- Licensing includes OEM and retail channel revenue and costs. Retail channel revenue includes Select and Open billings, and costs include associated disks and documents.

THE MICROSOFT FAMILY OF FUNDS

During Q95-4, MS's cash investment portfolio was migrated into five distinct sub-portfolios - four fixed-income portfolios and one opportunity portfolio. Each portfolio is a separate mutual fund or risk bucket, with unique guidelines and risk/return expectations. Collectively, the portfolios are the MS "Family of Funds". In Q97-4, the original Family of Funds performance benchmarks were replaced with benchmarks exhibiting higher return expectations and moderate increases in risk.

With this strategy, MS is increasing the sophistication of our portfolio management efforts, focusing on Total Rate-of-Return portfolio management (as opposed to yield-to-maturity) and using duration as a risk management tool (instead of term-to-maturity).

The goals of this strategy are to:

- Segregate the cash portfolio into individual funds of a more manageable size.
- Enhance the total return on Microsoft's Cash assets.
- Establish risk and return expectations for each Fund.
- Provide pro-active risk management of financial assets.
- Benchmark performance relative to market indices.
- Allow allocation of cash among the various risk segments of the short-term fixed-income market.

Following is a high level summary of the general guidelines of each Fund:

- **Level 1: Money Market Fund**–Designed to meet the operating cash requirements of MS Corporation, and other legal entities, MS MBV, MS IBV, MS Ireland, MSLI, MS Tsy, MS Operations and MS Puerto Rico, this fund has a targeted duration of 20-45 days and a maximum maturity of 91 days. Little principal value fluctuation is expected. Benchmark: 30-Day US Commercial Paper.
- **Level 2: Enhanced Money Market Fund**–Designed as a secondary source of liquidity supporting the Money Market Fund, this fund has a maximum maturity of 13 months. The longer targeted duration of 2 to 6 months, will provide opportunity for increased return with a modest increase in risk. A small amount of principal value fluctuation is expected. Benchmark: 90-Day US LIBOR.
- **Level 3: Short-term Fixed Income Fund**–This fund will carry an increased focus on interest rate changes, security sectors and temporary market anomalies to provide the opportunity for returns above money market rates. Duration is further extended to a target of 1.25 to 2.25 years. Some principal value fluctuation is expected, and negative monthly total returns may occur occasionally. Benchmark: 50% Lehman Brothers Corporate/50% Government 1-3 Year Index.
- **Level 4: Intermediate Fixed Income Fund**–An actively managed portfolio with a targeted duration of 2.5 to 4.0 years. This "short bond fund" will focus on the optimal security type, sector, and credit risk to achieve superior returns. Principal value fluctuation is expected. Months with negative returns will occur and an occasional negative quarter is possible. Benchmark: 50% Lehman Brothers Corporate/50% Government 3-5 Yr. Index.
- **Level 5: Opportunity Fund**–An actively managed portfolio with a targeted duration of 5.5 years. This "long bond fund" will focus on the optimal security type, sector, and credit risk to achieve superior returns. Principal value fluctuation is expected. Months with negative returns will occur and an occasional negative quarter is possible. This fund requires senior management approval of transactions based on current guideline policy, and does not carry specific maturity constraint. Benchmark: Lehman Brothers Government/Corporate.

Q99-4 GROSS REVENUE SUMMARY

($000s)	[illegible]				[illegible]				
	A	B	V	V	A	B	V	V	[illegible]
Office - Standard (FPP/MLP)	72,997	67,394	5,603	8%	222,267	186,181	36,086	19%	-
Office - Standard (Open)	107,319	97,883	9,436	10%	391,692	327,237	64,455	20%	-
Office - Standard (Select/OEM)	125,150	137,858	(12,708)	(9%)	520,832	577,523	(56,691)	(10%)	-
Office - Standard (Academic-FPP/MLP)	13,213	10,502	2,711	26%	106,391	88,397	17,994	20%	-
Office - Standard (Academic-Open/Select)	21,691	13,418	8,273	62%	429,359	248,546	180,813	73%	-
Small Business Edition - Standard	98,944	107,961	(9,017)	(8%)	843,784	1,245,261	(401,477)	(32%)	-
Small Business Edition (DSP) - Standard	42,396	24,435	17,960	74%	157,439	124,112	33,327	27%	-
Office - Standard Product	481,710	459,452	22,258	5%	2,671,764	2,797,257	(125,493)	(4%)	-
Office Professional - Standard (FPP/MLP)	103,823	97,876	5,947	6%	234,062	234,865	(803)	(0%)	-
Office Professional - Standard (Open)	102,114	87,486	14,627	17%	303,275	257,563	45,712	18%	-
Office Professional - Standard (Select/OEM)	226,954	141,699	85,255	60%	888,344	585,697	302,647	52%	-
Office Professional - Standard (Academic-FPP/MLP)	32,222	21,456	10,766	50%	228,043	165,303	62,740	38%	-
Office Professional - Standard (Academic-Open/Select)	47,462	32,526	14,936	46%	1,279,733	567,843	711,890	125%	-
Office Professional - Standard Product	512,575	381,044	131,531	35%	2,933,457	1,811,271	1,122,186	62%	-
Office Premium - Standard	37,930	36,022	1,908	5%	62,365	93,936	(31,571)	(34%)	-
All Office - Standard Product	1,032,215	876,518	155,697	18%	5,667,586	4,702,464	965,122	21%	-
Office - Upgrade (FPP/MLP)	86,102	59,117	26,985	46%	423,877	294,672	129,205	44%	-
Office - Upgrade (Select/Open)	154,804	124,146	30,658	25%	992,161	826,202	165,959	20%	-
Office - Upgrade (Academic/Other)	2,535	361	2,174	601%	52,881	10,057	42,824	426%	-
Small Business Edition - Upgrade	35,232	19,863	15,369	77%	244,761	110,308	134,453	122%	-
Office - Upgrade	278,674	203,487	75,187	37%	1,713,680	1,241,239	472,441	38%	-
Office Professional - Upgrade (FPP/MLP)	147,638	91,031	56,607	62%	559,048	346,287	212,761	61%	-
Office Professional - Upgrade (Select/Open)	138,975	127,996	10,979	9%	712,936	716,381	(3,445)	(0%)	-
Office Professional - Upgrade (Academic/Other)	8,581	2,946	5,635	191%	161,993	53,021	108,972	206%	-
Office Professional - Upgrade	295,194	221,973	73,221	33%	1,433,977	1,115,689	318,288	29%	-
Office Premium - Upgrade	92,725	33,236	59,489	179%	268,322	128,753	139,569	108%	-
All Office - Upgrade Product	666,593	458,697	207,896	45%	3,415,979	2,485,681	930,298	37%	-
All Office Standard and Upgrade - Total	1,698,808	1,335,215	363,593	27%	9,083,565	7,188,145	1,895,420	26%	-
Word/Excel Bundle - Standard	98,212	45,690	52,522	115%	940,801	566,001	374,800	66%	-
Standalone Office Apps - Standard	69,113	58,447	10,666	18%	2,606,085	1,126,152	1,479,933	131%	-
Standalone Office Apps - Upgrade	20,930	15,549	5,381	35%	273,910	210,689	63,221	30%	-
Project	83,526	78,066	5,460	7%	351,083	310,224	40,859	13%	-
Publisher	20,139	14,980	5,160	34%	502,654	263,278	239,376	91%	-
FrontPage	28,253	24,271	3,983	16%	738,167	313,438	424,729	136%	-
PhotoDraw	1,120	5,729	(4,609)	(80%)	16,098	60,525	(44,427)	(73%)	-
Other DAD	11,834	8,538	3,296	39%	374,969	160,549	214,420	134%	-
Desktop Applications (Non-Office) - Total	333,127	251,268	81,859	33%	5,803,767	3,010,856	2,792,911	93%	-
DAD Enterprise Agreements	308,715	224,096	84,619	38%	3,455,620	1,905,428	1,550,192	81%	-
DAD EA Deferred/Recognized	(115,577)	(70,224)	(45,352)	65%	-	-	-	-	-
DAD Recognized Maintenance	74,986	52,767	22,218	42%	845,142	529,349	315,793	60%	-
Desktop Applications Division - Total	2,300,059	1,793,122	506,936	28%	19,188,094	12,633,778	6,554,316	52%	-
Windows NT CALs - Standard (Open/Other)	43,333	41,315	2,018	5%	2,274,634	1,945,535	329,099	17%	1,410
Windows NT CALs - Standard (Select)	21,680	20,404	1,276	6%	1,056,023	1,010,117	45,906	5%	-
Windows NT CALs - Upgrade	5,708	6,708	(1,000)	(15%)	513,424	593,312	(79,888)	(13%)	-
Windows NT Server - Standard (FPP/MLP)	151,368	147,740	3,628	2%	250,130	258,745	(8,615)	(3%)	1,391,800
Windows NT Server - Standard (Open/Select)	66,155	47,382	18,773	40%	139,923	122,104	17,819	15%	5,755
Windows NT Server - Upgrade	10,501	16,089	(5,589)	(35%)	48,969	60,432	(11,463)	(19%)	109,290
Windows NT Server - Enterprise	23,793	9,759	14,033	144%	12,041	4,403	7,638	173%	48,500
Windows NT Server	251,816	220,970	30,846	14%	451,063	445,684	5,379	1%	1,555,345
SQL CALs (Open/Other)	20,048	17,344	2,705	16%	257,884	201,885	55,999	28%	793
SQL CALs (Select)	10,518	11,000	(481)	(4%)	142,989	154,281	(11,292)	(7%)	-
SQL Server - Standard (FPP/MLP)	32,231	27,875	4,356	16%	28,373	23,136	5,237	23%	165,000
SQL Server - Standard (Open/Select)	16,104	9,885	6,218	63%	22,931	18,199	4,732	26%	-
SQL Server - Upgrade	4,649	4,081	568	14%	9,830	10,550	(720)	(7%)	30,225
SQL Runtime	2,169	4,838	(2,669)	(55%)	28,895	82,836	(53,941)	(65%)	34,718
SQL Server	52,983	41,841	11,142	27%	61,134	51,885	9,249	18%	195,225
Exchange CALs (Open/Other)	31,411	36,420	(5,009)	(14%)	1,141,895	1,057,383	84,512	8%	222
Exchange CALs (Select)	25,377	28,818	(3,441)	(12%)	815,113	942,212	(127,099)	(13%)	-
Exchange Server - Standard	12,505	17,099	(4,594)	(27%)	20,563	22,731	(2,168)	(10%)	85,440
Exchange Enterprise Server - Standard	6,401	12,324	(5,923)	(48%)	5,305	8,494	(3,189)	(38%)	17,250
Exchange Server - Upgrade (All)	3,932	3,536	395	11%	8,750	7,658	1,092	14%	7,745
Exchange Server	22,838	32,960	(10,122)	(31%)	34,618	38,883	(4,265)	(11%)	110,435
BackOffice CALs (Open/Other)	29,032	31,765	(2,733)	(9%)	301,686	262,015	39,671	15%	-
BackOffice CALs (Select)	31,889	36,603	(4,715)	(13%)	654,722	337,706	317,016	94%	-
BackOffice Server - Standard (FPP/MLP)	7,635	12,354	(4,719)	(38%)	4,314	6,928	(2,614)	(38%)	11,590
BackOffice Server - Standard (Open/Select)	16,779	18,475	(1,696)	(9%)	13,976	15,414	(1,438)	(9%)	-
BackOffice Server - Upgrade	6,209	5,922	287	5%	5,768	6,286	(518)	(8%)	9,450
BackOffice Server	30,622	36,750	(6,128)	(17%)	24,058	28,628	(4,570)	(16%)	21,040

