

PLAINTIFF'S
EXHIBIT

42114

(Comes v. Microsoft)

Microsoft Administration



Microsoft Corporation, Board of Directors Q94-1

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BOARD OF DIRECTORS' REPORT

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This report was prepared with Word for Windows 2.0. All tables were created in Excel and either embedded in the document or linked to master spreadsheets. Each table is made accurate in its footings by using the "Precision as Displayed" option in Excel. Most schedules are presented in millions with an emphasis on having accurate totals. Therefore, individual numbers may be rounded and may not tie precisely to supporting schedules.

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COMPARISON WITH PLAN (QUARTER)

Income Statement (in millions)

| | Actual | | Plan | | Variance | |
|---------------------|--------|--------|-------|--------|----------|-------|
| | \$ | % NRev | \$ | % NRev | \$ | % |
| Net revenues | \$983 | 100% | \$827 | 100% | \$156 | 19% |
| Cost of revenues | 159 | 16 | 135 | 16 | (24) | (15%) |
| Gross profit | 824 | 84 | 692 | 84 | 132 | 19% |
| People expenses | 263 | 27 | 304 | 37 | 41 | 16% |
| Facilities expenses | 78 | 8 | 91 | 11 | 13 | 17% |
| Marketing expenses | 87 | 9 | 88 | 11 | 1 | 1% |
| Other expenses | 53 | 6 | 74 | 9 | 21 | 40% |
| Total expenses | 481 | 49 | 557 | 67 | 76 | 16% |
| Contribution margin | 343 | 35 | 135 | 16 | 208 | 154% |
| Nonoperating income | 19 | 2 | 20 | 2 | (1) | (5%) |
| Income taxes | 123 | 13 | 51 | 6 | (72) | (59%) |
| Net income | \$239 | 24% | \$104 | 13% | \$135 | 130% |

Net Revenue

- Worldwide revenues were better than plan primarily due to sales in the OEM channel. In addition, Desktop Applications throughout most channels exceeded plan (NA up 29%, Europe up 8%, ICON up 13%, FE up 20%, OEM down 36%).
- Affordable pricing for personal computers continued to drive momentum in Worldwide OEM which exceeded its revenue plan by \$75 million. The combined US OEM Large Accounts contributed \$25 million to the variance. In Japan, NEC and Toshiba combined were above plan by \$11 million.
- Desktop applications exceeded plan by \$51 million primarily due to sales of Office, which exceeded plan by 18%.

Cost of Revenue

- Cost of revenues as a percent of net revenues were as planned. Product costs were favorable compared to budget due to increased OEM revenue and lower than planned material costs.

Controllable Expenses

- Overall, controllable expenses were better than plan largely due to lower than planned headcount of 1,584, 10% below plan. The variance by responsibility group was product group (below planned headcount by 620), sales and marketing (below planned headcount by 729), general and administration (below planned headcount by 133) and manufacturing and distribution (below planned headcount by 102). The result was below planned spending in all categories of people expense.
- Facilities expenses were well below plan. Depreciation was under plan by \$4 million due mainly to the headcount shortfall. Maintenance and repairs and telecommunications (\$3 million each) were also below plan.
- The favorable variance in the Other expense category was mainly from third party product development, which was \$23 million below plan. By product group, Systems contributed \$9 million, and Consumer, Advanced Technology, and Database & Development Tools contributed \$3 million each.

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COMPARISON WITH PLAN (QUARTER)

RESULTS OF OPERATIONS SUMMARY (IN MILLIONS)

Channel

| | Net Revenue | | Gross Profit | | Responsibility Margin | | Contribution Margin | |
|------------------|--------------|-------------|--------------|-------------|-----------------------|-------------|---------------------|-------------|
| | Actual | % of Plan | Actual | % of Plan | Actual | % of Plan | Actual | % of Plan |
| North America FG | \$287 | 103% | \$223 | 99% | \$104 | 141% | \$64 | 200% |
| Europe FG | 261 | 102 | 215 | 101 | 129 | 115 | 83 | 130 |
| ICON FG | 66 | 114 | 53 | 120 | 30 | 214 | 19 | 475 |
| Far East FG | 60 | 131 | 46 | 135 | 24 | 185 | 6 | 55 |
| OEM | 255 | 142 | 244 | 142 | 225 | 142 | 156 | 197 |
| Other | 54 | 900 | 43 | 1,075 | 4 | (400) | 15 | (100) |
| | <u>\$983</u> | <u>119%</u> | <u>\$824</u> | <u>119%</u> | <u>\$516</u> | <u>144%</u> | <u>\$343</u> | <u>196%</u> |

| | Net Revenue Mix | | Gross Profit | | Responsibility Margin | | Contribution Margin | |
|------------------|-----------------|----------|--------------|----------|-----------------------|----------|---------------------|-----------|
| | Actual | % vs Var | % Net Rev | % vs Var | % Net Rev | % vs Var | % Net Rev | % vs Var |
| North America FG | 29% | (5) | 78% | (3) | 36% | 10 | 22% | 11 |
| Europe FG | 27 | (5) | 82 | 0 | 50 | 6 | 32 | 7 |
| ICON FG | 7 | 0 | 80 | 5 | 45 | 21 | 29 | 23 |
| Far East FG | 6 | 0 | 77 | 2 | 39 | 8 | 10 | (14) |
| OEM | 27 | 5 | 96 | 0 | 88 | 0 | 61 | 17 |
| Other | 5 | 5 | 80 | 13 | 7 | 207 | 28 | 278 |
| | <u>100%</u> | <u>0</u> | <u>84%</u> | <u>0</u> | <u>53%</u> | <u>9</u> | <u>35%</u> | <u>14</u> |

Product Group

| | Net Revenue | | Gross Profit | | Responsibility Margin | | Contribution Margin | |
|-----------------------|--------------|-------------|--------------|-------------|-----------------------|-------------|---------------------|-------------|
| | Actual | % of Plan | Actual | % of Plan | Actual | % of Plan | Actual | % of Plan |
| Desktop Applications | \$381 | 115% | \$322 | 118% | \$237 | 137% | \$154 | 151% |
| Database & Dev. Tools | 80 | 94 | 59 | 85 | 23 | 99 | 6 | 112 |
| Consumer | 54 | 125 | 44 | 125 | 20 | 1,275 | 10 | 243 |
| Workgroup | 20 | 117 | 17 | 123 | 3 | 200 | (2) | 75 |
| Systems | 392 | 115 | 337 | 115 | 237 | 137 | 172 | 160 |
| Advanced Technology | 2 | 92 | 1 | 72 | (8) | 48 | (9) | 47 |
| Other | 54 | 664 | 44 | 772 | 15 | 469 | 12 | 500 |
| | <u>\$983</u> | <u>119%</u> | <u>\$824</u> | <u>119%</u> | <u>\$526</u> | <u>149%</u> | <u>\$343</u> | <u>186%</u> |

| | Net Revenue Mix | | Gross Profit | | Responsibility Margin | | Contribution Margin | |
|-----------------------|-----------------|----------|--------------|----------|-----------------------|-----------|---------------------|-----------|
| | Actual | % vs Var | % Net Rev | % vs Var | % Net Rev | % vs Var | % Net Rev | % vs Var |
| Desktop Applications | 39% | (1) | 85% | 2 | 62% | 10 | 40% | 10 |
| Database & Dev. Tools | 8 | (2) | 74 | (8) | 29 | 1 | 7 | 1 |
| Consumer | 6 | 0 | 80 | 1 | 36 | 33 | 18 | 34 |
| Workgroup | 2 | 0 | 87 | 4 | 17 | 35 | (10) | 37 |
| Systems | 40 | (1) | 86 | 0 | 60 | 10 | 44 | 12 |
| Advanced Technology | 0 | 0 | 64 | (16) | (83) | 359 | (405) | 368 |
| Other | 5 | 4 | 81 | 11 | 28 | (11) | 22 | (7) |
| | <u>100%</u> | <u>0</u> | <u>84%</u> | <u>0</u> | <u>54%</u> | <u>11</u> | <u>35%</u> | <u>13</u> |

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SUMMARY CHANNEL COMMENTARY

Net Revenue

- Net FG revenues for the North American channel were 103% of plan. Revenues from the Advanced Systems were \$26 million below plan in part as a result of the delay in the release of Windows NT. This shortfall was offset by the Desktop Applications business unit revenues being \$30 million over plan.
- Europe net FG revenues were 102% of plan, in part from a favorable exchange rate variance of \$10 million. Sales of Win Office continued strong, exceeding plan by 26%.
- Within ICON, FG revenues in Latin America were 141% of plan; AIME was 115% of plan; APAC was 99% of plan. However, revenues in September in Mexico, South Africa, and Australia were below plan.

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COMPARISON WITH PLAN (QUARTER)

- In the Far East, FG revenues from Database & Development Tools, Desktop Applications, and Advanced Systems exceeded plan by \$12.3 million. Windows was under plan by \$2.5 million.
- As a result of increased price competition, the Worldwide pricing of MS applications is being addressed, as well as the internal cost of overall operations and programs.
- OEM revenues were 142% of plan, a positive variance of \$75 million.

Cost of Revenue

- Cost of revenue was essentially on plan. Below plan costs in ROW and Far East offset the higher costs in North America.
- Cost of revenue in North America was 22.3% of net revenues in comparison with plan of 19%, resulting in a negative variance of \$10 million. This variance was due from a \$4 million write down of hardware inventories and actual manufacturing cost in excess of the standards.

Controllable Expenses

- Controllable expenses of the worldwide channels were 84% of plan, representing a favorable variance of \$47 million. Marketing expense was \$24 million less than plan. People expense was \$20 million less than plan, principally from delays in hiring additional headcount.

SUMMARY PRODUCT GROUPS COMMENTARY

Net Revenue

- Systems exceeded its revenue plan by \$51 million due to strong Windows performance in the OEM channel (positive \$26 million variance) and the North American FG channel (\$15 million).
- Windows NT, experiencing a slower sales ramp than planned, was below plan by \$19 million, \$15 million of which was reported in North America FG. Limited availability of 32-bit applications and lack of client support by Novell networks contributed to the decreased performance.
- Desktop Applications exceeded plan by \$51 million due primarily to sales of Office. However, revenues in Q94-1 were 9% below Q93-4 and 10% below Q93-1 levels, reflecting competitive factors and the Q94-2 anticipated release of Office 4.0.
- Consumer was above plan by \$11 million. Of that, \$8 million was in North America FG where Publisher exceeded plan by \$5 million, and release of PC Flight Simulator 5.0 created an additional \$2 million above plan variance.

Cost of Revenue

- Cost of revenue was at plan levels. On a product basis compared to budget, cost of revenue was favorable. However, both Database & Development Tools and Systems had write-offs / write-downs of inventory.
- Overall, all products were negatively impacted by unabsorbed manufacturing overhead as manufacturing activity was less than planned, and positively impacted by significant price reductions in materials.

Controllable Expenses

- Worldwide Product Groups under spent its controllable expense plan by \$40 million (12%).
- Product development posted a favorable \$23 million dollar variance with Systems contributing \$9 million, and Consumer, Advanced Technology, and Database & Development Tools contributing \$3 million each.
- Worldwide Product Groups headcount finished the quarter at 88% of plan, a 620 shortfall. This was the main contributor to the \$12 million people expense variance. Advanced Technology was responsible for \$5 million of the variance while Systems accounted for \$4 million.
- Facilities spending was down \$67 million from plan, the variance was spread across all the business units.

Results of Operations

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COMPARISON WITH PLAN (QUARTER)

REVENUE SUMMARY (REVENUE IN MILLIONS, UNITS IN THOUSANDS)

Q94-1

| | Revenue | | | Licenses | | | \$/License | | |
|----------------------------|---------|-------|-------|----------|-------|-------|------------|-------|-------|
| | Actual | Plan | % Var | Actual | Plan | % Var | Actual | Plan | % Var |
| WIN Office | \$148 | \$126 | 18% | 400 | 368 | 9% | \$370 | \$342 | 8% |
| MAC Office | 17 | 14 | 19% | 47 | 40 | 17% | 365 | 360 | 1% |
| Excel PU* | 65 | 51 | 26% | 378 | 277 | 37% | 171 | 186 | (8%) |
| Graphics PU* | 8 | 8 | 1% | 57 | 49 | 16% | 143 | 164 | (13%) |
| Project PU | 21 | 20 | 6% | 69 | 65 | 6% | 310 | 311 | 0% |
| Word PU* | 84 | 68 | 24% | 548 | 383 | 43% | 153 | 176 | (13%) |
| DAD BU New Users** | \$343 | \$287 | 20% | 1,499 | 1,181 | 27% | \$229 | \$243 | (6%) |
| WIN Office | \$19 | \$15 | 22% | 117 | 80 | 46% | \$160 | \$191 | (16%) |
| MAC Office | 2 | 2 | (9%) | 23 | 10 | 137% | 99 | 259 | (62%) |
| Excel PU* | 10 | 12 | (15%) | 123 | 124 | (1%) | 83 | 96 | (14%) |
| Graphics PU* | 1 | 1 | (4%) | 19 | 14 | 34% | 53 | 74 | (28%) |
| Project PU | 1 | 1 | 2% | 27 | 9 | 186% | 46 | 129 | (65%) |
| Word PU* | 17 | 21 | (18%) | 188 | 216 | (13%) | 91 | 97 | (5%) |
| DAD BU Existing Users** | \$50 | \$53 | (4%) | 497 | 453 | 10% | \$102 | \$117 | (13%) |
| Basic PU | \$19 | \$14 | 33% | 158 | 105 | 51% | \$118 | \$134 | (12%) |
| Database Mgmt (Access) PU* | 16 | 24 | (33%) | 95 | 108 | (12%) | 170 | 223 | (24%) |
| Fox Database PU* | 18 | 31 | (41%) | 177 | 160 | 10% | 103 | 192 | (47%) |
| Languages PU* | 16 | 12 | 32% | 120 | 73 | 64% | 133 | 166 | (20%) |
| DBDT BU* | \$69 | \$81 | (12%) | 549 | 445 | 23% | \$125 | \$181 | (31%) |
| Entry PU | \$22 | \$16 | 34% | 503 | 349 | 44% | \$43 | \$46 | (7%) |
| M/M Pubs | 5 | 4 | 34% | 81 | 60 | 35% | 60 | 61 | (1%) |
| Works PU | 20 | 19 | 4% | 345 | 270 | 28% | 58 | 71 | (19%) |
| Consumer BU | \$46 | \$39 | 19% | 929 | 679 | 37% | \$50 | \$57 | (13%) |
| MS-DOS BU | \$19 | \$30 | (37%) | 490 | 587 | (17%) | \$38 | \$51 | (25%) |
| Hardware BU | \$40 | \$44 | (8%) | 778 | 601 | 29% | \$52 | \$73 | (29%) |
| Windows BU | \$52 | \$43 | 21% | 941 | 644 | 46% | \$55 | \$66 | (17%) |
| Win NT | \$23 | \$41 | (45%) | 130 | 204 | (36%) | \$174 | \$199 | (13%) |
| Win NT Adv. Server | 5 | 8 | (38%) | 8 | 13 | (37%) | 648 | 653 | (1%) |
| Other Server (SQL, SNA) | 5 | 8 | (37%) | 23 | 4 | 433% | 228 | 1,920 | (88%) |
| Other Operating Systems PU | 7 | 7 | (3%) | 39 | 38 | 3% | 182 | 194 | (6%) |
| Adv. Systems | \$40 | \$65 | (38%) | 200 | 259 | (23%) | \$201 | \$250 | (20%) |
| Workgroups BU* | \$14 | \$12 | 19% | 447 | 178 | 150% | \$32 | \$67 | (52%) |
| Digital Office Systems | \$1 | \$2 | (77%) | 5 | 22 | (77%) | \$110 | \$110 | 0% |
| ACT and APD PU's | 2 | 2 | (3%) | 101 | 63 | 59% | 23 | 37 | (39%) |
| Other PU's | 2 | 3 | (33%) | 7 | 27 | (72%) | 240 | 99 | 141% |
| Other | \$5 | \$7 | (38%) | 113 | 111 | 1% | \$41 | \$66 | (39%) |
| Total FG Revenue | \$679 | \$661 | 3% | 6,441 | 5,139 | 25% | \$105 | \$129 | (19%) |
| Other Materials | \$19 | \$0 | - | - | - | - | - | - | - |
| Total | \$698 | \$661 | 6% | 6,441 | 5,139 | 25% | | | |

*excludes allocation from sales of Office bundles

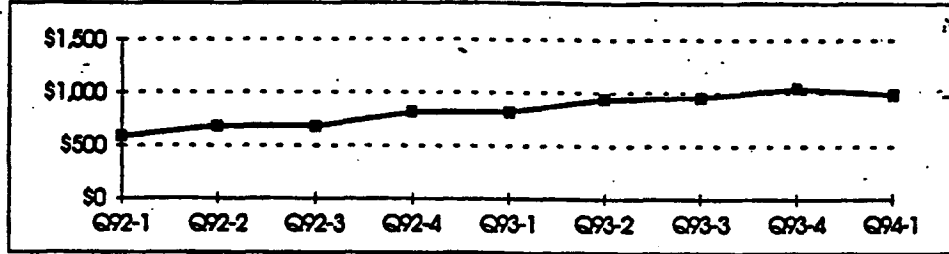
** includes database and MS Mail products sold through Office bundles

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COMPARISON WITH PLAN (QUARTER)

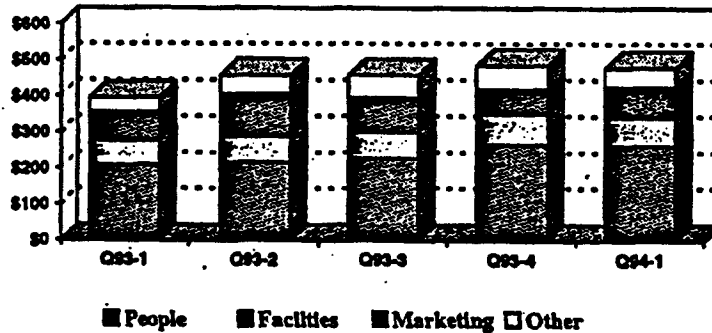
TREND ANALYSES

Net Revenue (in millions)



- Q92-1 was still benefiting from the Q91-4 release of the MS-DOS 5 Upgrade. Q92-2 saw the release of Win Word 2.0. Q92-4 revenues grew \$134 million to \$815 million on the release of Windows 3.1.
- Q93-1 included favorable foreign exchange rates (\$34 million) and continued growth for Windows applications offset a reduction in Windows 3.1 revenues. Q93-2 revenues increased from \$818 million to \$938 million due to strong sales of Office which increased \$46 million, and the release of Access. Q93-4 was the first quarter to break \$1 billion in revenues due to the late March release of the MS-DOS 6.0 Upgrade.
- Q94-1 revenues decreased as there were no major product releases, except for Win NT which was not expected to generate significant revenues during the quarter.

Controllable Expenses (in millions)



- Q94-1 total expenses of \$481 million were \$86 million, or 22% higher than Q93-1, and slightly less (\$5 million) than Q93-4. As a percent of net revenue, Q94-1 expenses were as follows; people (27%), facilities (8%), marketing (9%) and other (5%).
- Q94-1 people expenses were 25% higher than Q93-1, reflecting the 22% increase in average headcount and increased use of temporary help and consultants.

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Results of Operations

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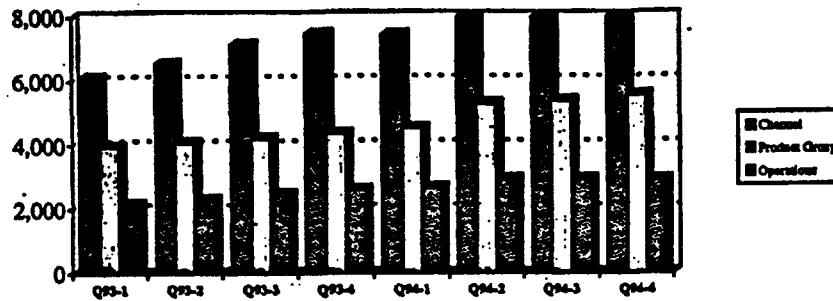
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COMPARISON WITH PLAN (QUARTER)

- Sequentially, Q94-1 facilities decreased \$7 million, or 9%, to \$78 million due to decreases for maintenance and repairs (\$2 million), telecommunications (\$1 million) and delays of several facilities projects. Though total marketing increased, actual spending (without accruals) decreased by \$79 million due to seasonality and spring promotions. People expenses dropped due to lower travel and entertainment (\$12 million). Payroll actually increased \$10 million, or 6% over Q93-4 due to bonuses paid and increased average headcount of 3%.

Headcount



- The Channel headcount plan for the remaining three quarters of FY94 is for flat headcount.
- The Product Group headcount increase is keyed to the growth in Advanced Technology.
- The Operations headcount plan for the remaining three quarters of FY94 assumes flat headcount.

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Industry

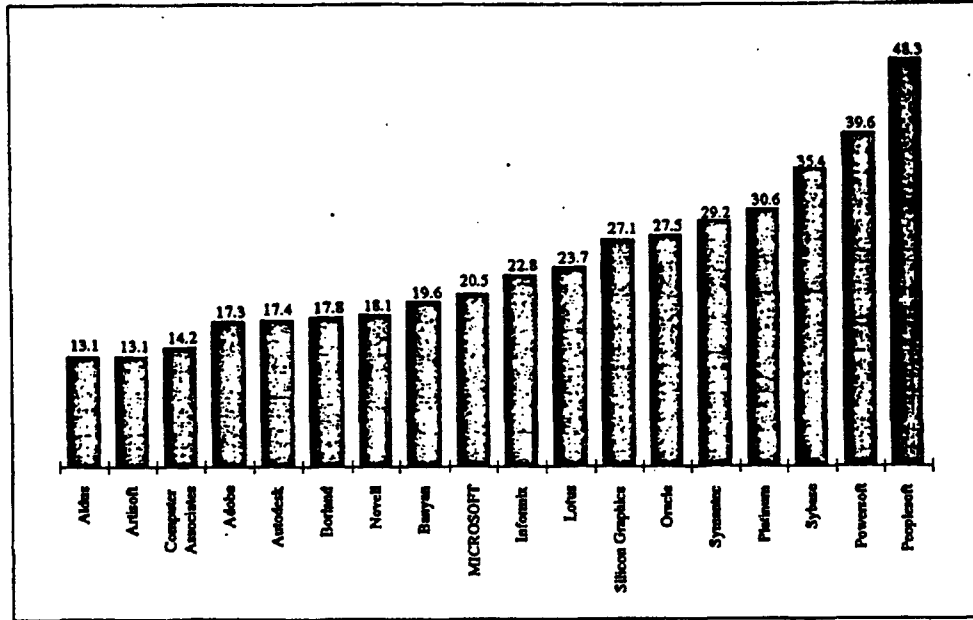
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SOFTWARE INDUSTRY FORWARD P/E RATIOS



Closing price on October 20, 1993 / analysts' earnings estimate for the future four quarters

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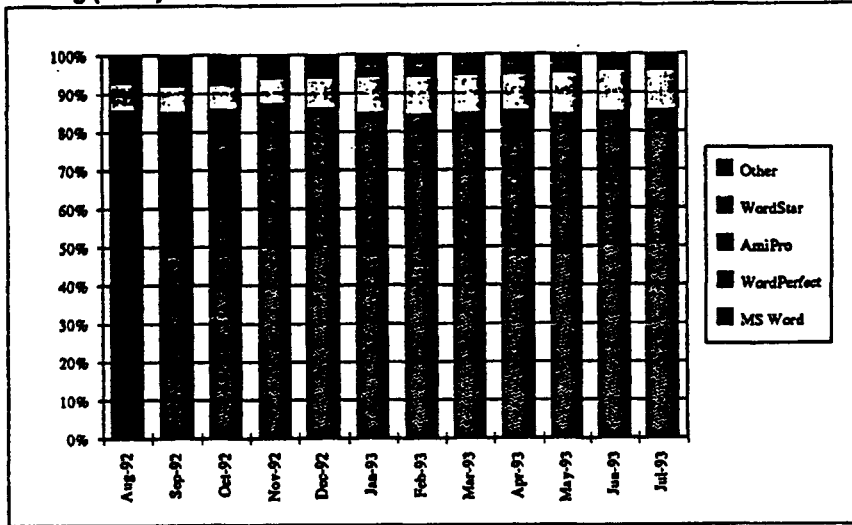
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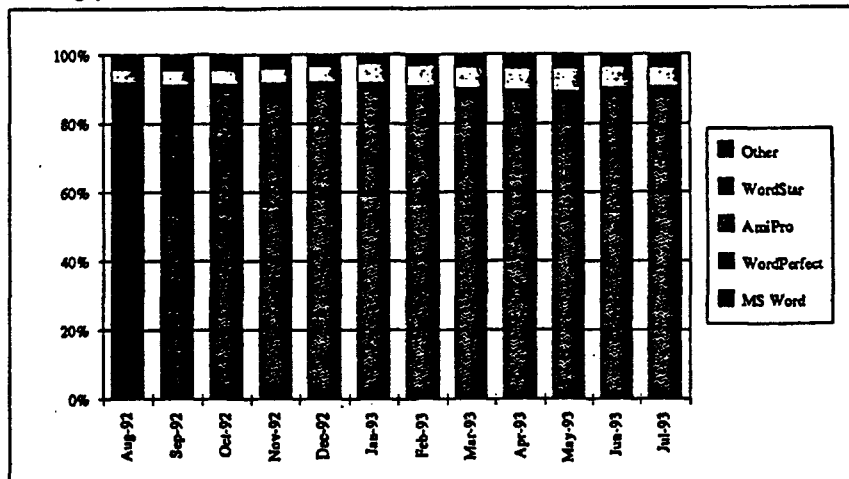
MARKET SHARE

MARKET SHARE

Word Processing (Units)



Word Processing (Revenues)



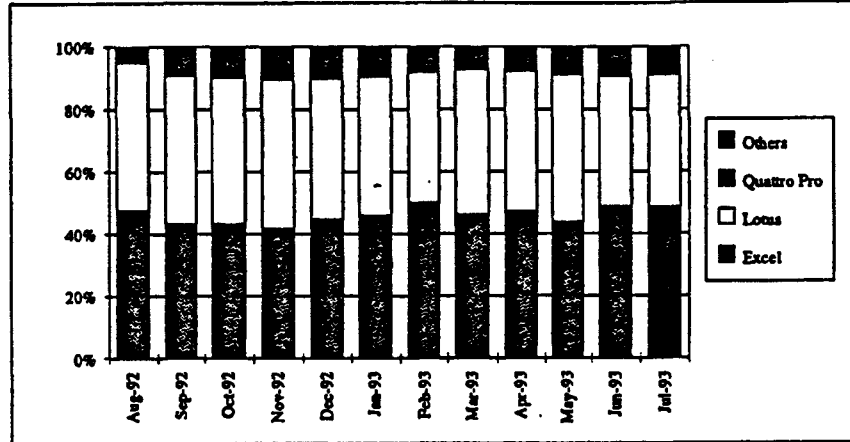
Market share is calculated by Microsoft Office marketing personnel by using three month rolling averages. Market share data for competitors is estimated based on SPA, IDC, and DataQuest information.

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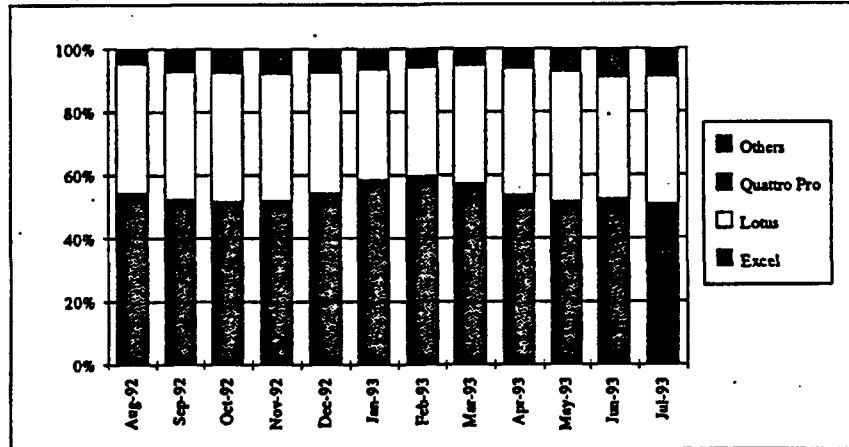
MARKET SHARE

Market Share (Cont.)

Spreadsheets (Units)



Spreadsheets (Revenues)



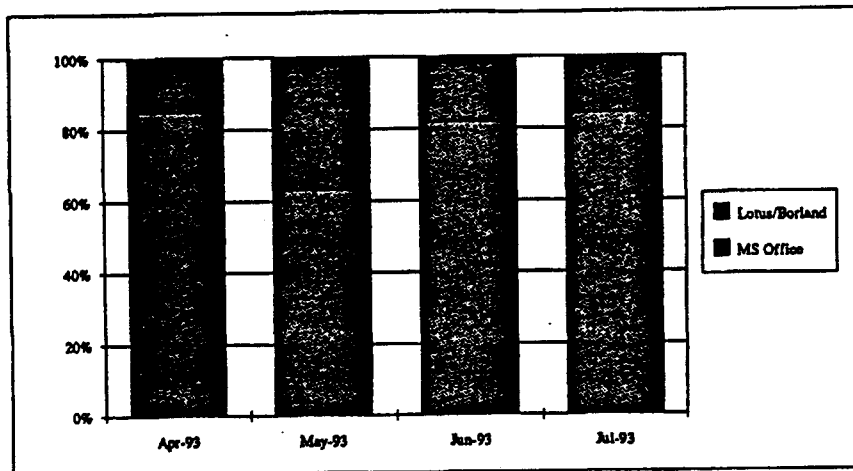
Market share is calculated by Microsoft Office marketing personnel by using three month rolling averages. Market share data for competitors is estimated based on SPA, IDC, and DataQuest information.

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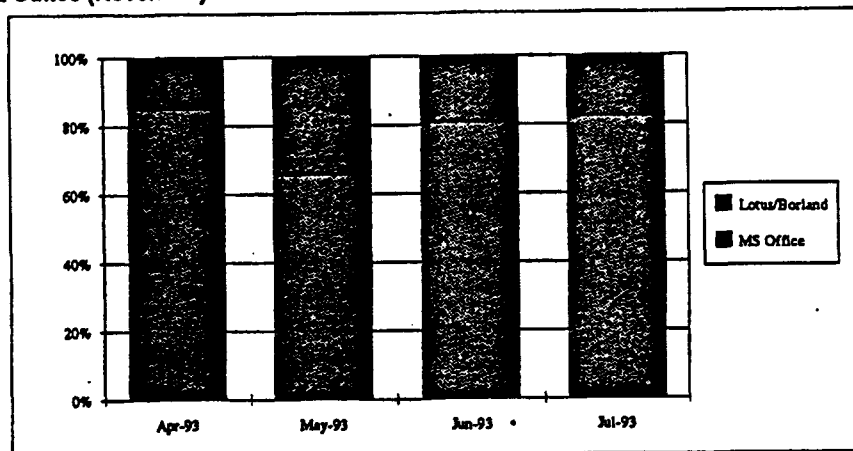
MARKET SHARE

Market Share (Cont.)

Bundled Suites (Units)



Bundled Suites (Revenues)



Market share is calculated by Microsoft Office marketing personnel.
Market share data for competitors is estimated based on SPA, IDC, and DataQuest information.

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SOFTWARE COMPETITION

SOFTWARE COMPETITION

Novell - Closing stock price: 10/20/93 \$19.00, 9/30/93 \$18.88

- UNIX trademark transferred to X/Open, which will manage application and test of the brand.
- Board authorized repurchase of 11 million shares (3.5% of outstanding shares).
- Cash and short-term investments down \$106 million to \$624 million.
- Accounts receivable of \$304 million is 100 days outstanding; analysts blame excessive inventory levels in channel.
- \$321 million write-off of purchased R&D related principally to USL acquisition.
- \$11 million incremental quarterly revenues generated from recent acquisitions.
- Announced Personal NetWare, a peer-to-peer network upgrade to NetWare Lite.
- NetWare 4.0 sales are slow to ramp up.