Q99-4 GROSS REVENUE SUMMARY (CONTINUED)

(000s)	R				L				
	A	B	V	V	A	B	V	V	FY A CAL
Small Business Server	18,138	45,306	(27,168)	(60%)	19,014	36,588	(17,574)	(48%)	91,325
SMS CALs	23,480	16,767	6,713	40%	1,078,489	674,239	404,250	60%	-
SMS Server	4,576	2,930	1,645	56%	11,279	8,736	2,543	29%	31,445
SNA CALs	4,310	4,704	(395)	(8%)	153,470	151,341	2,129	1%	-
SNA Server	3,485	4,162	(677)	(16%)	5,350	6,334	(984)	(16%)	7,435
Proxy Server	6,436	7,075	(638)	(9%)	10,600	11,284	(684)	(6%)	-
Business Systems Courseware	28,520	27,461	1,058	4%	253,337	243,508	9,829	4%	-
Commerce Server	2,569	5,377	(2,808)	(52%)	1,965	5,003	(3,038)	(61%)	11,235
Other Business Systems	40,762	10,159	30,603	301%	585,684	162,252	423,432	261%	77,491
BSD Enterprise Agreements	146,331	95,660	50,671	53%	4,457,990	2,419,748	2,038,242	84%	-
BSD EA Deferred/Recognized	(58,739)	(28,062)	(30,678)	109%	-	-	-	-	-
BSD Recognized Maintenance	33,734	15,436	18,298	119%	2,031,793	908,226	1,123,567	124%	8,188
Business Systems Division - Total	833,025	774,711	58,314	8%	16,367,109	11,779,621	4,587,488	39%	2,136,307
Visual Basic	26,275	29,163	(2,888)	(10%)	139,662	152,956	(13,294)	(9%)	-
Visual C++	13,106	14,886	(1,779)	(12%)	74,484	83,423	(8,939)	(11%)	-
Visual J++	(336)	2,089	(2,425)	(116%)	(3,118)	24,957	(28,075)	(112%)	-
Visual InterDev	974	1,441	(467)	(32%)	3,520	5,599	(2,079)	(37%)	-
Office Developers Edition	14,504	7,034	7,470	106%	33,773	19,581	14,192	72%	-
MS Mastering	735	5,105	(4,370)	(86%)	9,194	51,720	(42,526)	(82%)	-
Visual Studio - Pro	10,947	8,151	2,796	34%	391,942	22,001	369,941	1000%	-
Visual Studio - Enterprise	25,174	14,237	10,937	77%	39,723	19,464	20,259	104%	-
Visual FoxPro	3,449	2,512	938	37%	14,362	13,822	540	4%	-
MSDN Universal	39,005	30,918	8,088	26%	20,380	16,651	3,729	22%	-
MSDN Other	6,082	8,302	(2,221)	(27%)	15,659	21,461	(5,802)	(27%)	-
Other Developer Tools	12,247	3,838	8,409	219%	60,387	53,441	6,946	13%	-
Tools Division - Total	152,163	127,677	24,486	19%	799,968	485,076	314,892	65%	-
Windows 9X - Standard	954,156	875,051	79,105	9%	17,211,172	16,079,974	1,131,198	7%	-
Windows 9X - Upgrade	72,210	75,447	(3,236)	(4%)	979,955	1,005,424	(25,469)	(3%)	-
Windows NT Workstation - Standard	432,567	383,314	49,254	13%	4,483,680	3,562,652	921,028	26%	-
Windows NT Workstation - Upgrade	81,260	70,975	10,285	14%	700,808	686,703	14,105	2%	-
MS Plus!	923	2,284	(1,361)	(60%)	97,775	125,312	(27,537)	(22%)	-
IE Starter Kit/Other	5,833	130	5,703	1000%	680,041	5,949	674,092	1000%	-
Other Platforms - Desktop	19,398	16,142	3,255	20%	1,348,254	657,678	690,576	105%	-
Platforms-Desktop Enterprise Agrmts	172,488	132,002	40,486	31%	3,084,926	2,387,102	697,824	29%	-
PDD EA Deferred/Recognized	(65,543)	(42,160)	(23,383)	55%	-	-	-	-	-
PDD Recognized Maintenance	28,211	20,791	7,420	36%	694,458	265,282	429,176	162%	-
Platforms - Desktop Division - Total	1,701,503	1,533,977	167,526	11%	29,281,069	24,776,076	4,504,993	18%	-
SoftImage Division	-	-	-	-	-	-	-	-	-
Consumer Platforms Division	5,438	11,488	(6,050)	(53%)	271,161	657,757	(386,596)	(59%)	-
Total Platforms and Applications Group - Total	4,992,188	4,240,975	751,213	18%	65,907	50,332	15,575,093	31%	2,136,307
Games - Action/Strategy	852	26,883	(26,032)	(97%)	504,733	930,429	(425,696)	(46%)	-
Games - Simulation	7,210	21,607	(14,397)	(67%)	433,334	702,997	(269,663)	(38%)	-
Games - Sports	1,706	2,585	(880)	(34%)	213,307	578,179	(364,872)	(63%)	-
Encarta	10,532	15,075	(4,543)	(30%)	19,099,064	1,717,331	17,381,733	1000%	-
Home Essentials & Works	35,346	39,820	(4,474)	(11%)	5,090,588	3,651,116	1,439,472	39%	-
Graphics Studio	1,144	2,720	(1,576)	(58%)	175,592	581,513	(405,921)	(70%)	-
Other LED(Kids,Geo,Bookshelf,Atlas)	17,818	10,741	7,077	66%	133,799,872	1,351,939	132,447,933	1000%	-
Learning & Entertainment Division - Total	74,607	119,432	(44,825)	(38%)	159,316,490	9,513,504	149,802,986	1000%	-
Interactive Service Media	35,299	28,131	7,169	25%	410,069,512	328,454,464	81,615,048	25%	-
Microsoft Network	122,764	131,907	(9,143)	(7%)	2,047,723,836	5,442,786,483	(3,395,062,647)	(62%)	-
Commercial Internet Server	2,215	2,872	(658)	(23%)	1,937,437	65,155	1,872,282	1000%	-
Microsoft Network Division - Total	124,979	134,779	(9,801)	(7%)	2,049,661,273	5,442,851,638	(3,393,190,365)	(62%)	-
WebTV	54,756	65,142	(10,386)	(16%)	1,181,363,182	27	1,181,363,155	1000%	-
Keyboards	9,504	10,583	(1,079)	(10%)	370,687	406,204	(35,517)	(9%)	-
Mouse	59,407	78,388	(18,981)	(24%)	5,573,166	7,355,109	(1,781,943)	(24%)	-
Gamepads / Freestyle Pro	2,553	3,011	(458)	(15%)	103,884	99,621	4,263	4%	-
Joysticks · FFB Wheel	4,992	15,658	(10,665)	(68%)	98,383	234,273	(135,890)	(58%)	-
Actimates	(1,455)	4,165	(5,619)	(135%)	(30,365)	82,160	(112,525)	(137%)	-
Speakers · Phone · Other Hardware	3,106	7,250	(4,144)	(57%)	33,785	51,044	(17,259)	(34%)	-
Hardware Division - Total	78,108	119,055	(40,947)	(34%)	6,149,540	8,228,411	(2,078,871)	(25%)	-
Desktop Finance Division - Total	6,302	9,030	(2,728)	(30%)	227,053,189	109,250,209	117,802,980	108%	-
Product Group - Total	5,366,239	4,716,543	649,696	14%	4,099,520,587	5,948,630,561	(1,849,109,974)	(31%)	2,136,307
Press	45,918	56,984	(11,067)	(19%)	5,688,832	-	5,688,832	-	-
Technet	12,235	8,737	3,498	40%	37,732	31,590	6,142	19%	-
Other (Mac, MES, Xenix, OS2)	18,871	11,934	6,937	58%	176,297,376	429,021	175,868,355	1000%	57,425
80/20 Allocation Total	(0)	67	(67)	(100%)	-	-	-	-	-
Revenue Revenue	5,443,263	4,794,266	648,997	14%	4,281,544,527	5,949,091,172	(1,667,546,645)	(28%)	2,193,732