Lotus - Closing stock price: 10/20/93 \$46.50, 9/30/93 \$45.50

- Board authorized repurchase of 2.5 million shares (6.0% of outstanding shares).
- Stock price increase of 31% since June 1993.
- Smart Suite is selling well and now represents 35% of Lotus's Windows applications.
- Communication applications (cc:Mail and Notes) increased 60% year-over-year and 30% sequentially. They are now 19% of sales and management expects 20-25% in CY94.
- Windows applications represent 62% of sales; MS-DOS applications are down to 28%.

Borland - Closing stock price: 10/20/93 \$14.75, 9/30/93 \$15.13

- Latest Windows version of Quattro Pro priced at \$49.95 (\$39.95 upgrade) Sell-in has exceeded 500 thousand units since September.
- Borland Office was pulled from the channel due to quality problems. The next version will be delayed until the release of WordPerfect 6.0.
- dBase for Windows still scheduled for release in March quarter.
- Borland found to be in violation of Lotus copyrights; trial set for October 1994 to assess damages; which are estimated to range from \$60M to \$100M.
- Cash balances decreased \$22 million to \$60 million.
- DSO increased to 60 days (from 44 days in June quarter).
- Jack Blount, senior vice president for business development resigned. He was hired by Novell several months ago.
- Board member Stephen Dow (from Sevin Rosen Funds) resigned.

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Industry

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TOP FOUR SOFTWARE COMPANIES

TOP FOUR SOFTWARE COMPANIES

| | Microsoft | | Novell | | Lotus | | Borland | |
|----------------------------|-----------|--------|------------|---------|---------|--------|---------|--------|
| Most recent quarter | | | | | | | | |
| Net revenues | \$ 983 | 100.0% | \$ 273 (1) | 100.0% | \$ 240 | 100.0% | \$ 107 | 100.0% |
| Cost of revenues | 159 | 16.2 | 57 | 20.8 | 47 | 19.5 | 25 | 23.5 |
| Gross profit | 824 | 83.8 | 216 | 79.2 | 193 | 80.5 | 82 | 76.5 |
| Operating expenses: | | | | | | | | |
| Research and development | 134 | 13.6 | 42 | 15.5 | 33 | 13.6 | 15 | 13.6 |
| Sales and marketing | 312 | 31.7 | 71 | 26.3 | 114 | 47.9 | 64 | 60.2 |
| General and administrative | 35 | 3.6 | 18 | 6.5 | 18 (3) | 7.3 | -- | -- |
| Write-off/restructuring | -- | -- | 321 (2) | 117.5 | -- | -- | -- | -- |
| Total operating expenses | 481 | 48.9 | 452 | 165.8 | 165 | 68.8 | 79 | 73.8 |
| Operating income | 343 | 34.9 | (236) | (86.6) | 28 | 11.7 | 3 | 2.7 |
| Nonoperating income | 19 | 1.9 | 7 | 2.6 | 1 | 0.2 | 1 | 0.8 |
| Income before income taxes | 362 | 36.8 | (229) | (84.0) | 29 | 11.9 | 4 | 3.5 |
| Provision for income taxes | 123 | 12.5 | 26 | 9.6 | 11 | 4.3 | 1 | 0.9 |
| Net income | \$ 239 | 24.3% | \$ (255) | (93.6)% | \$ 18 | 7.6% | \$ 3 | 2.6% |
| Average shares outstanding | 303 | | 318 | | 45 | | 27 | |
| EPS | \$ 0.79 | | \$ (0.80) | | \$ 0.41 | | \$ 0.11 | |

| | Microsoft | | Novell | | Lotus | | Borland | |
|----------------------------|-----------|--------|-----------|--------|----------|--------|-----------|---------|
| Trailing twelve months | | | | | | | | |
| Net revenues | \$ 3,918 | 100.0% | \$ 1,074 | 100.0% | \$ 949 | 100.0% | \$ 452 | 100.0% |
| Cost of revenues | 658 | 16.8 | 210 | 19.5 | 202 | 21.3 | 125 | 27.6 |
| Gross profit | 3,260 | 83.2 | 864 | 80.5 | 747 | 78.7 | 327 | 72.4 |
| Operating expenses: | | | | | | | | |
| Research and development | 499 | 12.7 | 147 | 13.7 | 128 | 13.5 | 65 | 14.3 |
| Sales and marketing | 1,252 | 32.0 | 245 | 23.0 | 453 | 47.7 | 278 | 61.8 |
| General and administrative | 129 | 3.3 | 72 | 6.7 | 70 | 7.4 | -- | -- |
| Write-off/restructuring | -- | -- | 321 | 29.8 | -- | -- | 25 (5) | 5.5 |
| Total operating expenses | 1,880 | 48.0 | 785 | 73.2 | 651 | 68.6 | 368 | 81.6 |
| Operating income | 1,380 | 35.2 | 79 | 7.3 | 96 | 10.1 | (41) | (9.2) |
| Nonoperating income | 76 | 1.9 | 27 | 2.5 | (19) (4) | (2.0) | 3 | 0.8 |
| Income before income taxes | 1,456 | 37.1 | 106 | 9.8 | 77 | 8.1 | (38) | (8.4) |
| Provision for income taxes | 474 | 12.0 | 141 | 13.0 | 36 | 3.8 | 9 | 2.1 |
| Net income | \$ 982 | 25.1% | \$ (35) | (3.2)% | \$ 41 | 4.3% | \$ (47) | (10.5)% |
| Average shares outstanding | 304 | | 313 | | 43 | | 27 | |
| EPS | \$ 3.23 | | \$ (0.11) | | \$ 0.93 | | \$ (1.72) | |

- (1) Novell's revenues for the quarter ended July 31, 1993 include approximately \$11 million from recent acquisitions.
- (2) Novell's results of operations include a charge of \$321 million related to the acquisitions of USL, Software Transformation, Serius and Fluent. The write-off of purchased research and development and other costs represents a one-time charge against earnings of \$1.00 per share which resulted in a net loss of \$.80 per share for the quarter.
- (3) In September 1993, Lotus announced plans to consolidate its operations into one facility. Beginning in 1996, the company expects the consolidation to save \$10 million annually.
- (4) Lotus' trailing twelve months non-controllable expense includes a \$20 million write-off in the quarter ended June 30, 1993 in connection with the acquisition of Approach.
- (5) Borland's trailing twelve months controllable expense includes a pro-tax charge of \$25 million, or 7% of annually expenses, for workforce reductions and software technology write-offs. The charge was taken in December 1992.

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TOP FOUR SOFTWARE COMPANIES

Top Four Software Companies (Cont.)

| | Microsoft 9/30/93 | | Novell 7/31/93 | | Lotus 10/2/93 | | Borland 9/30/93 | |
|-------------------------------------|----------------------|-------------|-------------------|-------------|------------------|-------------|--------------------|-------------|
| Balance sheet | | | | | | | | |
| Current assets: | | | | | | | | |
| Cash and short-term investments | \$ 2,532 | 63% | \$ 767 | 54% | \$ 377 | 46% | \$ 81 (7) | -22% |
| Accounts receivable - net | 365 | 9 | 304 | 21 | 168 | 20 | 72 | 20 |
| Inventories | 95 | 2 | 4 | -- | 21 | 3 | 8 | 2 |
| Other | 81 | 2 | 51 | 5 | 31 | 3 | 10 | 3 |
| Total current assets | 3,073 | 76 | 1,126 | 80 | 597 | 72 | 171 | 47 |
| Property, plant and equipment - net | 892 | 22 | 212 | 15 | 124 | 15 | 172 | 47 |
| Capitalized software | -- | -- | -- | -- | 93 | 11 | -- | -- |
| Other assets | 83 | 2 | 76 | 5 | 14 | 2 | 21 | 6 |
| | <u>\$ 4,048</u> | <u>100%</u> | <u>\$ 1,414</u> | <u>100%</u> | <u>\$ 828</u> | <u>100%</u> | <u>\$ 364</u> | <u>100%</u> |
| Current liabilities | \$ 581 | 14% | \$ 219 | 15% | \$ 280 | 34% | \$ 143 | 39% |
| Long-term liabilities | -- | -- | -- | -- | 78 | 9 | 23 | 6 |
| Other liabilities | -- | -- | 31 | 2 | -- | -- | -- | -- |
| Stockholders' equity | 3,467 | 86 | 1,164 (1) | 83 | 470 (3) | 57 | 198 | 55 |
| | <u>\$ 4,048</u> | <u>100%</u> | <u>\$ 1,414</u> | <u>100%</u> | <u>\$ 828</u> | <u>100%</u> | <u>\$ 364</u> | <u>100%</u> |

Other data

| | | | | |
|--------------------------------------|----------|---------|-------------|---------|
| Closing stock price (Sept. 30, 1993) | \$82.50 | \$18.88 | \$45.50 (4) | \$15.13 |
| Common shares outstanding | 303 | 318 | 45 | 27 |
| Market value | \$24,998 | \$6,004 | \$2,048 | \$409 |

| | | | | |
|--|-------|-------|-------|-------|
| Price/revenues ratio | 6.4x | 5.6x | 2.2x | 0.9x |
| Price/earnings ratio - trailing twelve | 25.5x | • (2) | 48.9x | • (8) |
| Price/earnings ratio - future 4 quarters | 20.5x | 18.1x | 23.7x | 17.8x |

| | | | | |
|--|-----------|-----------|-----------|-----------|
| Avg headcount (most recent disclosure) | 13,033 | 3,424 | 4,350 | 1,989 |
| Net revenues/employee | \$300,621 | \$313,668 | \$218,161 | \$227,250 |

| | | | | |
|------------------------|---------|--------|---------|--------|
| Cash per share | \$8.36 | \$2.41 | \$8.38 | \$3.00 |
| Book value per share | \$11.44 | \$3.66 | \$10.44 | \$7.33 |
| Price/book value ratio | 7.2x | 5.2x | 4.4x | 2.1x |

Growth statistics (over comparable quarter):

| | | | | |
|----------------------------|-----|--------|-----------|-------|
| Revenue | 20% | 12% | 16% (5) | (16%) |
| Research and development | 27% | 37% | 18% | (25%) |
| Sales and marketing | 18% | 21% | 11% | (10%) |
| General and administrative | 41% | 42% | 4% | n/a |
| Net income | 14% | (487%) | (39%) (6) | (47%) |

- (1) Novell's Board recently authorized the re-purchase of 11 million shares. Novell has 316 million shares outstanding.
- (2) Novell's trailing twelve months P/E ratio is negative due to the net loss resulting from a \$321 million acquisition charge related primarily to the acquisition of USL.
- (3) In September 1993, Lotus' Board expanded their stock re-purchase program by 2.5 million shares. Lotus has 42 million shares outstanding.
- (4) Lotus' stock prices has increased 31% from \$34.625 since June 30, 1993 with the release of new versions of SmartSuite, 1-2-3 for Windows, and Notes.
- (5) Lotus' net revenues for the quarter ended October 2, 1993, grew 16% over the same period last year. The company's international business grew 26%.
- (6) Lotus' net income on a comparable quarter basis decreased 39% due to the company's pro-tax gain of \$35 million from the September 1992 sales of its investment accounting for 50% of the quarter's revenues.
- (7) In August 1993, Borland was found to be in violation of certain copyrights held by Lotus. A trial to assess damages has been set for October 1994.
- (8) Borland's trailing twelve months P/E ratio is negative due to a net loss of \$47 million, including a \$25 million restructuring charge taken in December 1992.

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SOFTWARE COMPANY METRICS

SOFTWARE COMPANY METRICS

| | Adobe 8/27/93 | Aldus 6/30/93 | Artisoft 6/30/93 | Autodesk 7/31/93 | Banyan 6/30/93 |
|---|------------------|------------------|---------------------|---------------------|-------------------|
| Income statement | | | | | |
| Most recent quarter | | | | | |
| Net revenues | \$79 | \$46 | \$20 | \$104 | \$32 |
| Net income (loss) | 11 | 0 (2) | 2 | 16 | 3 |
| EPS | 0.24 | 0.02 | 0.12 | 0.65 | 0.19 |
| Trailing twelve months | | | | | |
| Net revenues | \$298 | \$178 | \$85 | \$398 | \$121 |
| Net income | 50 | 4 | 9 | 56 | 11 |
| EPS | 1.70 | 0.26 | 0.52 | 2.24 | 0.60 |
| Net income as a % of net revenues | 17% | 2% | 11% | 14% | 9% |
| Balance sheet | | | | | |
| Cash | \$198 | \$62 | \$31 | \$166 | \$55 |
| Other current assets | 70 | 46 | 26 | 104 | 33 |
| Other assets | 60 | 50 | 35 | 106 | 12 |
| | <u>\$328</u> | <u>\$158</u> | <u>\$92</u> | <u>\$376</u> | <u>\$100</u> |
| Liabilities | \$61 | \$32 | \$9 | \$91 | \$31 |
| Equity | 267 | 126 | 83 | 285 | 69 |
| | <u>\$328</u> | <u>\$158</u> | <u>\$92</u> | <u>\$376</u> | <u>\$100</u> |
| Other data | | | | | |
| Closing stock price (September 30, 1993) | \$18.25 (1) | \$19.50 | \$9.75 | \$44.50 | \$16.50 |
| Common shares outstanding (in millions) | 47 | 13 | 18 | 25 | 18 |
| Market value (in millions) | \$858 | \$254 | \$176 | \$1,113 | \$297 |
| Price/revenues ratio | 2.9x | 1.4x | 2.1x | 2.8x | 2.4x |
| Price/earnings ratio - trailing twelve | 10.7x | 75.2x | 18.6x | 19.8x | 27.3x |
| Price/earnings ratio - future 4 qtrs. | 17.3x | 13.1x | 13.1x | 17.4x | 19.6x |
| Avg headcount (most recent disclosure) | 794 | 980 | 224 | 1,419 | 633 |
| Net revenues/employee | \$374,853 | \$182,130 | \$378,711 | \$280,291 | \$191,812 |
| Cash per share | \$4.21 | \$4.77 | \$1.72 | \$6.64 | \$3.06 |
| Book value per share | \$5.68 | \$9.69 | \$4.61 | \$11.40 | \$3.83 |
| Price/book value ratio | 3.2x | 2.0x | 2.1x | 3.9x | 4.3x |
| Growth statistics (over comparable quarter): | | | | | |
| Revenue | 25% | 17% (3) | (8%) | 21% | 17% |
| Research and development | (12%) | 41% | 98% | 4% | 8% |
| Sales and marketing | 35% | 9% | 6% | 22% | 16% |
| General and administrative | (2%) | 7% | n/a | (8%) | (1%) |
| Net income | 70% | 125% | (49%) | 56% | 83% |

- (1) Adobe's stock price decreased 70% from \$61.75 since June 30, 1993 resulting in a market value decline of \$1 billion in three months.
 (2) Aldus' net income for the quarter ended June 30, 1993 includes a pre-tax charge of \$3 million for the write-off of software development costs in connection with the acquisition of After Hours Software.
 (3) Aldus credits the increase of 17% in revenues to further expansion of its Japanese business, as well as localized releases of PageMaker 5.0.

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SOFTWARE COMPANY METRICS

Software Company Metrics (Cont.)

| | Computer | | | | |
|---|-------------------|---------------------|-------------------|-----------------------|----------------------------------|
| | Assoc. 6/30/93 | Informix 6/30/93 | Oracle 8/31/93 | Peoplesoft 6/30/93 | Platinum ¹ 6/30/93 |
| Income statement | | | | | |
| Most recent quarter | | | | | |
| Net revenues | \$423 | \$84 | \$398 | \$13 | \$16 |
| Net income (loss) | 31 | 12 | 37 | 2 | (17) (2) |
| EPS | 0.18 | 0.18 | 0.25 | 0.15 | (1.95) |
| Trailing twelve months | | | | | |
| Net revenues | \$1,897 | \$326 | \$1,594 | \$42 | \$39 |
| Net income (loss) | 257 | 58 | 169 | 6 | (16) |
| EPS | 1.51 | 1.37 | 1.15 | 0.55 | (2.09) |
| Net income (loss) as a % of net revenues | 14% | 18% | 11% | 15% | (40%) |
| Balance sheet | | | | | |
| Cash | \$253 | \$119 | \$289 | \$59 | \$50 |
| Other current assets | 504 | 88 | 475 | 22 | 17 |
| Other assets | 1,487 | 45 | 428 | 5 | 13 |
| | <u>\$2,244</u> | <u>\$252</u> | <u>\$1,192</u> | <u>\$86</u> | <u>\$80</u> |
| Liabilities | \$1,226 | \$94 | \$638 | \$22 | \$19 |
| Equity | 1,018 | 158 | 554 (1) | 64 | 61 |
| | <u>\$2,244</u> | <u>\$252</u> | <u>\$1,192</u> | <u>\$86</u> | <u>\$80</u> |
| Other data | | | | | |
| Closing stock price (September 30, 1993) | \$32.00 | \$23.50 | \$61.38 | \$36.50 | \$31.50 |
| Common shares outstanding (in millions) | 172 | 68 | 148 | 13 | 9 |
| Market value (in millions) | \$5,504 | \$1,598 | \$9,084 | \$475 | \$284 |
| Price/revenues ratio | 2.9x | 4.9x | 5.7x | 11.3x | 7.3x |
| Price/earnings ratio - trailing twelve | 21.1x | 17.1x | 53.2x | 66.0x | * |
| Price/earnings ratio - future 4 qtrs. | 14.2x | 22.8x | 27.5x | 48.3x | 30.6x |
| Avg headcount (most recent disclosure) | 7,300 | 1,283 | 7,813 | 181 | 207 |
| Net revenues/employee | \$259,851 | \$253,841 | \$204,010 | \$233,496 | \$187,065 |
| Cash per share | \$1.47 | \$1.75 | \$1.95 | \$4.54 | \$5.56 |
| Book value per share | \$5.92 | \$2.32 | \$3.74 | \$4.92 | \$6.78 |
| Price/book value ratio | 5.4x | 10.1x | 16.4x | 7.4x | 4.6x |
| Growth statistics (over comparable quarter): | | | | | |
| Revenue | 15% | 40% | 30% | 83% | 212% |
| Research and development | 6% | 78% | 53% | 48% | 211% |
| Sales and marketing | 12% | 38% | 9% | 113% | 195% |
| General and administrative | n/a | 6% | 8% | 71% | 83% |
| Net income | 60% | 33% | 212% | 79% | * |

(1) On October 12, 1993, Oracle announced a two-for-one stock split of the company's common stock. The split will be effective on November 8, 1993. The company also announced an expansion of its stock re-purchase plan to include an additional 2.5 million shares (pre-split). The company has re-purchased approximately 2.0 million shares since the program's inception in July 1992. The company currently has 143 million shares outstanding.

(2) Platinum's loss for the quarter ended June 30, 1993 is due to charges of \$21 million incurred in the acquisitions of three software companies in the last three months.

* Not meaningful.

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Industry

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SOFTWARE COMPANY METRICS

Software Company Metrics (Cont.)

| | Powersoft 9/30/93 | 3DO 6/30/93 | Silicon Graphics 6/30/93 | Software Publishing 6/30/93 | Sybase 6/30/93 | Symantec 6/30/93 |
|---|----------------------|----------------|--------------------------------|-----------------------------------|-------------------|---------------------|
| Income statement | | | | | | |
| Most recent quarter | | | | | | |
| Net revenues | \$13 | \$0 | \$319 | \$21 | \$96 | \$59 |
| Net income (loss) | 2 (1) | (30) | 35 | (6) (5) | 9 | (7) (6) |
| EPS | 0.21 | (1.60) | 0.47 | (0.49) | 0.36 | (0.27) |
| Trailing twelve months | | | | | | |
| Net revenues | \$39 | \$0 (2) | \$1,091 | \$126 | \$327 | \$203 |
| Net income (loss) | 7 | (40) | 95 | (8) | 32 | (24) (7) |
| EPS | 0.75 | (4.84) | 1.31 | (0.67) | 1.27 | (0.98) |
| Net income (loss) as a % of net revenues | 19% | 0% | 9% | (7%) | 10% | (12%) |
| Balance sheet | | | | | | |
| Cash | \$43 | \$41 | \$155 | \$68 | \$98 | \$51 |
| Other current assets | 10 | 1 | \$21 | 24 | 96 | 55 |
| Other assets | 3 | 5 | 270 | 22 | 63 | 30 |
| | <u>\$56</u> | <u>\$47</u> | <u>\$946</u> | <u>\$114</u> | <u>\$257</u> | <u>\$136</u> |
| Liabilities | \$11 | \$10 | \$312 | \$45 | \$111 | \$72 |
| Equity | 45 | 37 | 634 | 69 | 146 | 64 |
| | <u>\$56</u> | <u>\$47</u> | <u>\$946</u> | <u>\$114</u> | <u>\$257</u> | <u>\$136</u> |
| Other data | | | | | | |
| Closing stock price (September 30, 1993) | \$30.00 | \$34.00 (3) | \$43.00 | \$6.13 | \$67.00 | \$19.38 |
| Common shares outstanding (in millions) | 11 | 19 | 75 | 12 | 26 | 26 |
| Market value (in millions) | \$330 | \$646 | \$3,225 | \$74 | \$1,742 | \$504 |
| Price/revenues ratio | 8.4x | 0.0x | 3.0x | 0.6x | 5.3x | 2.5x |
| Price/earnings ratio - trailing twelve | 40.1x | • | 32.8x | • | 52.7x | • |
| Price/earnings ratio - future 4 qtrs. | 39.6x | • (4) | 27.0x | • | 35.4x | 29.2x |
| Avg headcount (most recent disclosure) | 106 | 95 | 3,663 | 721 | 1,348 | 1,049 |
| Net revenues/employee | \$372,566 | \$0 | \$297,939 | \$175,350 | \$242,594 | \$193,330 |
| Cash per share | \$3.91 | \$2.16 | \$2.07 | \$5.67 | \$3.77 | \$1.96 |
| Book value per share | \$4.09 | \$1.95 | \$8.45 | \$5.75 | \$5.62 | \$2.46 |
| Price/book value ratio | 7.3x | 17.5x | 5.1x | 1.1x | 11.9x | 7.9x |
| Growth statistics (over comparable quarter): | | | | | | |
| Revenue | 104% | 0% | 33% | (41%) | 54% | (3%) |
| Research and development | 106% | 307% | 2% | (14%) | 49% | 22% |
| Sales and marketing | 96% | 2,754% | 3% | (10%) | 48% | 6% |
| General and administrative | 81% | 438% | n/a | 7% | 24% | 59% |
| Net income | 103% | • | 132% | • | 98% | (216%) |

- (1) Powersoft's net income for the quarter ended September 30, 1993 includes a \$260,000 gain on the sale of discontinued operations.
 - (2) Information for 3DO was obtained from the company's prospectus dated March 12, 1993. Due to the lack of available historical data, the trailing twelve months shown covers the 15 month period from April 1, 1992 to June 30, 1993.
 - (3) 3DO completed its initial public offering on May 2, 1992 at \$15 per share. The stock closed at \$34.00 per share on September 30, 1993.
 - (4) Analysts are estimated that 3DO will incur net losses of approximately \$.33 to \$.37 per share through March 1994.
 - (5) Software Publishing experienced a decline in revenues resulting in a loss of the quarter ended June 30, 1993. The company attributes the loss to the impact of competitive bundling of software applications and declining conditions in the international marketplace.
 - (6) Symantec's loss generated in the quarter ended June 30, 1993 was due primarily to a \$12 million charge resulting from the \$47 million acquisition of Contact Software in June 1993, as well as general restructuring of the company's service operations.
 - (7) Symantec's net loss for the trailing twelve months was due to charges incurred in obtaining four software companies during the year.
- Not meaningful.

HIGHLY CONFIDENTIAL

HARDWARE COMPANY METRICS

HARDWARE COMPANY METRICS

| | Apple Computer 9/24/93 | DEC 10/2/93 | Hewlett- Packard 7/31/93 | IBM 6/30/93 |
|---|------------------------------|-----------------|--------------------------------|-----------------|
| Income statement | | | | |
| Most recent quarter | | | | |
| Net revenues | \$2,141 | \$3,015 | \$4,961 | \$15,519 |
| Net income (loss) | 3 | (83) | 272 | (8,041) (4) |
| EPS | 0.02 | (0.62) | 1.06 | (14.10) |
| Trailing twelve months | | | | |
| Net revenues | \$7,977 | \$14,072 | \$18,954 | \$62,839 |
| Net income (loss) | 87 (1) | (74) | 945 | (16,567) |
| EPS | 0.73 | (0.56) | 3.74 | (29.03) |
| Net income (loss) as a % of net revenues | 1% | (1%) | 5% | (26%) |
| Balance sheet | | | | |
| Cash | \$892 | \$1,274 | \$1,648 | \$6,771 |
| Other current assets | 3,446 | 5,245 | 7,597 | 34,094 |
| Other assets | 833 | 4,107 | 6,261 | 45,276 |
| | <u>\$5,171</u> | <u>\$10,626</u> | <u>\$15,506</u> | <u>\$86,141</u> |
| Liabilities | \$3,145 | \$5,806 | \$7,214 | \$66,329 |
| Equity | <u>2,026</u> | <u>4,820</u> | <u>8,292</u> | <u>19,812</u> |
| | <u>\$5,171</u> | <u>\$10,626</u> | <u>\$15,506</u> | <u>\$86,141</u> |
| Other data | | | | |
| Closing stock price (September 30, 1993) | \$23.38 (2) | \$36.75 | \$68.38 | \$42.00 |
| Common shares outstanding (in millions) | 117 | 135 | 254 | 570 |
| Market value (in millions) | \$2,735 | \$4,961 | \$17,369 | \$23,940 |
| Price/revenues ratio | 0.3x | 0.4x | 0.9x | 0.4x |
| Price/earnings ratio - trailing twelve | 32.0x | * | 18.3x | * |
| Price/earnings ratio - future 4 qtrs. | 16.7x | 10.4x | 13.7x | 29.7x |
| Avg headcount (most recent disclosure) | 12,276 | 104,000 | 90,800 | 339,543 |
| Net revenues/employee | \$649,801 | \$135,308 | \$208,744 | \$185,070 |
| Cash per share | \$7.62 | \$9.44 | \$6.49 | \$11.88 |
| Book value per share | \$17.32 | \$35.70 | \$32.65 | \$34.76 |
| Price/book value ratio | 1.3x | 1.0x | 2.1x | 1.2x |
| Growth statistics (over comparable quarter): | | | | |
| Revenue | 21% | (9%) (3) | 23% | (4%) |
| Research and development | (8%) | (22%) | 9% | (12%) |
| Sales and marketing | (15%) | (23%) | 9% | (9%) |
| General and administrative | n/a | n/a | n/a | n/a |
| Net income | (97%) | 68% | 42% | * |

- (1) Included in Apple's trailing twelve net income is a pre-tax charge of \$321 million, or \$1.63 per share, related to the company's latest restructuring. Apple announced in July 1993 that it was consolidating numerous divisions and establishing a separate software group, Applesoft.
 - (2) Apple's stock price has experienced a steady decline in the current year. The stock price has recently decreased 41% from June 30, 1993.
 - (3) Digital's net revenues for the quarter ended October 2, 1993 has declined slightly over the same period last year, while net income grew 68% due to the company's success in reducing costs since its latest restructuring in April 1992. The company attributes the revenue decline to continued weaknesses in Europe as well as negative foreign currency fluctuations.
 - (4) IBM's net loss for the quarter ended June 30, 1993 was \$8 billion, or \$14.10 per common share, due to its latest restructuring charge of \$8.9 billion. The net loss for the quarter before the charge was \$40 million or \$0.08 per common share. The charge was the main factor for the substantial decline in net income over the prior year.
- * Not meaningful.

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Industry

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HARDWARE COMPANY METRICS

Hardware Company Metrics (Cont.)

| | AT&T 6/30/93 | Compaq 9/30/93 | Dell Computer 8/1/93 | Intel 9/25/93 | Sun 9/26/93 |
|---|-----------------|-------------------|----------------------------|------------------|------------------|
| Income statement | | | | | |
| Most recent quarter | | | | | |
| Net revenues | \$16,316 | \$1,746 | \$701 | \$2,240 | \$960 |
| Net income (loss) | 1,044 (1) | 107 | (76) (2) | 584 | 17 |
| EPS | 0.77 | 1.25 | (2.03) | 1.33 | 0.16 |
| Trailing twelve months | | | | | |
| Net revenues | \$65,719 | \$6,413 | \$2,563 | \$8,250 | \$4,413 |
| Net income (loss) | (2,637) | 433 | (6) | 2,129 | 169 |
| EPS | (1.97) | 5.19 | (0.14) | 6.47 | 1.60 |
| Net income (loss) as a % of net revenues | (4%) | 7% | 0% | 26% | 4% |
| Balance sheet | | | | | |
| Cash | | | | | |
| Cash | \$603 | \$419 | \$106 | \$3,295 | \$902 |
| Other current assets | 26,125 | 2,566 | 740 | 2,530 | 1,177 |
| Other assets | 31,023 | 794 | 89 | 4,636 | 495 |
| | <u>\$57,751</u> | <u>\$3,779</u> | <u>\$935</u> | <u>\$10,461</u> | <u>\$2,574</u> |
| Liabilities | | | | | |
| Equity | \$44,092 | \$1,381 | \$623 | \$3,448 | \$1,069 |
| | <u>13,659</u> | <u>2,398</u> | <u>312</u> | <u>7,013</u> | <u>1,505</u> (4) |
| | <u>\$57,751</u> | <u>\$3,779</u> | <u>\$935</u> | <u>\$10,461</u> | <u>\$2,574</u> |
| Other data | | | | | |
| Closing stock price (September 30, 1993) | \$58.88 | \$58.13 | \$16.63 | \$70.75 (3) | \$24.00 |
| Common shares outstanding (in millions) | 1,352 | 85 | 37 | 440 | 101 |
| Market value (in millions) | \$79,599 | \$4,941 | \$615 | \$31,130 | \$2,424 |
| Price/revenues ratio | 1.2x | 0.8x | 0.2x | 3.8x | 0.5x |
| Price/earnings ratio - trailing twelve | * | 11.2x | * | 10.9x | 15.0x |
| Price/earnings ratio - future 4 qtrs. | 18.4x | 11.5x | 15.4x | 11.2x | 8.7x |
| Avg headcount (most recent disclosure) | 314,900 | 9,750 | 3,810 | 20,200 | 12,650 |
| Net revenues/employee | \$208,698 | \$657,697 | \$672,771 | \$408,406 | \$348,865 |
| Cash per share | \$0.45 | \$4.93 | \$2.86 | \$7.49 | \$8.93 |
| Book value per share | \$10.10 | \$28.21 | \$8.43 | \$15.94 | \$14.90 |
| Price/book value ratio | 5.8x | 2.1x | 2.0x | 4.4x | 1.6x |
| Growth statistics (over comparable quarter): | | | | | |
| Revenue | 3% | 64% | 53% | 57% | 12% |
| Research and development | 5% | 4% | 7% | 22% | 2% |
| Sales and marketing | 2% | 16% | 110% | 14% | 6% |
| General and administrative | n/a | n/a | 104% | n/a | n/a |
| Net income | 9% | 116% | (445%) | 143% | 244% |

- (1) Included in AT&T's net income for the quarter ended June 30, 1993 is a \$287 million restructuring charge.
- (2) Dell's net income decreased 445% over the same period last year despite significant revenue growth due to a substantial increase in a cost of sales and controllable expenses. COGS as a percent of revenues increased from 77% to 94% due to inventory obsolescence charges. Next quarter's results will include charges for Dell's recall of notebooks.
- (3) Intel's stock price was \$70.75 on September 30, 1993, up 29% from \$55 at June 30, 1993.
- (4) In June 1993, Sun announced a 10 million share stock buyback program. Since June, the company has re-purchased 7.5 million shares.