**Bundled CALs indicate client licenses bundled with server products. Not Included in Rev Lic calculation.*

FY99 GROSS REVENUE SUMMARY

(000s)	A	B	V	V	A	B	V	V	FY A CAL
Office - Standard (FPP/MLP)	276,511	266,905	9,606	4%	928,611	737,825	190,786	26%	-
Office - Standard (Open)	378,486	370,912	7,574	2%	1,292,385	1,239,133	53,252	4%	-
Office - Standard (Select/OEM)	560,681	566,654	(5,973)	(1%)	2,360,154	2,376,691	(16,537)	(1%)	-
Office - Standard (Academic-FPP/MLP)	45,049	46,334	(1,285)	(3%)	350,193	384,980	(34,787)	(9%)	-
Office - Standard (Academic-Open/Select)	72,797	49,791	23,006	46%	1,342,739	930,554	412,185	44%	-
Small Business Edition - Standard	377,781	413,203	(35,422)	(9%)	3,320,934	4,739,147	(1,418,213)	(30%)	-
Small Business Edition (DSP) - Standard	162,168	92,320	69,849	76%	875,444	466,298	409,146	88%	-
Office - Standard Product	1,873,471	1,806,118	67,355	4%	10,470,460	10,874,628	(404,168)	(4%)	-
Office Professional - Standard (FPP/MLP)	303,932	354,352	(50,420)	(14%)	689,848	834,999	(145,151)	(17%)	-
Office Professional - Standard (Open)	333,405	325,152	8,254	3%	939,244	933,388	5,856	1%	-
Office Professional - Standard (Select/OEM)	823,666	563,508	260,158	46%	3,183,467	2,313,531	869,936	38%	-
Office Professional - Standard (Academic-FPP/MLP)	79,886	92,271	(12,385)	(13%)	598,008	728,173	(130,165)	(18%)	-
Office Professional - Standard (Academic-Open/Select)	168,567	136,692	31,875	23%	3,778,520	2,461,486	1,317,034	54%	-
Office Professional - Standard Product	1,709,457	1,471,975	237,482	16%	9,209,087	7,291,577	1,917,510	26%	-
Office Premium - Standard	37,930	51,555	(13,625)	(26%)	62,365	132,794	(70,429)	(53%)	-
All Office - Standard Product	3,620,860	3,329,649	291,212	9%	19,741,912	18,298,999	1,442,913	8%	-
Office - Upgrade (FPP/MLP)	237,056	238,693	(1,637)	(1%)	1,134,550	1,179,588	(45,038)	(4%)	-
Office - Upgrade (Select/Open)	563,076	491,838	71,238	14%	3,537,407	3,256,141	281,266	9%	-
Office - Upgrade (Academic/Other)	12,146	1,404	10,743	765%	236,308	39,059	197,249	505%	-
Small Business Edition - Upgrade	71,212	74,727	(3,515)	(5%)	430,824	407,207	23,617	6%	-
Office - Upgrade	883,490	806,662	76,828	10%	5,339,089	4,881,995	457,094	9%	-
Office Professional - Upgrade (FPP/MLP)	332,994	352,370	(19,376)	(5%)	1,238,190	1,326,684	(88,494)	(7%)	-
Office Professional - Upgrade (Select/Open)	519,259	496,384	22,875	5%	2,679,800	2,772,054	(92,254)	(3%)	-
Office Professional - Upgrade (Academic/Other)	32,819	11,442	21,377	187%	538,378	205,914	332,464	161%	-
Office Professional - Upgrade	885,071	860,195	24,876	3%	4,456,368	4,304,652	151,716	4%	-
Office Premium - Upgrade	92,725	51,265	41,460	81%	268,322	189,530	78,792	42%	-
All Office - Upgrade Product	1,861,286	1,718,123	143,164	8%	10,063,779	9,376,177	687,602	7%	-
All Office Standard and Upgrade - Total	5,482,147	5,047,771	434,375	9%	29,805,691	27,675,176	2,130,515	8%	-
Word/Excel Bundle - Standard	357,570	166,637	190,933	115%	3,616,290	2,064,294	1,551,996	75%	-
Standalone Office Apps - Standard	256,347	213,576	42,771	20%	7,457,272	4,454,017	3,003,255	67%	-
Standalone Office Apps - Upgrade	74,957	56,860	18,098	32%	976,761	768,673	208,088	27%	-
Project	336,989	314,540	22,449	7%	1,354,143	1,247,836	106,307	9%	-
Publisher	59,464	56,415	3,050	5%	1,581,983	969,903	612,080	63%	-
FrontPage	77,349	78,363	(1,014)	(1%)	1,777,230	1,022,334	754,896	74%	-
PhotoDraw	10,973	15,797	(4,824)	(31%)	104,986	162,781	(57,795)	(36%)	-
Other DAD	53,793	39,595	14,198	36%	2,041,297	792,881	1,248,416	157%	-
Desktop Applications (Non-Office) - Total	1,227,442	941,783	285,660	30%	18,909,962	11,482,719	7,427,243	65%	-
DAD Enterprise Agreements	819,075	661,573	157,503	24%	9,161,495	6,950,504	2,210,991	32%	-
DAD EA Deferred/Recognized	(277,955)	(206,764)	(71,192)	34%	-	-	-	-	-
DAD Recognized Maintenance	325,159	202,616	122,543	60%	3,308,007	2,104,048	1,203,959	57%	-
Desktop Applications Division - Total	7,575,868	6,646,979	928,889	14%	61,185,155	48,212,447	12,972,708	27%	-
Windows NT CALs - Standard (Open/Other)	163,939	162,306	1,633	1%	8,227,352	7,542,912	684,440	9%	3,830
Windows NT CALs - Standard (Select)	80,984	82,487	(1,503)	(2%)	3,846,523	4,099,267	(252,744)	(6%)	-
Windows NT CALs - Upgrade	25,321	26,105	(784)	(3%)	2,212,465	2,316,783	(104,318)	(5%)	-
Windows NT Server - Standard (FPP/MLP)	552,110	548,213	3,897	1%	904,920	943,559	(38,639)	(4%)	5,202,690
Windows NT Server - Standard (Open/Select)	221,143	190,447	30,695	16%	467,242	486,983	(19,741)	(4%)	12,365
Windows NT Server - Upgrade	63,767	71,745	(7,978)	(11%)	206,446	269,561	(63,115)	(23%)	759,130
Windows NT Server - Enterprise	82,062	37,300	44,762	120%	38,760	16,881	21,879	130%	210,875
Windows NT Server	919,081	847,704	71,377	8%	1,617,368	1,716,984	(99,616)	(6%)	6,185,060
SQL CALs (Open/Other)	66,899	55,280	11,619	21%	813,574	644,991	168,583	26%	1,288
SQL CALs (Select)	34,150	34,463	(314)	(1%)	442,676	480,970	(38,294)	(8%)	-
SQL Server - Standard (FPP/MLP)	122,117	100,995	21,122	21%	101,408	82,642	18,766	23%	627,800
SQL Server - Standard (Open/Select)	48,914	35,321	13,593	38%	74,897	65,004	9,893	15%	-
SQL Server - Upgrade	15,308	11,440	3,868	34%	30,795	30,163	632	2%	107,620
SQL Runtime	8,663	15,823	(7,160)	(45%)	135,090	263,502	(128,412)	(49%)	36,848
SQL Server	186,339	147,756	38,584	26%	207,100	177,809	29,291	16%	735,420
Exchange CALs (Open/Other)	123,409	133,606	(10,197)	(8%)	4,224,336	3,863,007	361,329	9%	282
Exchange CALs (Select)	99,033	104,397	(5,364)	(5%)	3,104,901	3,390,867	(285,966)	(8%)	-
Exchange Server - Standard	52,653	63,068	(10,415)	(17%)	74,726	83,521	(8,795)	(11%)	370,070
Exchange Enterprise Server - Standard	28,243	45,605	(17,363)	(38%)	20,654	31,560	(10,906)	(35%)	98,275
Exchange Server - Upgrade (All)	16,242	13,308	2,935	22%	35,384	29,076	6,308	22%	33,015
Exchange Server	97,138	121,981	(24,843)	(20%)	130,764	144,157	(13,393)	(9%)	501,960
BackOffice CALs (Open/Other)	128,749	110,871	17,878	16%	1,391,188	910,622	480,566	53%	-
BackOffice CALs (Select)	131,329	132,077	(748)	(1%)	2,039,353	1,245,346	794,007	64%	-
BackOffice Server - Standard (FPP/MLP)	33,760	43,382	(9,623)	(22%)	20,913	24,155	(3,242)	(13%)	11,590
BackOffice Server - Standard (Open/Select)	58,727	70,473	(11,746)	(17%)	48,101	61,438	(13,337)	(22%)	-
BackOffice Server - Upgrade	25,021	21,364	3,657	17%	25,748	22,577	3,171	14%	16,925
BackOffice Server	117,508	135,219	(17,712)	(13%)	94,762	108,170	(13,408)	(12%)	28,515

AUTHOR: COLETTE KRESS (COLETTEK)

FY99 GROSS REVENUE SUMMARY (CONTINUED)