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KEY RELATIONSHIPS

KEY RELATIONSHIPS

| | Corporate | | RR | |
|---|--------------|--------------|--------------|----------------|
| | Software (1) | Egghead | Merisel | Donnelley |
| | 6/30/93 | 7/24/93 | 6/30/93 | 6/30/93 |
| Income statement | | | | |
| Most recent quarter | | | | |
| Net revenues | \$83 | \$218 | \$713 | \$994 |
| Net income (loss) | 0 (2) | (2) | 6 | 53 |
| EPS | 0.01 | (0.12) | 0.20 | 0.34 |
| Trailing twelve months | | | | |
| Net revenues | \$326 | \$742 | \$2,645 | \$4,202 |
| Net income (loss) | 5 | 3 | 24 | 107 |
| EPS | 0.76 | 0.19 | 0.78 | 0.69 |
| Net income (loss) as a % of net revenues | 1% | 0% | 1% | 3% |
| Balance sheet | | | | |
| Cash | \$12 | \$15 | \$0 | \$17 |
| Other current assets | 85 | 218 | 649 | 1,034 |
| Other assets | 12 | 23 | 67 | 2,314 |
| | <u>\$109</u> | <u>\$256</u> | <u>\$716</u> | <u>\$3,365</u> |
| Liabilities | \$52 | \$114 | \$508 | \$1,642 |
| Equity | <u>57</u> | <u>142</u> | <u>208</u> | <u>1,723</u> |
| | <u>\$109</u> | <u>\$256</u> | <u>\$716</u> | <u>\$3,365</u> |
| Other data | | | | |
| Closing stock price (September 30, 1993) | \$11.25 | \$7.00 | \$14.13 | \$29.50 |
| Common shares outstanding (in millions) | 6 | 17 | 30 | 155 |
| Market value (in millions) | \$68 | \$119 | \$424 | \$4,573 |
| Price/revenues ratio | 0.2x | 0.2x | 0.2x | 1.1x |
| Price/earnings ratio - trailing twelve | 14.9x | 37.0x | 18.0x | 42.9x |
| Price/earnings ratio - future 4 qtrs. | 7.4x | 29.5x | 13.0x | 17.4x |
| Avg headcount (most recent disclosure) | 544 | 2,350 | 1,695 | 30,950 |
| Net revenues/employee | \$599,345 | \$315,578 | \$1,560,789 | \$135,779 |
| Cash per share | \$2.00 | \$0.88 | \$0.00 | \$0.11 |
| Book value per share | \$9.50 | \$8.35 | \$6.93 | \$11.12 |
| Price/book value ratio | 1.2x | 0.8x | 2.0x | 2.7x |
| Growth statistics (over comparable quarter): | | | | |
| Revenue | 16% | 8% | 39% | (1%) |
| Research and development | n/a | n/a | n/a | n/a |
| Sales and marketing | 4% | 14% | 20% | 8% |
| General and administrative | 16% | n/a | n/a | n/a |
| Net income | (96%) | (219%) | 37% | (2%) |

(1) Corporate Software announced on October 19, 1993 that management is taking the company private. Shareholders will receive \$15 per share. On October 15, 1993, the closing stock price was \$11.75.

(2) Corporate Software's revenues and net income for the quarter ended June 30, 1993 reflect a pre-tax restructuring charge of \$1.5 million for the company's German operations which reduced reported net income by \$944,000 or \$3.15 per share. As a result, net income decreased 96% over the same period last year.

* Not meaningful.

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Industry

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Channel Reporting

MS-PCA 1191214
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CHANNEL SUMMARY

Results of Operations (In millions)

Q94-1

| | <u>Net Revenue</u> | | <u>Cost of Revenue</u> | | <u>Controllable Expense</u> | | <u>Responsibility Margin</u> | |
|-------------------|--------------------|------------------|------------------------|------------------|-----------------------------|------------------|------------------------------|------------------|
| | <u>Actual</u> | <u>% of Plan</u> | <u>Actual</u> | <u>% of Plan</u> | <u>Actual</u> | <u>% of Plan</u> | <u>Actual</u> | <u>% of Plan</u> |
| North American FG | \$287 | 103% | \$64 | 119% | \$119 | 78% | \$104 | 141% |
| Europe FG | 261 | 102 | 46 | 102 | 86 | 86 | 129 | 115 |
| ICON FG | 66 | 114 | 13 | 93 | 23 | 77 | 30 | 214 |
| Far East FG | 60 | 131 | 14 | 121 | 22 | 106 | 24 | 185 |
| OEM | 255 | 142 | 11 | 140 | 19 | 132 | 225 | 142 |
| Other | 54 | 900 | 11 | 590 | 40 | 229 | 4 | (400) |
| Worldwide | <u>\$983</u> | <u>119</u> | <u>\$159</u> | <u>118</u> | <u>\$309</u> | <u>93</u> | <u>\$516</u> | <u>144</u> |

| | <u>Net Revenue Mix</u> | | <u>Cost of Revenue</u> | | <u>Controllable Expense</u> | | <u>Responsibility Margin</u> | |
|-------------------|------------------------|------------------|------------------------|------------------|-----------------------------|------------------|------------------------------|------------------|
| | <u>Actual</u> | <u>% pts Var</u> | <u>% Net Rev</u> | <u>% pts Var</u> | <u>% Net Rev</u> | <u>% pts Var</u> | <u>% Net Rev</u> | <u>% pts Var</u> |
| North American FG | 29% | (5) | 22% | (3) | 41% | 13 | 36% | 10 |
| Europe FG | 27 | (5) | 18 | 0 | 33 | 6 | 50 | 6 |
| ICON FG | 7 | 0 | 20 | 5 | 35 | 17 | 45 | 21 |
| Far East FG | 6 | 0 | 23 | 2 | 38 | 6 | 39 | 8 |
| OEM | 27 | 5 | 4 | 0 | 7 | 0 | 88 | 0 |
| Other | 5 | 5 | 20 | 13 | 74 | 211 | 7 | 207 |
| Worldwide | <u>100%</u> | <u>0</u> | <u>16%</u> | <u>0</u> | <u>31%</u> | <u>9</u> | <u>53%</u> | <u>9</u> |

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CHANNEL SUMMARY

Net Revenue and Responsibility Margin by Subsidiary (in millions)

Q94-1

| | Excluding OEM | | | | Including OEM | | | |
|----------------------|---------------|-------------|-----------------------|-------------|---------------|-------------|-----------------------|-------------|
| | Net Revenue | | Responsibility Margin | | Net Revenue | | Responsibility Margin | |
| | Actual | % of Plan | Actual | % of Plan | Actual | % of Plan | Actual | % of Plan |
| North America | | | | | | | | |
| United States | 288.3 | 103% | 96.4 | 144% | 430.1 | 116% | 224.8 | 147% |
| Canada | 19.5 | 97% | 9.2 | 114% | 22.6 | 99% | 10.7 | 110% |
| Subtotal | 307.8 | 100% | 105.6 | 141% | 452.7 | 115% | 235.5 | 149% |
| Europe | | | | | | | | |
| Denmark | 4.6 | 101% | 2.9 | 107% | 4.9 | 103% | 3.2 | 110% |
| Finland | 1.7 | 76% | 0.9 | 69% | 4.0 | 73% | 3.2 | 70% |
| Norway | 4.1 | 93% | 2.7 | 98% | 5.2 | 115% | 3.7 | 128% |
| England | 46.5 | 94% | 22.8 | 123% | 51.7 | 96% | 27.8 | 124% |
| Sweden | 8.7 | 81% | 1.2 | 44% | 9.9 | 89% | 2.2 | 77% |
| Hungary | 1.1 | 211% | 0.8 | 1423% | 1.1 | 181% | 0.8 | 580% |
| Russia | 0.5 | 100% | 0.0 | - | 0.5 | 69% | 0.1 | 55% |
| Czechoslovakia | 1.2 | 139% | 0.9 | 463% | 1.4 | 126% | 1.1 | 292% |
| Switzerland | 17.5 | 130% | 11.3 | 153% | 18.1 | 151% | 11.9 | 154% |
| Germany | 84.0 | 109% | 45.9 | 125% | 100.8 | 105% | 62.2 | 114% |
| Poland | 1.0 | 107% | 0.8 | 313% | 1.5 | 123% | 1.3 | 242% |
| Austria | 7.5 | 105% | 4.6 | 112% | 8.0 | 106% | 5.1 | 113% |
| Netherlands | 4.5 | 72% | -0.3 | 18% | 6.8 | 85% | 1.8 | 63% |
| Spain | 2.3 | 98% | 0.0 | 29% | 2.8 | 99% | 0.5 | 121% |
| France | 45.6 | 76% | 20.5 | 68% | 47.4 | 77% | 22.0 | 69% |
| Italy | 22.3 | 267% | 15.7 | 511% | 27.6 | 224% | 20.8 | 304% |
| Belgium | 4.0 | 64% | 1.2 | 38% | 4.8 | 73% | 1.8 | 57% |
| Portugal | 2.0 | 117% | 1.0 | 138% | 2.1 | 106% | 1.1 | 111% |
| RHQ/Other | 2.2 | - | -3.2 | - | 3.0 | - | -2.5 | - |
| Subtotal | 261.5 | 102% | 129.7 | 130% | 301.3 | 102% | 167.8 | 115% |
| ICON | | | | | | | | |
| Caribbean | 0.6 | 133% | 0.3 | 604% | 0.6 | 128% | 0.3 | 441% |
| Ecuador | 1.0 | 284% | 0.7 | 2012% | 1.0 | 284% | 0.7 | 5333% |
| Chile | 1.6 | 102% | 0.7 | 140% | 1.4 | 101% | 0.7 | 137% |
| Colombia | 2.1 | 199% | 1.1 | 273% | 2.2 | 201% | 1.2 | 271% |
| Venezuela | 1.7 | 174% | 1.0 | 354% | 2.0 | 154% | 1.3 | 216% |
| Brazil | 5.6 | 223% | 2.3 | - | 6.2 | 195% | 2.9 | 1253% |
| Argentina | 3.1 | 156% | 1.6 | 280% | 3.1 | 147% | 1.6 | 233% |
| Mexico | 8.1 | 100% | 3.6 | 144% | 8.2 | 99% | 3.7 | 135% |
| Morocco | 0.9 | 75% | 0.2 | 229% | 0.3 | 71% | 0.2 | 177% |
| Middle East | 2.8 | 132% | 1.3 | 210% | 2.8 | 128% | 1.3 | 192% |
| Turkey | 1.5 | 100% | 0.8 | 241% | 1.5 | 95% | 0.8 | 196% |
| South Africa | 4.0 | 89% | 2.3 | 131% | 4.3 | 92% | 2.6 | 132% |
| Greece | 0.8 | 154% | 0.5 | 717% | 0.8 | 158% | 0.5 | 590% |
| Israel | 1.8 | 230% | 1.2 | 631% | 2.3 | 229% | 1.6 | 423% |
| India | 0.6 | 119% | 0.3 | 182% | 0.7 | 109% | 0.5 | 132% |
| Thailand | 0.4 | 59% | 0.1 | 25% | 0.4 | 55% | 0.1 | 22% |
| Malaysia | 0.9 | 63% | 0.4 | 60% | 1.3 | 77% | 0.8 | 84% |
| Singapore | 2.8 | 97% | 1.6 | 125% | 3.0 | 107% | 3.6 | 122% |
| Australia | 22.7 | 102% | 9.3 | 148% | 26.6 | 108% | 12.6 | 149% |
| New Zealand | 4.0 | 101% | 2.0 | 105% | 4.2 | 100% | 2.2 | 102% |
| RHQ/Other | 0.2 | - | -1.5 | - | 0.2 | - | -1.5 | - |
| Subtotal | 66.4 | 114% | 29.7 | 202% | 75.1 | 115% | 37.6 | 178% |
| Far East | | | | | | | | |
| PRC | 0.7 | 127% | 0.3 | 3333% | 0.7 | 127% | 0.3 | 3333% |
| Korea | 5.5 | 211% | 3.5 | 414% | 11.8 | 147% | 9.6 | 157% |
| Taiwan | 6.6 | 195% | 4.6 | 451% | 15.4 | 113% | 13.3 | 124% |
| Japan | 44.0 | 119% | 14.4 | 120% | 71.5 | 137% | 40.5 | 152% |
| Hong Kong | 3.2 | 126% | 1.7 | 161% | 5.4 | 126% | 3.9 | 141% |
| RHQ/Other | 0.4 | - | -1.0 | - | 7.2 | - | 5.8 | - |
| Sub Total | 60.3 | 131% | 23.6 | 167% | 112.0 | 142% | 73.5 | 162% |
| Worldwide | | | | | | | | |
| Other | 51.6 | - | 45.4 | - | 51.5 | - | 45.3 | - |
| Total | 727.5 | 105% | 333.0 | 135% | 982.6 | 113% | 599.8 | 138% |

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CHANNEL SUMMARY

METRICS SUMMARY (ANNUALIZED IN THOUSANDS)

| | Finished Goods | | | | OEM | Channel Aggregate |
|---|----------------|--------|------|----------|--------|-------------------|
| | No. Amer. | Europe | ICON | Far East | | |
| Revenue per Employee | | | | | | |
| Actual | 318 | 434 | 453 | 537 | 11,860 | 537 |
| Plan | 284 | 401 | 352 | 436 | 7,500 | 399 |
| Q93-4 | 400 | 496 | 502 | 553 | 10,716 | 549 |
| Q93-3 | 334 | 590 | 459 | 458 | 10,545 | 528 |
| Q93-2 | 382 | 671 | 551 | 398 | 8,256 | 564 |
| Q93-1 | 356 | 617 | 690 | 215 | 7,792 | 527 |
| People Expenses per Employee | | | | | | |
| Actual | 72 | 75 | 75 | 93 | 196 | 71 |
| Plan | 76 | 80 | 85 | 95 | 208 | 74 |
| Q93-4 | 76 | 73 | 97 | 72 | 296 | 73 |
| Q93-3 | 66 | 74 | 83 | 65 | 234 | 66 |
| Q93-2 | 67 | 78 | 91 | 60 | 236 | 69 |
| Q93-1 | 66 | 87 | 87 | 59 | 228 | 70 |
| Facilities Expenses per Employee | | | | | | |
| Actual | 21 | 27 | 27 | 30 | 32 | 23 |
| Plan | 23 | 27 | 30 | 38 | 42 | 24 |
| Q93-4 | 20 | 32 | 21 | 30 | 61 | 23 |
| Q93-3 | 17 | 28 | 26 | 30 | 54 | 21 |
| Q93-2 | 18 | 29 | 29 | 21 | 41 | 21 |
| Q93-1 | 18 | 33 | 22 | 19 | 38 | 21 |
| Marketing Expense % Net Revenue | | | | | | |
| Actual | 10% | 8% | 9% | 13% | 0% | 6% |
| Plan | 16% | 11% | 14% | 13% | 1% | 11% |
| Q93-4 | 5% | 10% | 9% | 20% | 0% | 6% |
| Q93-3 | 21% | 6% | 8% | 12% | 2% | 10% |
| Q93-2 | 19% | 10% | 12% | 19% | 3% | 12% |
| Q93-1 | 13% | 10% | 5% | 20% | 2% | 9% |

Top Customers (in millions)

| | No Amer | Europe | ICON | Far East | OEM | Worldwide |
|--------------------------|---------------|---------------|--------------|--------------|---------------|---------------|
| Ingram Micro | \$ 89 | \$ 13 | \$ -- | \$ -- | \$ -- | \$ 102 |
| Merisel | 67 | 33 | 5 | -- | -- | 105 |
| Egghead | 22 | -- | -- | -- | -- | 22 |
| C2000 | -- | 56 | -- | -- | -- | 56 |
| IBM | -- | -- | -- | -- | 22 | 22 |
| Compaq | -- | -- | -- | -- | 21 | 21 |
| Gateway 2000 | -- | -- | -- | -- | 14 | 14 |
| Soft Bank | -- | -- | -- | 9 | -- | 9 |
| Comp USA | 11 | -- | -- | -- | -- | 11 |
| Software Spectrum | 10 | -- | -- | -- | -- | 10 |
| Macrotron | -- | 14 | -- | -- | -- | 14 |
| Other Top Customers | 34 | 29 | 15 | 22 | 61 | 161 |
| | <u>\$ 233</u> | <u>\$ 145</u> | <u>\$ 20</u> | <u>\$ 31</u> | <u>\$ 118</u> | <u>\$ 547</u> |
| Percent of Gross Revenue | <u>76%</u> | <u>55%</u> | <u>30%</u> | <u>52%</u> | <u>44%</u> | <u>54%</u> |

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CHANNEL SUMMARY

Headcount Summary

| | Q94-1 | | | FY94 |
|------------------|--------------|--------------|------------|--------------|
| | Actual | Plan | Variance | Plan |
| North America FG | 3,623 | 3,941 | 318 | 3,862 |
| Europe FG | 2,404 | 2,655 | 251 | 2,789 |
| ICON FG | 583 | 674 | 91 | 726 |
| Far East FG | 447 | 422 | (25) | 471 |
| OEM | 86 | 96 | 10 | 98 |
| Other | 285 | 369 | 84 | 328 |
| | <u>7,428</u> | <u>8,157</u> | <u>729</u> | <u>8,274</u> |

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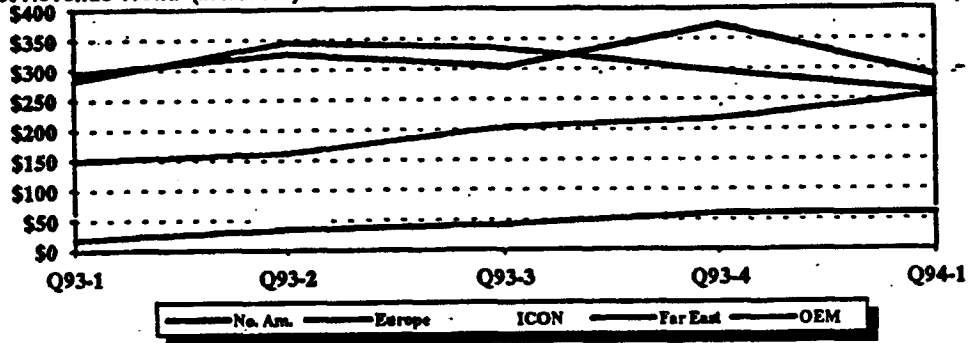
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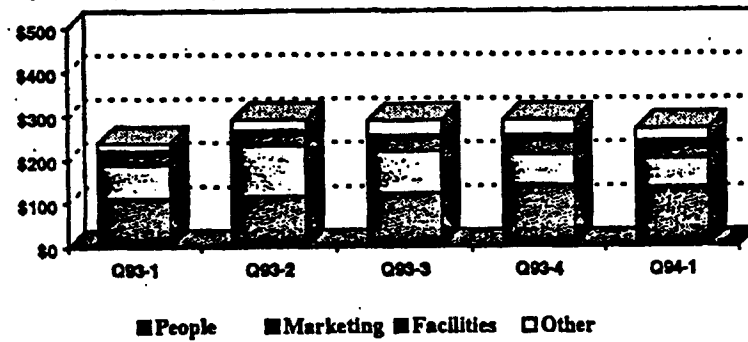
CHANNEL SUMMARY

TREND ANALYSES

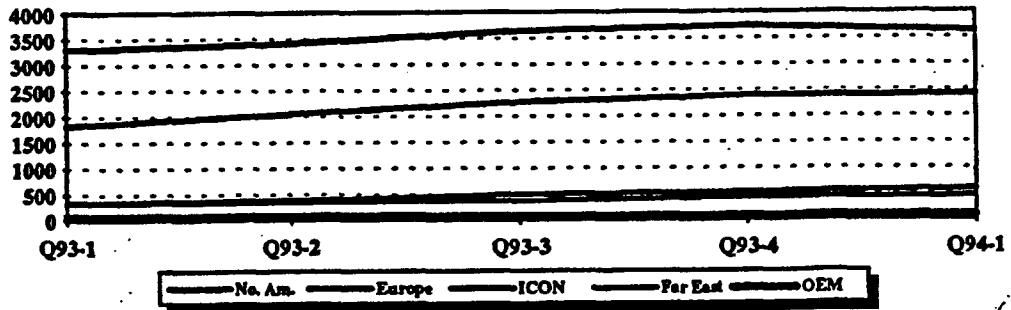
Net Revenue Trend (in millions)



Controllable Expenses (in millions)



Headcount Trend



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NORTH AMERICA FINISHED GOODS

NORTH AMERICA FINISHED GOODS

Results of Operations (in millions)

| | Q94-1 | | |
|------------------------|--------|--------|----------|
| | Actual | Plan | Variance |
| Net Revenues | \$287 | \$280 | \$7 |
| Cost of Revenues | 64 | 54 | (10) |
| Gross Profit | 223 | 226 | (3) |
| People Expenses | 66 | 75 | 9 |
| Facilities Expenses | 19 | 23 | 4 |
| Marketing Expenses | 28 | 44 | 16 |
| Other Expenses | 6 | 10 | 4 |
| Controllable Expenses | 119 | 152 | 33 |
| Responsibility Margin | 104 | 74 | 30 |
| Net Shared Resources | (7) | (8) | (1) |
| Shared Resource Margin | 111 | 82 | 31 |
| Net Revenues | 100.0% | 100.0% | 0.0% |
| Cost of Revenues | 22.3 | 19.2 | (3.1) |
| Controllable Expenses | 41.3 | 54.3 | 13.0 |
| Responsibility Margin | 36.4 | 26.5 | 9.9 |
| Net Shared Resources | (2.6) | (3.0) | (0.4) |
| Shared Resource Margin | 38.9% | 29.3% | 9.6% |

Q94-1

Net Revenues

- Net revenues for the quarter were 103% of plan. Revenues from the Advanced Systems product unit were below plan by \$26 million, in part from the delayed release of Windows NT. This shortfall was offset by the Desktop Applications business unit being \$34 million over plan.
- Stockouts at September 30, 1993 amounted to \$26.4 million, most notably PC Flight Simulator version 5.0 (\$5.1 million), Win Office version 4.0 (\$4.7 million), and Windows version 3.1 (\$3.4 million).

Cost of Revenues

- Cost of revenues for the quarter were 22.3% of net revenues in comparison with a plan of 19.2%, or a negative variance of \$10 million. This variance was due largely to a \$4.3 million write down of hardware and diskette inventories as well as actual manufacturing costs being in excess of budget.

Controllable Expenses

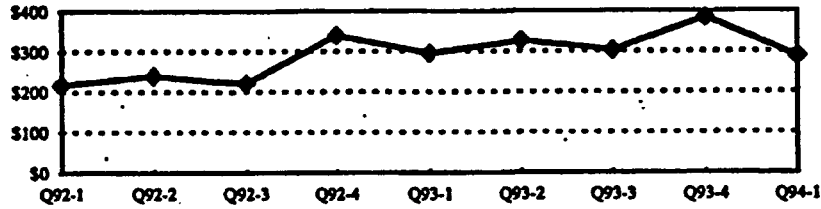
- Controllable expenses for the quarter were \$33 million below plan. Marketing spend was \$16 million below plan due to the delay in spending pending the Q94-2 launches of Win Office 4.0, Win Word 6.0, and Win Excel 5.0. People expenses were under plan by \$9 million due to delayed hiring.

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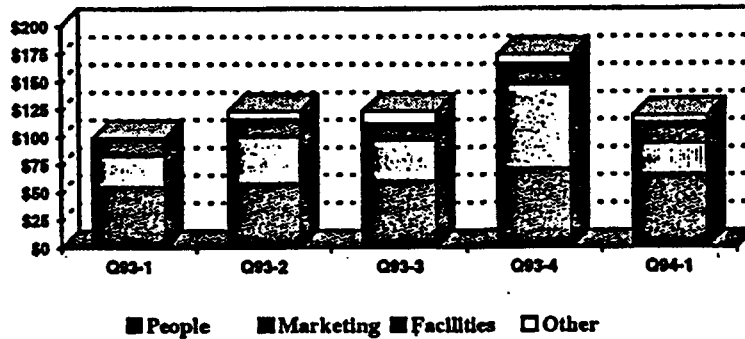
NORTH AMERICA FINISHED GOODS

TREND ANALYSES

Net Revenues



Controllable Expenses (in millions)



- Net revenues in Q94-1 were 103% of plan, and 75% of the revenues in Q93-4. Revenues from Win Office, Win Excel, Win Word, and Win 3.1 in Q94-1 accounted for the positive variance from plan. Quarter to quarter revenues decreased principally due to softening of MS-DOS 6.0 Upgrade launched in Q93-4.
- Strong sales of Win Office (\$22 million over plan), Win Excel (\$9 million over plan), Windows (\$7 million above plan) were primary reasons for favorable Q94-1 revenues.
- In Q94-1, people and people related expenses were 90% and 88% of plan, respectively, due mostly to below planned headcount in PSS (192), US FG (134) and Canada (35).
- Marketing expenses were 37% below plan with favorable variances occurring in all business units. Q94-1 marketing expenses were significantly below spending levels in Q93-4 due to the delay of spending to support the release of version updates in Q94-2.
- Facilities expenses were 85% of plan and 98% of Q93-4 expenses. The favorable variance was primarily due to lower than planned depreciation expense.

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Channel Reporting

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NORTH AMERICA FINISHED GOODS

REVENUE SUMMARY (REVENUE IN MILLIONS, UNITS IN THOUSANDS)

Q94-1

| | Revenue | | | Licenses | | | \$/License | | |
|------------------------------|---------|-------|-------|----------|-------|-------|------------|-------|-------|
| | Actual | Plan | % Var | Actual | Plan | % Var | Actual | Plan | % Var |
| WIN Office | \$50 | \$48 | 6% | 147 | 148 | (1%) | \$344 | \$321 | 7% |
| MAC Office | 12 | 10 | 22% | 34 | 27 | 25% | 359 | 369 | (3%) |
| Excel PU* | 26 | 13 | 104% | 194 | 96 | 103% | 135 | 135 | 1% |
| Graphics PU* | 6 | 5 | 10% | 46 | 37 | 25% | 127 | 145 | (12%) |
| Project PU | 13 | 13 | (4%) | 42 | 44 | (5%) | 299 | 296 | 1% |
| Word PU* | 32 | 21 | 54% | 276 | 155 | 78% | 116 | 134 | (13%) |
| DAD BU New Users** | \$139 | \$109 | 27% | 738 | 506 | 46% | \$189 | \$216 | (13%) |
| WIN Office | \$2 | \$5 | (48%) | 57 | 30 | 94% | \$41 | \$154 | (73%) |
| MAC Office | 1 | 2 | (30%) | 18 | 6 | 231% | 65 | 310 | (79%) |
| Excel PU* | 4 | 2 | 167% | 60 | 24 | 156% | 68 | 65 | 4% |
| Graphics PU* | 0 | 0 | 95% | 14 | 6 | 113% | 35 | 39 | (8%) |
| Project PU | 1 | 0 | 207% | 13 | 3 | 395% | 63 | 101 | (38%) |
| Word PU* | 5 | 5 | (3%) | 78 | 61 | 30% | 60 | 80 | (25%) |
| DAD BU Existing Users** | \$14 | \$13 | 4% | 241 | 128 | 88% | \$57 | \$103 | (45%) |
| Basic PU | \$9 | \$7 | 16% | 80 | 60 | 34% | \$107 | \$123 | (13%) |
| Database Mgmt (Access) PU* | 5 | 9 | (42%) | 34 | 40 | (16%) | 152 | 221 | (31%) |
| Fox Database PU* | 7 | 21 | (64%) | 113 | 107 | 6% | 66 | 194 | (66%) |
| Languages PU's | 7 | 8 | (9%) | 72 | 47 | 52% | 96 | 160 | (40%) |
| DBDT BU* | \$28 | \$44 | (37%) | 298 | 253 | 18% | \$94 | \$175 | (47%) |
| Entry PU | \$17 | \$11 | 49% | 391 | 234 | 67% | \$42 | \$48 | (11%) |
| MM Pubs | 4 | 3 | 16% | 57 | 49 | 15% | 62 | 62 | 1% |
| Works PU | 9 | 7 | 17% | 196 | 123 | 60% | 44 | 61 | (27%) |
| Consumer BU | \$29 | \$22 | 33% | 644 | 406 | 59% | \$45 | \$53 | (16%) |
| MS-DOS BU | \$2 | \$10 | (79%) | 86 | 257 | (67%) | \$24 | \$38 | (38%) |
| Hardware BU | \$24 | \$27 | (9%) | 439 | 354 | 24% | \$55 | \$75 | (27%) |
| Windows | \$23 | \$11 | 110% | 465 | 204 | 128% | \$50 | \$54 | (8%) |
| Win NT | \$15 | \$31 | (52%) | 78 | 161 | (51%) | \$191 | \$194 | (1%) |
| Win NT Adv. Server | 3 | 7 | (48%) | 5 | 10 | (46%) | 617 | 650 | (5%) |
| Other Server (SQL, SNA) | 3 | 6 | (45%) | 16 | 3 | 434% | 213 | 2,075 | (90%) |
| Other Operating Systems PU | 2 | 5 | (67%) | 8 | 29 | (73%) | 228 | 186 | 23% |
| Adv. Systems | \$23 | \$49 | (52%) | 107 | 203 | (47%) | \$219 | \$243 | (10%) |
| Workgroups BU* | \$9 | \$7 | 27% | 348 | 134 | 160% | \$27 | \$55 | (51%) |
| Digital Office Systems | \$0 | \$2 | (87%) | 2 | 16 | (87%) | \$107 | \$111 | (3%) |
| ACT and APD PU's | 2 | 2 | 5% | 93 | 51 | 81% | 21 | 36 | (42%) |
| Other PU's | 2 | 0 | - | 7 | 0 | - | 240 | - | - |
| Other | \$4 | \$4 | 4% | 102 | 67 | 51% | \$37 | \$54 | (31%) |
| Finished Goods Revenue Total | \$296 | \$297 | (1%) | 3,610 | 2,514 | 44% | \$82 | \$118 | (31%) |
| Other Materials | \$11 | \$0 | - | - | - | - | - | - | - |
| Total Gross Revenue | \$307 | \$297 | 3% | 3,610 | 2,514 | 44% | | | |

*excludes allocation from sales of Office bundles

** includes database and MS Mail products sold through Office bundles

NORTH AMERICA FINISHED GOODS

Revenues Summary

- Gross FG revenues for the United States and Canada combined were \$307 million for Q94-1, representing 103% of plan.
- Actual revenues from Desktop applications in the quarter were \$34 million over plan, principally from sales of Excel and Word. This was achieved in spite of the pending launches of version updates of key products in Q94-2. Desktop application revenues accounted for 50% of gross revenues for the United States and Canada combined. Revenues from new users of Excel were \$26 million, representing 204% of plan. The average revenues per license for Excel was \$135, approximating the planned revenues per license. Revenues from new users of Word were \$32 million, representing 154% of plan. The average revenues per license for Word was \$116, a negative variance from plan of \$18 per license.
- Revenues from consumer products in the quarter were \$7 million over plan, principally from the sales of Win Publisher (\$5 million over plan) PC Flight Simulator (\$2 million over plan) and Mac Works (\$2 million over plan) offset by Win Accounting (\$1 million below plan).
- Revenues from Advanced systems were \$26 million under plan, due to revenue shortfall occurring in Windows NT (\$16 million), SQL Server - Enterprise (\$3 million), Windows NT Advanced Server (\$3 million) and Lan Manager (\$3 million).
- Significant variances occurred in Database and Development tools (\$15 million below plan), products contributing to the shortfall were Win FoxPro (\$7 million below plan), PC FoxPro (\$5 million below plan), Win Access (\$2 million below plan) and Win NT Visual C++ (\$1 million) offset by positive product variance occurring in Win Visual Basic Professional (\$3 million above plan).