(000s)	R A	R B	R V	R V	L A	L B	L V	L V	FY A CAL
Small Business Server	82,472	157,062	(74,590)	(47%)	77,536	127,829	(50,293)	(39%)	498,880
SMS CALs	71,198	69,046	2,152	3%	2,821,772	2,705,999	115,773	4%	-
SMS Server	12,364	11,358	1,006	9%	31,305	32,863	(1,558)	(5%)	65,375
SNA CALs	18,642	19,051	(409)	(2%)	607,183	619,754	(12,571)	(2%)	-
SNA Server	13,941	17,016	(3,075)	(18%)	24,293	24,919	(626)	(3%)	25,730
Proxy Server	26,939	26,957	(18)	(0%)	42,943	43,044	(101)	(0%)	-
Business Systems Courseware	133,870	110,533	23,337	21%	1,121,735	970,555	151,180	16%	-
Commerce Server	8,512	20,491	(11,978)	(58%)	6,739	21,625	(14,886)	(69%)	40,965
Other Business Systems	90,491	38,859	51,631	133%	2,522,850	619,682	1,903,168	307%	81,968
BSD Enterprise Agreements	371,199	279,552	91,647	33%	10,907,009	6,905,938	4,001,071	58%	-
BSD EA Deferred/Recognized	(120,362)	(79,862)	(40,500)	51%	-	-	-	-	-
BSD Recognized Maintenance	101,615	57,293	44,322	77%	5,815,360	3,639,552	2,175,808	60%	15,847
Business Systems Division - Total	2,993,424	2,837,434	155,990	5%	52,466,177	42,617,147	9,849,030	23%	8,221,968
Visual Basic	121,526	135,899	(14,374)	(11%)	679,864	717,312	(37,448)	(5%)	-
Visual C++	65,625	70,006	(4,381)	(6%)	400,306	389,304	11,002	3%	-
Visual J++	5,655	10,945	(5,291)	(48%)	88,778	126,664	(37,886)	(30%)	-
Visual InterDev	4,839	7,304	(2,465)	(34%)	19,203	29,460	(10,257)	(35%)	-
Office Developers Edition	29,485	30,502	(1,017)	(3%)	74,934	84,954	(10,020)	(12%)	-
MS Mastering	4,134	22,012	(17,877)	(81%)	51,642	229,009	(177,367)	(77%)	-
Visual Studio - Pro	61,428	40,099	21,329	53%	907,357	109,348	798,009	730%	-
Visual Studio - Enterprise	139,897	75,648	64,250	85%	193,589	107,491	86,098	80%	-
Visual FoxPro	15,745	11,318	4,427	39%	85,243	61,010	24,233	40%	-
MSDN Universal	150,579	116,116	34,462	30%	79,376	62,280	17,096	27%	-
MSDN Other	24,672	32,484	(7,812)	(24%)	66,063	83,939	(17,876)	(21%)	-
Other Developer Tools	51,612	17,422	34,190	196%	315,856	208,315	107,541	52%	-
Tools Division - Total	675,196	569,755	105,441	19%	2,962,211	2,209,086	753,125	34%	-
Windows 9X - Standard	3,871,519	3,498,765	372,754	11%	68,485,046	63,907,709	4,577,337	7%	-
Windows 9X - Upgrade	386,729	309,674	77,055	25%	7,069,488	4,367,529	2,701,959	62%	-
Windows NT Workstation - Standard	1,508,222	1,279,882	228,340	18%	14,796,145	11,949,391	2,846,754	24%	-
Windows NT Workstation - Upgrade	368,110	283,628	84,482	30%	3,027,245	2,693,691	333,554	12%	-
MS Plus!	17,410	13,598	3,812	28%	784,062	668,118	115,944	17%	-
IE Starter Kit Other	15,168	524	14,644	1000%	214,768	22,966	191,802	835%	-
Other Platforms - Desktop	85,590	72,790	12,801	18%	6,015,061	2,964,704	3,050,357	103%	-
Platforms-Desktop Enterprise Agrmts	461,211	386,398	74,813	19%	8,342,276	6,832,298	1,509,978	22%	-
PDD EA Deferred/Recognized	(161,598)	(126,259)	(35,339)	28%	-	-	-	-	-
PDD Recognized Maintenance	149,000	101,173	47,827	47%	2,699,185	1,112,806	1,586,379	143%	-
Platforms - Desktop Division Total	6,701,362	5,820,173	881,189	15%	111,433,276	94,519,212	16,914,064	18%	-
SoftImage Division	2,401	-	2,401	-	1,476	-	1,476	-	-
Consumer Platforms Division	22,989	33,870	(10,881)	(32%)	1,342,499	1,826,227	(483,728)	(26%)	-
Total Platforms and Applications Group - Total	17,971,241	15,908,212	2,063,029	13%	229,391	189,384	40,006,675	21%	8,221,968
Games - Action Strategy	72,095	95,955	(23,860)	(25%)	5,997,381	3,507,560	2,489,821	71%	-
Games - Simulation	80,106	76,913	3,193	4%	2,932,963	2,587,205	345,758	13%	-
Games - Sports	8,700	19,899	(11,199)	(56%)	1,788,634	2,569,115	(780,481)	(30%)	-
Encarta	104,186	120,775	(16,589)	(14%)	46,308,977	7,913,815	38,395,162	485%	-
Home Essentials & Works	187,267	183,852	3,415	2%	15,780,080	15,168,881	611,199	4%	-
Graphics Studio	23,986	28,895	(4,908)	(17%)	1,820,208	2,839,265	(1,019,057)	(36%)	-
Other LED (Kids, Geo, Bookshelf, Atlas)	71,371	62,851	8,519	14%	412,867,771	6,000,130	406,867,641	1000%	-
Learning & Entertainment Division - Total	547,712	589,141	(41,429)	(7%)	487,496,014	40,585,971	446,910,043	1000%	-
Interactive Service Media	84,694	77,661	7,033	9%	630,266,002	1,023,687,226	(393,421,224)	(38%)	-
Microsoft Network	440,980	403,337	37,643	9%	4,705,393,069	17,702,576,361	(12,997,183,292)	(73%)	-
Commercial Internet Server	10,049	13,755	(3,707)	(27%)	8,774,581	240,322	8,534,259	1000%	-
Microsoft Network Division - Total	451,028	417,092	33,936	8%	4,714,167,650	17,702,816,683	(12,988,649,033)	(73%)	-
WebTV	166,279	176,974	(10,695)	(6%)	2,006,047,662	108	2,006,047,554	1000%	-
Keyboards	44,381	48,245	(3,864)	(8%)	1,578,213	1,750,751	(172,538)	(10%)	-
Mouse	281,583	311,867	(30,284)	(10%)	24,127,747	27,034,783	(2,907,036)	(11%)	-
Gamepads - Freestyle Pro	48,906	28,722	20,184	70%	1,504,573	871,295	633,278	73%	-
Joysticks - FFB Wheel	92,382	104,624	(12,242)	(12%)	1,288,600	1,503,517	(214,917)	(14%)	-
Actimates	40,622	64,969	(24,347)	(37%)	703,075	1,144,051	(440,976)	(39%)	-
Speakers - Phone - Other Hardware	16,881	31,672	(14,791)	(47%)	144,698	228,038	(83,340)	(37%)	-
Hardware Division - Total	524,754	590,099	(65,345)	(11%)	29,346,906	32,532,435	(3,185,529)	(10%)	-
Desktop Finance Division - Total	54,932	61,971	(7,039)	(11%)	525,904,022	385,848,642	140,055,380	36%	-
Product Group - Total	19,800,630	17,821,139	1,979,491	11%	8,622,619,050	19,374,855,184	(10,752,236,134)	(55%)	8,221,968
Press	141,199	199,072	(57,873)	(29%)	12,996,162	-	12,996,162	-	-
Technet	38,940	31,828	7,113	22%	122,295	116,072	6,223	5%	-
Other (Man, MES, Xenix, OS2)	79,493	42,960	36,534	85%	183,230,946	1,810,288	181,420,658	1000%	238,405
50/20 Allocation Total	0	(0)	0	(154%)	-	-	-	-	-
Revenue Revenue	20,060,272	18,095,008	1,965,264	11%	8,818,968,453	19,376,781,544	(10,557,813,091)	(54%)	8,460,373

**Bundled CALs indicate client licenses bundled with server products. Not included in Rev/Lic calculation*

BALANCE SHEETS

(in millions)	Mar. 31, 1999	June 30, 1999	Change
Assets			
Current assets:			
Cash and short-term investments	$ 21,761	$ 17,236	$ (4,525)
Accounts receivable	1,689	2,245	556
Other	608	752	144
Total current assets	24,058	20,233	(3,825)
Property and equipment	1,445	1,611	166
Equity investments	7,474	14,372	6,898
Other assets	584	940	356
Total assets	$ 33,561	$ 37,156	$ 3,595
Liabilities and stockholders' equity			
Current liabilities:			
Accounts payable	$ 1,016	$ 874	$ (142)
Accrued compensation	289	396	107
Income taxes payable	1,347	1,607	260
Unearned revenue	4,195	4,239	44
Other	992	1,602	610
Total current liabilities	7,839	8,718	879
Stockholders' equity:			
Convertible preferred stock	980	980	0
Common stock and paid-in capital	12,418	13,844	1,426
Retained earnings	12,324	13,614	1,290
Total stockholders' equity	25,722	28,438	2,716
Total liabilities and stockholders' equity	$ 33,561	$ 37,156	$ 3,595

HEADCOUNT

	Mar-99	Jun-99		vs Mar-99		vs Plan	
		Actual	Plan	# of heads	%	# of heads	%
SPAR FG	2,757	2,807	2,908	50	(2%)	(101)	3%
EMEA FG	2,184	2,140	2,188	(44)	2%	(48)	2%
Asia FG	911	897	968	(14)	2%	(71)	7%
Total FG	5,852	5,844	6,064	(8)	0%	(220)	4%
WW G&A	467	471	470	4	(1%)	1	(0%)
WW PSS	4,485	4,660	4,740	175	(4%)	(80)	2%
WW OEM	369	400	379	31	(8%)	21	(6%)
WW MCS	2,273	2,423	2,509	150	(7%)	(86)	3%
VP	119	134	127	15	(13%)	7	(6%)
Other	429	624	619	195	(45%)	5	(1%)
Sales, Marketing and Support Total	13,994	14,556	14,908	562	(4%)	(352)	2%
Business Divisions:							
Business & Enterprise Group	2,221	2,339	2,583	118	(5%)	(244)	9%
Business Productivity Group	3,313	3,327	3,661	14	(0%)	(334)	9%
Consumer and Commerce Group	2,256	2,408	2,368	152	(7%)	40	(2%)
Consumer Windows	801	828	1,061	27	(3%)	(233)	22%
Developer Group	1,926	2,064	2,189	138	(7%)	(125)	6%
Business Divisions Total	10,517	10,966	11,862	449	(4%)	(896)	8%
Home & Retail	1,037	1,154	1,080	117	(11%)	74	(7%)
MS Research	424	451	463	27	(6%)	(12)	3%
Press	108	118	127	10	(9%)	(9)	7%
Product Development Total	12,086	12,689	13,532	603	(5%)	(843)	6%
General & Administrative							
Info Technology Group	917	1,106	998	189	(21%)	108	(11%)
HR/Admin Services	551	571	543	20	(4%)	28	(5%)
Executive Staff	15	26	9	11	(73%)	17	(189%)
Legal & Corporate Affairs	437	451	473	14	(3%)	(22)	5%
Finance	770	787	864	17	(2%)	(77)	9%
Corporate Marketing	32	22	29	(10)	31%	(7)	24%
General and Administrative Total	2,722	2,963	2,916	241	(9%)	47	(2%)
Operations	1,235	1,177	1,262	(58)	5%	(85)	7%
Total Headcount	30,037	31,385	32,618	1,348	(4%)	(1,233)	4%