Channels and Discounts (in millions)

| | Q94-1 | | |
|--------------------------|--------|---------|----------|
| | Sales | Percent | Discount |
| Resellers | | | |
| Distributors | \$ 164 | 53% | 44% |
| Major Chains | 33 | 11 | 40 |
| Large Volume Resellers | 43 | 14 | 37 |
| Total Resellers | 240 | 78 | 43 |
| VAR's/Solution Providers | 8 | 3 | 54 |
| Direct | 38 | 12 | 43 |
| Canada | 21 | 6 | 36 |
| Gross Revenues | \$ 307 | 100% | 43% |

Channels

- Revenues from distributors in the United States in Q94-1 were \$164 million compared to a plan of \$149 million. Ingram Micro purchased \$83 million in the quarter in the US (\$89 million, including Canada) in comparison with plan of \$70 million. Merisel purchased \$57 million in the US (\$67 million, including Canada) in comparison with plan of \$51 million.
- Revenues from major chains were \$33 million (70% of plan), consisting principally of revenues from Egghead (\$22 million) and CompUSA (\$11 million).
- Revenues from large volume resellers were \$43 million (98% of plan).

Canada

- Net FG revenue from Canada was \$21 million for the quarter (99% of plan). Responsibility margin was 113% of plan.

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Significant Customers (in millions)

| | <u>Q92-4</u> | <u>Q93-1</u> | <u>Q93-2</u> | <u>Q93-3</u> | <u>Q93-4</u> | <u>Q94-1</u> |
|--------------------------|---------------|---------------|---------------|---------------|---------------|---------------|
| Ingram Micro | \$ 93 | \$ 93 | \$ 61 | \$ 92 | \$ 72 | \$ 89 |
| Merisel | 66 | 66 | 56 | 56 | 51 | 67 |
| Egghead | 52 | 52 | 51 | 46 | 22 | 22 |
| Comp USA | 22 | 22 | 19 | 11 | 8 | 11 |
| Software Spectrum | 24 | 24 | 11 | 18 | 14 | 10 |
| Corporate Software | 21 | 21 | 11 | 17 | 10 | 9 |
| 800 Software | 10 | 10 | 7 | 8 | 8 | 8 |
| Computerland | 10 | 10 | 8 | 6 | 9 | 6 |
| Softmart | 9 | 9 | 6 | 8 | 6 | 6 |
| Intelligent Electronics | 6 | 6 | 4 | 5 | 2 | 5 |
| | <u>\$ 313</u> | <u>\$ 313</u> | <u>\$ 234</u> | <u>\$ 267</u> | <u>\$ 202</u> | <u>\$ 233</u> |
| Percent of Gross Revenue | <u>81%</u> | <u>81%</u> | <u>82%</u> | <u>80%</u> | <u>76%</u> | <u>76%</u> |

Significant Customers

- Revenues from the top customers in Q94-1 represented 76% of the gross FG revenues for the United States and Canada.
- Sales to Ingram Micro in August and September were \$36 million and \$30 million respectively, representing 74% of the sales to that customer in Q94-1.
- Sales to Merisel increased 31% to \$67 million in Q94-1 from \$51 million in Q93-4.
- Sales to Egghead dropped to \$22 million in both Q93-4 and Q94-1, down from \$56 million in Q93-3.

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Results of Operations (in millions)

| | Q94-1 | | |
|------------------------|--------|--------|----------|
| | Actual | Plan | Variance |
| Net Revenues | \$261 | \$257 | \$4 |
| Cost of Revenues | 46 | 45 | (1) |
| Gross Profit | 215 | 212 | 3 |
| People Expenses | 45 | 51 | 6 |
| Facilities Expenses | 16 | 17 | 1 |
| Marketing Expenses | 21 | 28 | 7 |
| Other Expenses | 4 | 4 | 0 |
| Controllable Expenses | 86 | 100 | 14 |
| Responsibility Margin | 129 | 112 | (11) |
| Net Shared Resources | (1) | (1) | 0 |
| Shared Resource Margin | 128 | 111 | 17 |
| | | | |
| Net Revenues | 100.0% | 100.0% | 0.0% |
| Cost of Revenues | 17.6 | 17.5 | (0.1) |
| Controllable Expenses | 32.8 | 39.1 | 6.3 |
| Responsibility Margin | 49.6 | 43.2 | 6.4 |
| Net Shared Resources | (0.5) | (0.5) | 0.0 |
| Shared Resource Margin | 49.1% | 42.7% | 6.4% |

Q94-1

Net Revenue

- Net revenues were \$10 million lower than plan but were positively effected by exchange rate trends. France had a 27% revenue shortfall to plan, while the U.K. was 12% lower than plan. There was strong performance in Italy which resulted from favorable anti-piracy initiatives by the government.
- Win Office continued its strong performance, exceeding plan 26%.

Cost of Revenue

- Cost of revenues were slightly over plan. Product costs for Desktop applications were positive due to better than planned sales mix. Database and development tools offset this with higher than planned product costs and sales mix. The Systems division product costs were similar to plan.

Controllable Expenses

- Controllable expenses were \$14 million lower than plan primarily due to less than planned hiring and underspending in marketing.

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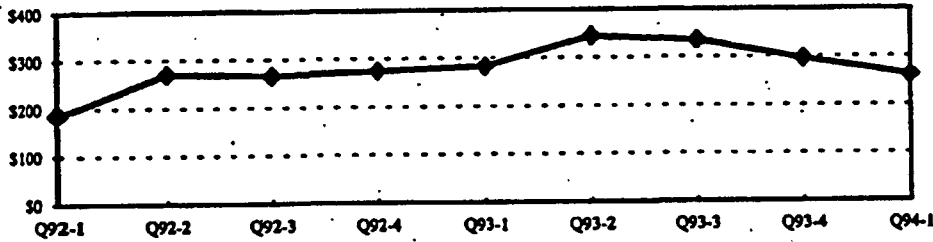
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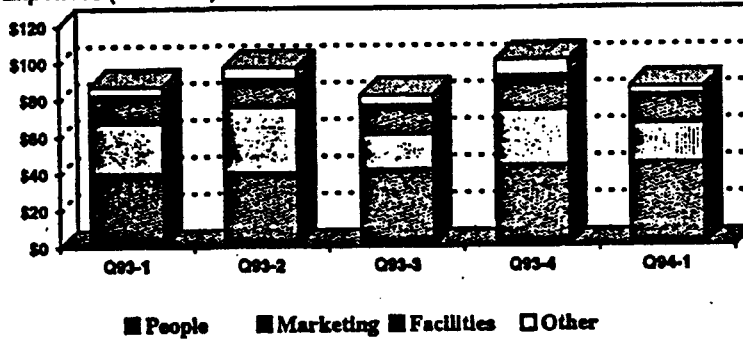
TREND ANALYSES

Net Revenue



- Net revenues in Q94-1 were \$22 million or 8% lower than in Q93-1. Local currency revenues increased 9% from Q93-1.

Controllable Expenses (in millions)



- People expenses in local currencies have increased significantly due to a headcount growth of 595 people since Q93-1. People expense increased slightly from Q93-4 although a hiring freeze was implemented. The increased costs were caused by salary adjustments and hiring individuals who had employment offers extended prior to the freeze.
- Marketing costs decreased from the prior quarter by \$9 million or 30%. This is due to the trend of spending significant marketing funds in the last quarter of the fiscal year.
- Facilities costs increased from Q93-1 due to new facilities in Eastern Europe and additional office facilities in France. Depreciation increased due to fixed asset acquisitions caused by headcount increases. Facilities costs decreased \$3 million from Q93-4 to Q94-1 due in part to the closure of the warehouse in Spain. The warehouse in Germany is scheduled to be closed in Q94-2.

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REVENUE SUMMARY (REVENUE IN MILLIONS, UNITS IN THOUSANDS)

Q94-1

| | Revenue | | | Licenses | | | \$/License | | |
|----------------------------|---------|-------|-------|----------|-------|-------|------------|-------|-------|
| | Actual | Plan | % Var | Actual | Plan | % Var | Actual | Plan | % Var |
| WIN Office | \$74 | \$59 | 26% | 170 | 162 | 5% | \$437 | \$364 | 20% |
| MAC Office | 4 | 3 | 19% | 10 | 10 | 4% | 395 | 348 | 14% |
| Excel PU* | 26 | 27 | (5%) | 111 | 115 | (4%) | 230 | 232 | (1%) |
| Graphics PU* | 2 | 2 | (6%) | 7 | 7 | 3% | 235 | 256 | (8%) |
| Project PU | 6 | 6 | 12% | 15 | 14 | 2% | 427 | 387 | 10% |
| Word PU* | 39 | 35 | 12% | 179 | 152 | 18% | 219 | 231 | (5%) |
| DAD BU New Users** | \$151 | \$131 | 15% | 492 | 460 | 7% | \$306 | \$286 | 7% |
| WIN Office | \$12 | \$8 | 58% | 37 | 33 | 12% | \$325 | \$231 | 41% |
| MAC Office | 1 | 0 | 66% | 3 | 3 | 23% | 257 | 191 | 34% |
| Excel PU* | 5 | 8 | (44%) | 46 | 77 | (40%) | 103 | 110 | (6%) |
| Graphics PU* | 0 | 1 | (56%) | 2 | 5 | (58%) | 124 | 118 | 5% |
| Project PU | 0 | 1 | (76%) | 2 | 5 | (69%) | 120 | 157 | (24%) |
| Word PU* | 7 | 11 | (39%) | 58 | 107 | (46%) | 119 | 107 | 11% |
| DAD BU Existing Users** | \$25 | \$29 | (15%) | 148 | 230 | (36%) | \$168 | \$128 | 31% |
| Basic PU | \$6 | \$4 | 45% | 41 | 27 | 49% | \$138 | \$142 | (3%) |
| Database Mgmt (Access) PU* | 9 | 13 | (32%) | 45 | 53 | (16%) | 197 | 246 | (20%) |
| Fox Database PU* | 7 | 8 | (13%) | 43 | 41 | 3% | 160 | 189 | (15%) |
| Languages PU's | 4 | 2 | 49% | 23 | 15 | 50% | 156 | 157 | (1%) |
| DBDT BU* | \$25 | \$27 | (8%) | 151 | 137 | 10% | \$165 | \$198 | (17%) |
| Entry PU | \$3 | \$3 | 0% | 67 | 69 | (3%) | \$44 | \$42 | 3% |
| MM Pubs | 1 | 0 | 42% | 12 | 9 | 29% | 60 | 54 | 11% |
| Works PU | 8 | 8 | (7%) | 92 | 93 | (1%) | 83 | 89 | (7%) |
| Consumer BU | \$11 | \$12 | (3%) | 171 | 171 | 0% | \$66 | \$68 | (3%) |
| MS-DOS BU | \$9 | \$15 | (41%) | 225 | 235 | (4%) | \$40 | \$65 | (38%) |
| Hardware BU | \$9 | \$11 | (11%) | 210 | 157 | 34% | \$45 | \$68 | (34%) |
| Windows | \$15 | \$18 | (20%) | 230 | 246 | (6%) | \$64 | \$75 | (14%) |
| Win NT | \$3 | \$7 | (51%) | 29 | 27 | 6% | \$113 | \$245 | (54%) |
| Win NT Adv. Server | 1 | 1 | (26%) | 1 | 2 | (32%) | 714 | 659 | 8% |
| Other Server (SQL, SNA) | 2 | 1 | 9% | 5 | 1 | 559% | 315 | 1,900 | (83%) |
| Other Operating Systems PU | 4 | 1 | 385% | 24 | 4 | 491% | 175 | 213 | (18%) |
| Adv. Systems | \$10 | \$10 | (2%) | 59 | 34 | 75% | \$168 | \$300 | (44%) |
| Workgroups BU* | \$4 | \$3 | 19% | 69 | 30 | 132% | \$53 | \$103 | (49%) |
| Digital Office Systems | \$0 | \$1 | (53%) | 2 | 6 | (56%) | \$113 | \$107 | 6% |
| ACT and APD PU's | 0 | 1 | (58%) | 5 | 12 | (57%) | 43 | 43 | (1%) |
| Other PU's | 0 | 0 | 16% | 1 | 2 | (65%) | 237 | 71 | 234% |
| Other | \$1 | \$1 | (46%) | 8 | 20 | (58%) | \$83 | \$65 | 28% |
| Total FG Revenue | \$259 | \$258 | 0% | 1,764 | 1,720 | 3% | \$147 | \$150 | (2%) |
| Other Materials | \$5 | \$0 | - | - | - | - | - | - | - |
| Total | \$264 | \$258 | 2% | 1,764 | 1,720 | 3% | - | - | - |

*excludes allocation from sales of Office bundles

** includes database and MS Mail products sold through Office bundles

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- Desktop applications were \$16 million higher than plan on the strength of Win Office. Win) revenues represented 33% of total gross revenue in Q94-1.
- MS-DOS was lower than plan due, in part to the upcoming release of MS DOS 6.2 in Q94-2.
- There was a significant decrease in revenue/license for all products compared to Q93-1, driven by foreign exchange trends, price reductions and product mix differences.
- Win Excel, Win Word, and Win Office (existing users) experienced lower prices from Q93-1 of 35%, 34%, and 26% respectively.

Net Revenue by Major Subsidiary (In millions)

| | Q94-1 | | Q94-1 Plan | | Net Variance | Operations Variance | Exchange Rate Variance |
|----------------|---------------|-------------|---------------|-------------|-----------------|------------------------|------------------------------|
| Germany | \$ 84 | 32 | \$ 77 | 30 | \$ 7 | \$ 1 | \$ 6 |
| England | 47 | 18 | 49 | 19 | (2) | (9) | 4 |
| France | 46 | 18 | 60 | 23 | (14) | (16) | 2 |
| Italy | 22 | 8 | 8 | 3 | 14 | 14 | - |
| Nordic Region | 19 | 7 | 23 | 9 | (4) | (3) | (1) |
| Switzerland | 17 | 7 | 13 | 5 | 4 | 2 | 2 |
| Benelux | 9 | 3 | 13 | 5 | (4) | (5) | 1 |
| Austria | 7 | 3 | 7 | 3 | - | - | - |
| Eastern Europe | 4 | 2 | 3 | 1 | 1 | 1 | - |
| Spain | 2 | 1 | 2 | 1 | - | - | - |
| Portugal | 2 | 1 | 2 | 1 | - | - | - |
| Redmond | 2 | 1 | - | - | 2 | 2 | - |
| | <u>\$ 261</u> | <u>100%</u> | <u>\$ 257</u> | <u>100%</u> | <u>\$ 4</u> | <u>\$ (10)</u> | <u>\$ 14</u> |

- Net revenues exceeded plan due to favorable exchange rate trends. Volumes in Europe were 4% lower than plan.
- Net revenues in France 27% lower than planned volume. Win Excel and Win Word were \$20 million lower than plan while Win Office was \$6 million over plan. Windows and MS-DOS were 72% and 81% lower than plan respectively.
- Italy net revenues were 175% over plan due to continued anti-piracy initiatives by the Italian fiscal authorities.
- Benelux net revenues were 38% lower than planned volume.

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Significant Customers in Major Subsidiaries (in millions)

| | <u>Q93-1</u> | <u>Q93-2</u> | <u>Q93-3</u> | <u>Q93-4</u> | <u>Q94-1</u> |
|-------------------------------|---------------|---------------|---------------|---------------|---------------|
| Germany | | | | | |
| Computer 2000 | \$ 24 | \$ 35 | \$ 33 | \$ 27 | \$ 28 |
| Merisel | 4 | 15 | 13 | 12 | 16 |
| Macrotron | 6 | 9 | 13 | 7 | 12 |
| England | | | | | |
| C2000 | 13 | 18 | 20 | 12 | 15 |
| Merisel | 11 | 8 | 14 | 10 | 14 |
| Ingram Micro | 6 | 4 | 8 | 6 | 5 |
| France | | | | | |
| CEGOS | 9 | 18 | 7 | 8 | 5 |
| Softmart | 6 | 11 | 9 | 5 | 5 |
| ISTA | 6 | 9 | 4 | 5 | 4 |
| Italy | | | | | |
| Ingram | 1 | 1 | 2 | 6 | 4 |
| C2000 | 1 | 2 | 2 | 5 | 3 |
| Nordic region | | | | | |
| C2000 | 8 | 16 | 20 | 27 | 4 |
| Microsoftware | 5 | 10 | 14 | 18 | 4 |
| Scribona AB | 3 | 6 | 6 | 6 | 2 |
| Switzerland | | | | | |
| Also ABC | 4 | 5 | 4 | 5 | 5 |
| Wyrsch Trading | 4 | 4 | 4 | 3 | 4 |
| Merisel | - | 1 | 1 | 2 | 3 |
| Benelux | | | | | |
| Ingram | 5 | 7 | 7 | 9 | 4 |
| C2000 | 4 | 5 | 6 | 5 | 2 |
| A-Line | 2 | 1 | 1 | 1 | - |
| Austria | | | | | |
| C2000 | 5 | 6 | 4 | 5 | 4 |
| Macrotron | - | - | - | 1 | 2 |
| | <u>\$ 127</u> | <u>\$ 191</u> | <u>\$ 192</u> | <u>\$ 185</u> | <u>\$ 145</u> |
| Percent of Net Revenue | <u>45%</u> | <u>55%</u> | <u>57%</u> | <u>63%</u> | <u>56%</u> |

- The European channel is planned to decrease the number of direct ship customers significantly during the upcoming quarters, in order to facilitate efficient distribution practices. This will have an effect of increased sales levels to the remaining individual customers.