FY00 PLAN

CONSOLIDATED P&L

(in millions)	FY00 Plan		FY99 Actual		Growth
Revsum revenue	$22,716.3	102.7%	$20,060.3	105.3%	13%
Revenue adjustments	(603.2)	(2.7%)	(1,001.6)	(5.3%)	(40%)
Net revenue	22,113.1	100.0%	19,058.7	100.0%	16%
Cost of revenue	1,932.5	8.7%	1,613.8	8.5%	20%
Gross profit	20,180.6	91.3%	17,444.9	91.5%	16%
Operating expenses:					
Product development:					
Business & Enterprise Division	836.8	3.8%	586.2	3.1%	43%
Consumer Windows	269.2	1.2%	215.2	1.1%	25%
Streaming Media	94.6	0.4%	45.7	0.2%	107%
Business Productivity	1,083.0	4.9%	825.9	4.3%	31%
Developer	649.3	2.9%	446.4	2.3%	45%
Consumer and Commerce	1,145.4	5.2%	804.7	4.2%	42%
Business Divisions	4,078.4	18.4%	2,924.1	15.3%	39%
Home & Retail	337.7	1.5%	305.9	1.6%	10%
MS Research	198.8	0.9%	124.4	0.7%	60%
Unspecified & other products	51.0	0.2%	68.5	0.4%	(26%)
Product development total	4,665.9	21.1%	3,422.8	18.0%	36%
Product marketing:					
Business & Enterprise Group	69.8	0.3%	73.6	0.4%	(5%)
Consumer Windows	15.8	0.1%	23.8	0.1%	(34%)
Streaming Media	33.3	0.2%	11.4	0.1%	192%
Business Productivity Group	199.1	0.9%	130.1	0.7%	53%
Developer Group	57.4	0.3%	68.1	0.4%	(16%)
Consumer and Commerce Group	775.0	3.5%	178.7	0.9%	334%
Business Divisions	1,150.4	5.2%	485.7	2.5%	137%
Home & Retail	43.0	0.2%	55.9	0.3%	(23%)
MS Research	15.2	0.1%	8.2	0.0%	85%
Unspecified & other products	3.1	0.0%	2.7	0.0%	17%
Product marketing total	1,211.7	5.5%	552.5	2.9%	119%
Sales expense:					
SPAR FG	718.8	3.3%	543.0	2.8%	32%
EMEA FG	509.7	2.3%	434.8	2.3%	17%
Asia FG	170.3	0.8%	146.4	0.8%	16%
Total FG	1,398.8	6.3%	1,124.2	5.9%	24%
OEM	131.7	0.6%	186.4	1.0%	(29%)
Online	123.0	0.6%	115.2	0.6%	7%
Other	182.6	0.8%	174.5	0.9%	5%
Sales expense total	1,836.1	8.3%	1,600.3	8.4%	15%
Product support (net of revenue)	918.6	4.2%	720.0	3.8%	28%
MCS (net of revenue)	134.4	0.6%	86.7	0.5%	55%
Channel G&A costs	137.2	0.6%	90.6	0.5%	52%
Channel marketing:					
SPAR	621.4	2.8%	475.8	2.5%	31%
EMEA	450.2	2.0%	357.9	1.9%	26%
Asia	202.5	0.9%	166.9	0.9%	21%
TV Advertising/Broad reach	40.0	0.2%	79.5	0.4%	(50%)
Corp HQ	-	-	12.1	0.1%	(100%)
Channel marketing total	1,314.1	5.9%	1,092.2	5.7%	20%
General and administrative	776.3	3.5%	695.1	3.6%	12%
Total operating expenses	10,994.4	49.7%	8,260.1	43.3%	33%
Operating income	$9,186.3	41.5%	$9,184.7	48.2%	0%

Note: CCG is not final. FY99 has been restated for Employee Stock Option expense.

FY00 PRODUCT P&L

	Business Productivity Group	CCG	CCG Plat	Developer Group	Business & Enterprise	Consumer Windows	Streaming Media	Business Divisions Total	Home & Retail	MS Research	Other	Total
RevSum Revenue	8,417.2	1,299.6	80.0	1,482.3	5,155.1	4,633.8	-	21,067.9	1,185.5	-	462.9	22,716.3
Revenue Adjustments	(56.0)	(16.6)	(0.5)	(73.3)	(188.3)	(90.8)	-	(425.5)	(105.0)	-	(72.6)	(603.1)
Net Revenue	8,361.3	1,283.0	79.6	1,408.9	4,966.7	4,543.0	-	20,642.4	1,080.4	-	390.3	22,113.1
Cost of Revenue												
Product Costs	117.6	8.9	-	69.7	63.0	17.2	-	276.4	306.8	-	90.4	673.6
Royalties	4.4	4.5	-	0.2	(8.5)	-	-	0.5	28.7	-	18.7	47.9
Business Operations	98.3	589.7	2.6	21.2	45.3	27.0	-	784.0	53.6	-	12.8	850.4
Obso/Damaged Inventory	22.7	1.9	-	3.4	8.5	7.5	-	44.0	27.4	-	6.2	77.6
Channel Costs	43.4	8.4	20.3	27.9	22.6	7.2	-	129.8	26.3	-	126.8	282.9
Cost of Revenue	286.3	613.4	22.8	122.4	131.0	58.8	-	1,234.7	442.8	-	254.9	1,932.5
Gross Margin	8,075.0	669.5	56.7	1,286.6	4,835.7	4,484.2	-	19,407.7	637.6	-	135.4	20,180.6
Direct Controllable Operating Expenses:												
Regular Headcount Expense	609.9	570.3	66.8	435.3	446.4	158.7	55.6	2,343.0	193.3	140.4	73.5	2,750.2
Other Headcount Expense	92.2	98.9	9.3	43.7	105.5	41.9	11.1	402.6	26.4	11.8	5.4	446.2
Infrastructure Expense	139.7	162.2	10.3	100.6	127.5	45.2	15.9	601.4	37.4	23.3	11.2	673.2
Product Development	134.3	215.9	2.2	48.0	98.7	15.4	14.2	528.8	47.4	21.9	16.4	614.5
Acquisition Amortization	41.0	36.0	-	-	-	-	-	77.0	13.5	-	-	90.5
External Localization	49.3	28.5	1.0	19.8	34.2	19.8	2.1	154.8	21.9	-	4.5	181.1
Product Marketing	201.9	739.9	35.0	57.4	76.8	15.8	30.0	1,156.7	36.6	15.2	3.1	1,211.7
Channel Mktg Controllable	-	99.0	1.5	-	-	-	-	100.5	-	-	9.6	110.2
Other	14.0	48.4	(15.0)	1.2	(5.2)	0.0	-	43.5	0.4	1.2	7.9	53.0
Direct Controllable Operating Expens	1,282.3	1,999.2	111.0	706.1	883.9	296.9	128.8	5,408.3	376.8	213.7	131.7	6,130.5
Product-Related Operating Expenses:												
Taxes, Insurance, & Settlements	0.1	7.9	0.1	0.0	0.1	0.0	-	8.2	0.0	0.0	0.0	8.2
Product Support Services	271.5	135.8	0.3	145.2	227.6	145.7	0.0	926.2	22.5	-	0.0	948.7
Loc Proc Dist to COGS	-	-	-	-	-	-	-	-	-	-	-	-
Bad Debt Expense	21.8	33.3	0.8	3.2	16.5	19.1	-	94.7	3.1	-	0.3	98.2
R&D Shared Resources	5.8	(12.2)	1.1	(43.8)	8.7	25.4	6.7	(8.4)	8.5	(0.7)	0.7	0.0
Product-Related Operating Expenses	299.1	164.8	2.2	104.7	252.9	190.3	6.7	1,020.7	34.1	(8.7)	1.0	1,055.0
TOTAL Operating Expenses	1,581.5	2,164.0	113.2	810.8	1,136.8	487.2	135.5	6,428.9	410.9	213.0	132.7	7,185.6
Responsibility Margin	6,493.5	(1,494.5)	(56.5)	475.8	3,699.0	3,997.0	(135.5)	12,978.8	226.7	(213.0)	2.6	12,995.1
Allocations	1,707.5	169.9	19.8	461.1	939.1	264.4	13.6	3,575.5	196.2	28.6	8.4	3,808.6
Over/Under Allocated												(0.1)
Contribution Margin	4,786.0	(1,664.4)	(76.3)	14.7	2,759.8	3,732.6	(149.1)	9,403.3	30.5	(241.6)	(5.7)	9,186.3

FY00 CHANNEL P&L

	SPAR	% Net Rev	EMEA	% Net Rev	Asia	% Net Rev	Total IC	% Net Rev	Total OEM	% Net Rev	On Line	% Net Rev	Other	% Net Rev	Total	% Net Rev
Net Revenue																
RevSum Revenue	7,134.3	103.4%	4,975.1	103.6%	2,033.4	100.9%	14,142.9	103.1%	7,722.3	101.4%	1,299.3	100.3%	189.0	162.4%	22,716.3	102.7%
Revenue Adjustments	(231.7)	(3.4%)	(172.2)	(3.6%)	(18.2)	(0.9%)	(422.0)	(3.1%)	(104.8)	(1.4%)	(3.8)	(0.3%)	(72.6)	(62.4%)	(603.1)	(2.7%)
Net Revenue	6,902.7	100.0%	4,803.0	100.0%	2,015.2	100.0%	13,720.9	100.0%	7,617.5	100.0%	1,295.5	100.0%	116.4	100.0%	22,113.1	100.0%
Cost of Revenue																
Product Costs	267.9	3.9%	190.7	4.0%	78.0	3.9%	536.6	3.9%	101.7	1.3%	-	0.0%	35.4	30.4%	673.6	3.0%
Royalties	16.3	0.2%	10.7	0.2%	6.1	0.3%	33.1	0.2%	1.6	0.0%	4.5	0.3%	9.0	7.7%	47.9	0.2%
Business Operations	110.1	1.6%	79.4	1.7%	32.7	1.6%	222.2	1.6%	32.6	0.4%	595.3	46.0%	0.3	0.3%	850.4	3.8%
Obsolete & Scrapped Inv	32.8	0.5%	25.2	0.5%	11.0	0.5%	69.0	0.5%	2.9	0.0%	-	0.0%	5.6	4.8%	77.6	0.4%
Channel Costs	152.8	2.2%	58.1	1.2%	23.9	1.2%	234.8	1.7%	2.2	0.0%	26.7	2.1%	18.7	16.1%	282.9	1.3%
Costs of Revenue	579.9	8.4%	364.0	7.6%	151.8	7.5%	1,095.7	8.0%	141.4	1.9%	626.5	48.4%	69.0	59.3%	1,932.5	8.7%
Gross Margin	6,322.8	91.6%	4,438.9	92.4%	1,863.5	92.5%	12,625.1	92.0%	7,476.1	98.1%	669.1	51.6%	47.4	40.7%	20,180.6	91.3%
Sales Expense																
Total Regular Headcount Ex	541.3	7.8%	369.1	7.7%	112.8	5.6%	1,023.2	7.5%	81.7	1.1%	57.4	4.4%	95.0	81.6%	1,257.3	5.7%
Total Other Headcount Exp	10.6	0.2%	15.6	0.3%	3.7	0.2%	29.9	0.2%	1.0	0.0%	1.7	0.1%	5.9	5.1%	38.6	0.2%
Vendors	30.7	0.4%	29.8	0.6%	8.0	0.4%	68.5	0.5%	0.7	0.0%	0.3	0.0%	14.0	12.0%	83.4	0.4%
Infrastructure	115.6	1.7%	75.9	1.6%	34.0	1.7%	225.5	1.6%	13.4	0.2%	13.0	1.0%	52.4	45.1%	304.3	1.4%
Other Misc Expenses	20.7	0.3%	19.3	0.4%	11.8	0.6%	51.8	0.4%	34.9	0.5%	50.6	3.9%	15.2	13.1%	152.5	0.7%
Sales Expense	718.8	10.4%	509.7	10.6%	170.3	8.5%	1,398.8	10.2%	131.7	1.7%	123.0	9.5%	182.6	156.9%	1,836.1	8.3%
Marketing:																
Marketing Spend	498.2	7.2%	393.4	8.2%	179.5	8.9%	1,071.1	7.8%	67.0	0.9%	100.5	7.8%	35.5	30.5%	1,274.1	5.8%
Marketing Recovery	-	0.0%	-	0.0%	-	0.0%	-	0.0%	-	0.0%	-	0.0%	-	0.0%	-	0.0%
TV Advertising	40.0	0.6%	-	0.0%	-	0.0%	40.0	0.3%	-	0.0%	-	0.0%	-	0.0%	40.0	0.2%
Product Marketing	367.0	5.3%	-	0.0%	-	0.0%	367.0	2.7%	51.3	0.7%	775.0	59.8%	18.3	15.7%	1,211.7	5.5%
Marketing (Net)	905.2	13.1%	393.4	8.2%	179.5	8.9%	1,478.1	10.8%	118.3	1.6%	875.5	67.6%	53.8	46.2%	2,525.8	11.4%
PSS (Net)	545.7	7.9%	165.7	3.4%	71.4	3.5%	782.7	5.7%	7.4	0.1%	128.5	9.9%	-	0.0%	918.6	4.2%
Net MCS	101.7	1.5%	23.1	0.5%	9.6	0.5%	134.4	1.0%	-	0.0%	-	0.0%	-	0.0%	134.4	0.6%
G&A Costs	57.1	0.8%	44.3	0.9%	11.1	0.5%	112.5	0.8%	2.1	0.0%	2.3	0.2%	0.3	0.3%	117.2	0.5%
Operating Expenses	2,328.5	33.7%	1,136.3	23.7%	441.8	21.9%	3,906.6	28.5%	259.6	3.4%	1,129.3	87.2%	236.7	203.3%	5,532.1	25.0%
Responsibility Margin	3,994.2	57.9%	3,302.7	68.8%	1,421.6	70.5%	8,718.5	63.5%	7,216.5	94.7%	(460.2)	(35.5%)	(189.3)	(162.6%)	14,648.5	66.2%
Shared Resources	107.8	1.6%	77.6	1.6%	30.9	1.5%	216.3	1.6%	6.9	0.1%	0.0	0.0%	(142.4)	(122.3%)	80.8	0.4%
Corporate Allocations	1,547.8	22.4%	1,011.3	21.1%	454.1	22.5%	3,013.3	22.0%	1,365.3	17.9%	967.0	74.6%	42.1	36.2%	5,381.4	24.3%
Contribution Margin	2,338.6	33.9%	2,213.7	46.1%	936.6	46.5%	5,489.0	40.0%	5,844.3	76.7%	(1,427.2)	(110.2%)	(89.1)	(76.5%)	9,186.3	41.5%

Note: CCG is not final. FY99 has been restated for Employee Stock Option expense.

REVENUE SUMMARY

	Revenue			Licenses		
	Actual FY99	Budget FY00	Growth	Actual FY99	Budget FY00	Growth
Windows NTS/2000	918,932	1,155,563	26%	1,615,257	2,101,938	30%
Windows NTS/2000 Server CALs	270,242	322,558	19%	14,284,625	16,397,301	15%
Windows NTW/2000 Pro - Standard	1,754,702	1,954,571	11%	15,788,506	19,210,105	22%
Windows NTW/2000 Pro - Upgrade	120,358	118,002	(2%)	1,120,967	974,469	(13%)
Windows NTW/2000 Pro - ROEM	-	248,101	-	-	1,545,408	-
Business & Enterprise Annuity/EA	308,621	569,037	84%	10,850,606	14,344,271	32%
Courseware	133,870	139,370	4%	1,121,735	1,188,829	6%
Other Business & Enterprise	268,559	276,400	3%	9,165,367	6,853,237	(25%)
Business & Enterprise Division - Total	3,775,284	4,783,602	27%	53,947,063	62,615,558	16%
Windows 9X - Upgrade	386,729	341,864	(12%)	7,069,488	4,426,580	(37%)
Other Consumer Windows	4,063,651	4,284,108	5%	76,774,141	79,096,574	3%
Consumer Windows Division - Total	4,450,380	4,625,972	4%	83,843,629	83,523,154	(0%)
Office & Office Pro - FPP/MLP Standard	674,986	491,557	(27%)	1,858,742	1,337,626	(28%)
Office & Office Pro - FPP/MLP Upgrade	725,686	526,724	(27%)	2,960,571	2,187,900	(26%)
Office & Office Pro - Open Standard	729,764	783,014	7%	2,320,534	2,451,056	6%
Office & Office Pro - Open Upgrade	447,693	546,701	22%	2,315,229	2,881,037	24%
Office & Office Pro - Select/Other Standard	1,671,313	1,663,990	(0%)	8,557,788	9,440,033	10%
Office & Office Pro - Select/Other Upgrade	654,751	620,907	(5%)	4,056,548	3,914,493	(4%)
Office & Office Pro - Academic	395,020	414,460	5%	5,750,847	6,983,368	21%
Office & Office Pro - ROEM	178,570	248,415	39%	943,311	1,304,811	38%
Office Maintenance	325,416	188,617	(42%)	3,316,113	2,197,274	(34%)
Word/Excel Bundle	357,588	374,605	5%	3,616,423	3,701,744	2%
DAD Annuity/EA	546,068	987,230	81%	11,018,372	14,371,709	30%
Suite Subtotal	6,706,854	6,846,221	2%	46,714,478	50,771,051	9%
Project	336,987	399,141	18%	1,347,639	1,915,770	42%
Exchange Server	97,099	113,573	17%	130,456	152,673	17%
Exchange Server CALs	222,431	256,373	15%	7,327,522	8,544,974	17%
BackOffice Server	117,508	142,617	21%	94,762	112,778	19%
BackOffice Server CALs	258,811	321,668	24%	2,533,439	3,873,537	53%
BackOffice Annuity/EA	226,311	408,298	80%	9,233,071	12,549,138	36%
Small Business Server	82,472	136,745	66%	77,536	291,423	276%
Other Business Productivity	656,665	641,331	(2%)	18,149,143	23,309,153	28%
Business Productivity Division - Total	8,705,137	9,265,968	6%	85,608,046	101,520,497	19%
SQL Server	189,567	245,472	29%	219,957	288,819	31%
SQL Server CALs	106,446	149,856	41%	1,378,167	2,041,591	48%
Visual Basic	121,863	91,170	(25%)	679,117	567,349	(16%)
Visual C++/J++/VI/VFP	92,696	68,821	(26%)	593,323	518,151	(13%)
Visual Studio	195,946	165,297	(16%)	335,458	312,024	(7%)
Microsoft Office Developer	29,563	43,268	46%	74,694	119,876	60%
MSDN	175,244	167,168	(5%)	145,339	153,932	6%
Tools Annuity/EA	14,010	18,136	29%	1,305,648	692,538	(47%)
Other Developer	103,985	78,874	(24%)	1,235,361	1,013,755	(18%)
Developer Group - Total	1,029,320	1,028,064	(0%)	5,967,064	5,708,035	(4%)
Games	167,752	213,785	27%	403,358,843	15,166,274	1000%
Productivity	247,434	250,689	1%	33,650,996	21,834,923	54%
Learning	133,145	134,160	1%	50,583,287	12,747,273	297%
Hardware Division	524,754	536,729	2%	29,346,906	41,133,666	(29%)
Home & Retail Group - Total	1,073,086	1,135,364	6%	516,940,032	90,882,136	(82%)
Consumer & Commerce Group - Total	765,363	1,362,792	78%	7,883,676,940	72,255,689	(99%)
Product Group - Total	19,798,569	22,201,762	12%	8,629,982,774	416,505,069	(95%)
TechNet/MCP/MCSP	38,940	273,365	602%	122,295	2,427,744	1000%
Other (Manuals, Press)	222,763	241,131	8%	188,863,384	1,355,157	(99%)
80/20 Allocation Total	(0)	(0)	193%	-	-	-
Revsum Revenue	20,060,272	22,716,259	13%	8,818,968,453	420,287,970	(95%)

Note: CCG is not final.

HEADCOUNT

Employee Type: MS Employee

	May FY99 Headcount	June FY99 Headcount	June FY00 Headcount	June - June Growth	June - June Growth %
Finished Goods	13,043	13,287	16,062	2,775	20.9%
OEM	389	400	474	74	18.5%
VP	161	175	196	21	12.0%
Other	149	148	173	25	16.9%
On-Line	454	563	425	(138)	(24.5%)
Sales & Marketing	14,196	14,573	17,330	2,757	18.9%
MS Research Group	439	451	648	197	43.7%
Developer Tools	725	760	976	216	28.4%
Distributed Applications Platforms	877	913	1,325	412	45.1%
Platforms Management	4	4	60	56	1400.0%
Server Applications	771	773	1,018	245	31.7%
Business & Enterprise	1,976	1,997	2,584	587	29.4%
Business Productivity Marketing	135	135	193	58	43.0%
Communications	157	165	415	250	151.5%
Consumer Windows	814	828	1,074	246	29.7%
Developer Marketing	191	197	231	34	17.3%
Office	1,312	1,328	1,436	108	8.1%
Portal	805	738	537	(201)	(27.2%)
Business Productivity Group Mgmt	4	4	51	47	1175.0%
CCG Central	251	253	638	385	152.2%
Commerce Platform	228	240	265	25	10.4%
Personal Finance	121	125	136	11	8.8%
Productivity Appliances	355	364	415	51	14.0%
TV	514	529	1,010	481	90.9%
Access	45	46	118	72	156.5%
Developer Group Mgmt	205	205	284	79	38.5%
Office Family	307	317	352	35	11.0%
BED Marketing	220	225	268	43	19.1%
CCG Archives	70	64	0	(64)	(100.0%)
eBooks	28	33	65	32	97.0%
Expedia.com	125	128	179	51	39.8%
Intelligent Interface Technology	126	127	225	98	77.2%
MAC	149	156	172	16	10.3%
Net Docs	119	127	210	83	65.4%
Streaming Media	169	179	306	127	70.9%
TransPoint	102	170	226	56	32.9%
Platforms Bus Development	26	26	57	31	119.2%
Business Divisions	10,931	11,156	14,826	3,670	32.9%
Home & Retail	1,115	1,131	1,214	83	7.3%
Other Products	111	118	170	52	44.1%
Product Development	12,596	12,856	16,858	4,002	31.1%
Corporate Marketing	31	22	22	0	0.0%
Finance	778	789	923	134	17.0%
HR/Admin Services	555	573	675	102	17.8%
Info Technology Group	955	1,013	1,262	249	24.6%
Law & Corporate Affairs	447	451	572	121	26.8%
Corporate Procurement	0	0	0	0	n/m
Executive Support	25	26	35	9	34.6%
General & Administrative	2,791	2,874	3,489	615	21.4%
Online Factory	0	0	0	0	n/m
Online Data Center	58	66	114	48	72.7%
ITG E-Commerce Business Solutions	95	93	162	69	74.2%
WW PIRS (RT)	197	195	202	7	3.6%
WW Ops IT (GH)	94	95	102	7	7.4%
Americas FPP (ME)	182	187	198	11	5.9%
WWOPS Mgmt (BS)	3	3	27	24	800.0%
WW Hardware (SK)	47	48	62	14	29.2%
WW Central Services Operations	0	0	0	0	n/m
MSLI Licensing Operations (TB)	129	132	145	13	9.8%
Asia Pacific Ops Center (PL)	78	78	91	13	16.7%
European Ops Center (KD)	175	176	196	20	11.4%
Prgms, Product Mgmt & Ops Dev (CM	199	199	210	11	5.5%
Operations	1,257	1,272	1,509	237	18.6%
Total	30,840	31,575	39,186	7,611	24.1%

Note: CCG is not final.