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Results of Operations (in millions)

| | Q94-1 | | |
|------------------------|--------|--------|----------|
| | Actual | Plan | Variance |
| Net Revenues | \$66 | \$58 | \$8 |
| Cost of Revenues | 13 | 14 | 1 |
| Gross Profit | 53 | 44 | 9 |
| People Expenses | 11 | 14 | 3 |
| Facilities Expenses | 4 | 5 | 1 |
| Marketing Expenses | 6 | 8 | 2 |
| Other Expenses | 2 | 3 | 1 |
| Controllable Expenses | 23 | 30 | 7 |
| Responsibility Margin | 30 | 14 | 16 |
| Net Shared Resources | 0 | 0 | 0 |
| Shared Resource Margin | \$30 | \$14 | \$16 |
| | | | |
| Net Revenues | 100.0% | 100.0% | 0.0% |
| Cost of Revenues | 20.2 | 24.8 | 4.6 |
| Controllable Expenses | 34.6 | 51.2 | 16.6 |
| Responsibility Margin | 45.3 | 24.0 | 21.3 |
| Net Shared Resources | 0.0 | 0.0 | 0.0 |
| Shared Resource Margin | 45.3% | 24.0% | 21.3% |

Q94-1

Net Revenue

- For the quarter, Latin America was 141% of plan, AIME was 115% of plan and APAC was 99% of plan.
- While net revenues for the quarter were \$8 million higher than plan, revenues in September were \$3 million below plan. Until Office 4.0 is available, this unfavorable variance to plan is expected to continue.
- Mexico was \$1 million below plan in September due to the Mexican economy and uncertainty with NAFTA. Coupled with some excess inventory among the distributors, Mexico's sales are expected to be about 70% of plan for Q94-2.
- Net revenues in Brazil were \$3 million (122%) higher than plan due to much better than expected sales in this market after the near bankruptcy of Agoal, a key distributor. Net Revenues were \$1 million (130%) higher than plan in Israel due to greater than expected sales of localized product (Hebrew Word).

Cost of Revenue

- Cost of revenues were lower than plan due to higher than planed mix of licenses versus full package product and conservative budgeting of product costs.

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Controllable Expenses

- People expenses were favorable to plan due to delayed hiring of headcount and the freezing of 21 heads in the region (21 additional heads were terminated in Australia in October), along with lower than expected travel expenses. Actual headcount was 583 versus plan of 633 at September 30, 1993.
- Facilities expenses were lower mostly due to lower telecommunications and depreciation expense. The lower depreciation was due to later than planned occupation of offices in the five new subsidiaries opening in Q94-1, and later than planned purchases of capital items.
- Marketing expenses were lower than plan as marketing funds were being conserved for the Q94-2 launches of Win Office 4.0, Win Word 6.0, and Win Excel 5.0.

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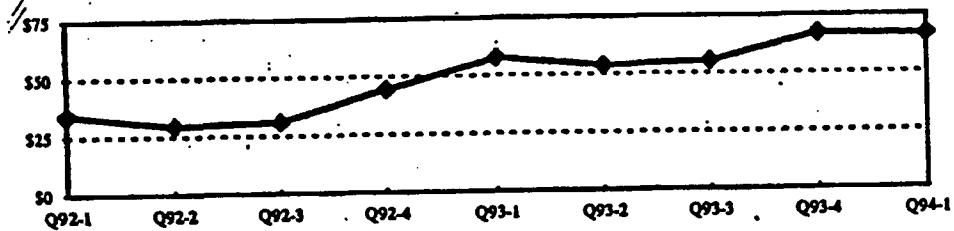
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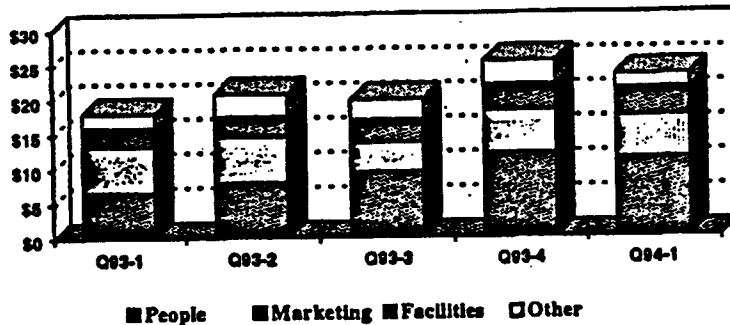
TREND ANALYSES

Net Revenue



- Quarterly revenues increased 94% over Q92-1, but only 14% over Q93-1. This compares to a 28% expense increase over Q93-1. The small increase over Q93-1 was due to a 25% decrease in sales in Australia, which was in part due to a 9% decrease in the value of the Australian dollar. Excluding Australia, quarterly revenues increased 60% over Q93-1.
- Q94-1 revenues decreased slightly from Q93-4, as sales decreased in Australia, Mexico, and South Africa. Sales in Q93-4 were aided significantly by the release of MS-DOS 6, while sales in Q94-1 were negatively impacted by the delayed release of Win Word 6.0 and Win Office 4.0 as the channel delayed purchases in anticipation of new product.

Controllable Expenses (in millions)



- People expenses increased in each quarter of FY93, but decreased in Q94-1 due to a significant reduction in payroll and travel expenses. Travel expenses were down because subsidiaries were consciously cutting back on non-essential travel.
- Facilities expense continue to increase due to the opening of new offices. Six new offices were opened in FY93 and five new offices have opened in FY94. Also, in FY94 additional office space was occupied in South Africa, New Zealand, India, and Mexico. In addition, more subsidiaries are connecting to the corporate net as data compression technology and leased line costs were making it economically feasible.
- Other expenses decreased in Q94-1 over the previous quarter, due to lower bad debt expense and higher PSS revenues in Australia which are accounted for as contra expenses.

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REVENUE SUMMARY (REVENUE IN MILLIONS, UNITS IN THOUSANDS)

Q94-1

| | Revenue | | | Licenses | | | \$/License | | |
|----------------------------|----------|----------|--------|----------|---------|--------|------------|-------|-------|
| | Actual | Plan | % Var | Actual | Plan | % Var | Actual | Plan | % Var |
| WIN Office | \$14,679 | \$12,020 | 22% | 59,682 | 39,152 | 52% | \$246 | \$307 | (20%) |
| MAC Office | 980 | 1,050 | (7%) | 2,915 | 3,162 | (8%) | 336 | 332 | 1% |
| Excel PU* | 3,285 | 3,811 | (14%) | 27,103 | 21,808 | 24% | 121 | 175 | (31%) |
| Graphics PU* | 340 | 512 | (33%) | 2,916 | 3,398 | (14%) | 117 | 151 | (23%) |
| Project PU | 2,183 | 1,278 | 71% | 11,198 | 5,611 | 100% | 195 | 228 | (14%) |
| Word PU* | 6,526 | 4,447 | 47% | 60,765 | 26,900 | 126% | 107 | 165 | (35%) |
| DAD BU New Users** | \$27,993 | \$23,117 | 21% | 164,579 | 100,031 | 65% | \$170 | \$231 | (26%) |
| WIN Office | \$3,691 | \$3,211 | 15% | 20,606 | 17,836 | 16% | \$179 | \$180 | 0% |
| MAC Office | 209 | 285 | (27%) | 1,161 | 1,521 | (24%) | 180 | 187 | (4%) |
| Excel PU* | 1,052 | 1,843 | (43%) | 15,078 | 21,952 | (31%) | 70 | 84 | (17%) |
| Graphics PU* | 199 | 134 | 49% | 2,339 | 1,969 | 19% | 85 | 68 | 25% |
| Project PU | 237 | 118 | 101% | 12,752 | 1,512 | 743% | 19 | 78 | (76%) |
| Word PU* | 1,512 | 2,254 | (33%) | 16,845 | 27,135 | (38%) | 90 | 83 | 8% |
| DAD BU Existing Users** | \$6,900 | \$7,845 | (12%) | 68,781 | 71,925 | (4%) | \$100 | \$109 | (8%) |
| Basic PU | \$1,024 | \$711 | 44% | 8,968 | 5,473 | 64% | \$114 | \$130 | (12%) |
| Database Mgmt (Access) PU* | 1,832 | 1,850 | (1%) | 13,885 | 13,275 | 5% | 132 | 139 | (5%) |
| Fox Database PU* | 2,024 | 1,639 | 23% | 13,036 | 9,537 | 37% | 155 | 172 | (10%) |
| Languages PU's | 832 | 331 | 151% | 6,115 | 2,163 | 183% | 136 | 153 | (11%) |
| DBDT BU* | \$5,713 | \$4,531 | 26% | 42,004 | 30,448 | 38% | \$136 | \$149 | (9%) |
| Entry PU | \$1,070 | \$1,238 | (14%) | 28,026 | 32,344 | (13%) | \$38 | \$38 | 0% |
| MM Pubs | 568 | 124 | 358% | 10,824 | 1,595 | 579% | 52 | 78 | (33%) |
| Works PU | 1,838 | 2,088 | (12%) | 42,156 | 40,983 | 3% | 44 | 51 | (14%) |
| Consumer BU | \$3,476 | \$3,450 | 1% | 81,006 | 74,922 | 8% | \$43 | \$46 | (7%) |
| MS-DOS BU | \$5,237 | \$4,208 | 24% | 131,989 | 79,629 | 66% | \$40 | \$53 | (25%) |
| Hardware BU | \$3,260 | \$3,462 | (6%) | 69,692 | 55,408 | 26% | \$47 | \$62 | (25%) |
| Windows | \$8,861 | \$6,024 | 47% | 190,801 | 92,278 | 107% | \$46 | \$65 | (29%) |
| Win NT | \$2,112 | \$2,657 | (20%) | 14,211 | 15,204 | (7%) | \$149 | \$175 | (15%) |
| Win NT Adv. Server | 761 | 348 | 119% | 1,103 | 610 | 81% | 690 | 571 | 21% |
| Other Server (SQL, SNA) | 170 | 619 | (73%) | 1,715 | 510 | 236% | 99 | 1,213 | (92%) |
| Other Operating Systems PU | 548 | 710 | (23%) | 3,822 | 1,339 | 185% | 143 | 530 | (73%) |
| Adv. Systems | \$3,591 | \$4,334 | (17%) | 20,851 | 17,663 | 18% | \$172 | \$245 | (30%) |
| Workgroups BU* | \$982 | \$1,235 | (20%) | 21,710 | 10,717 | 103% | \$45 | \$115 | (61%) |
| Digital Office Systems | \$28 | \$0 | - | 286 | 0 | - | \$98 | - | - |
| ACT and APD PU's | 68 | 0 | - | 1,736 | 0 | - | 39 | - | - |
| Other PU's | 4 | 1,468 | (100%) | 16 | 17,478 | (100%) | 251 | 84 | 199% |
| Other | \$100 | \$1,468 | (93%) | 2,038 | 17,478 | (88%) | \$49 | \$84 | (41%) |
| Total FG Revenue | \$66,115 | \$59,673 | 11% | 793,451 | 550,499 | 44% | \$82 | \$108 | (24%) |
| Other Materials | \$951 | \$0 | - | - | - | - | - | - | - |
| Total Gross Revenue | \$67,066 | \$59,673 | 11% | 793,451 | 550,499 | 44% | - | - | - |

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Channel Reporting

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ICON FINISHED GOODS

Q94-1

- Gross revenues were 12% over plan while units were 46% over plan, thus average revenue per unit was down from plan. This was mainly due to more multiple user licenses than plan being sold, and lower than planned prices.
- New user Win Office was \$2.7 million (22%) over revenue plan, and 52% over unit plan. The average sales price was brought down because multiple user licenses were 33% of actual versus 13% planned.
- Revenues per license for new user Excel were 31% below plan, mostly due to lower than planned sales prices in Australia and Brazil.
- New user Word was \$2.1 million (47%) over revenue plan, and 126% over unit plan. \$0.8 million of the positive variance was due to the release of localized product in Israel and the Middle East. The average sales price was 35% under plan because multiple user licenses were 30% of actual sales versus 15% planned.
- MS-DOS was \$1.0 million (24%) over revenue plan and 66% over unit plan. The decrease in revenue per license is due to lower pricing in Australia (25% of ICON sales) of MS-DOS than plan.
- Windows sales were \$2.8 million (47%) over plan due in part to lower than planned penetration of the OEM market.

Significant Customers in Major Subsidiaries (in millions)

| | <u>Q93-1</u> | <u>Q93-2</u> | <u>Q93-3</u> | <u>Q93-4</u> | <u>Q94-1</u> |
|---------------------------------|----------------|----------------|----------------|----------------|----------------|
| Australia | | | | | |
| Tech Pacific | \$ 4.2 | \$ 4.8 | \$ 4.8 | \$ 8.1 | \$ 7.4 |
| Merisel | 3.4 | 3.8 | 6.1 | 9.0 | 5.7 |
| Mexico | | | | | |
| Ingram-Dicom | 2.9 | 3.9 | 2.1 | 4.8 | 1.4 |
| Brazil | | | | | |
| Agoal | 2.7 | 4.6 | 0.4 | 0.2 | 0.2 |
| Compucenter | 1.9 | 1.8 | 1.7 | 2.2 | 2.3 |
| South Africa | | | | | |
| Workgroup | 3.1 | 2.6 | 2.0 | 3.5 | 3.0 |
| | <u>\$ 18.2</u> | <u>\$ 21.5</u> | <u>\$ 17.1</u> | <u>\$ 27.8</u> | <u>\$ 20.0</u> |
| Percent of Gross Revenue | <u>32%</u> | <u>40%</u> | <u>31%</u> | <u>41%</u> | <u>30%</u> |

- Revenues for the top six distributors during the past five quarters have not grown as rapidly as sales for the region as a whole and sales to these distributors decreased as a percentage of total sales. Growth continues to come from smaller distributors especially those in newer subsidiaries.
- Sales to Ingram-Dicom in Mexico decreased significantly in Q94-1 due to a high number of Select deals in the prior quarter as well as the effects of excess inventory currently held. The forecast for Q94-2 indicates similar sales as Q94-1.

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ICON FINISHED GOODS

- Sales to Agoal in Brazil decreased 93% in Q93-3 over the previous quarter due to its near bankruptcy. They are currently in a debt work out program that appears will be successful. Sales in recent months have begun to increase again, but were offset by credits given in July for obsolete product. The forecast for Q94-2 indicates revenue of up to \$3 million.
- Due to the wide geographic area and the lack of multinational distributors in the region, ICON sales are distributed across a much wider base of customers. There are an additional 12 to 14 distributors whose average quarterly sales approximate \$1 million.

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Channel Reporting

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FAR EAST FINISHED GOODS

FAR EAST FINISHED GOODS

Results of Operations (In millions)

| | Q94-1 | | |
|------------------------|--------|--------|----------|
| | Actual | Plan | Variance |
| Net Revenues | \$60 | \$46 | \$14 |
| Cost of Revenues | 14 | 12 | (2) |
| Gross Profit | 46 | 34 | 12 |
| People Expenses | 10 | 10 | 0 |
| Facilities Expenses | 3 | 4 | 1 |
| Marketing Expenses | 8 | 6 | (2) |
| Other Expenses | 1 | 1 | 0 |
| Controllable Expenses | 22 | 21 | (1) |
| Responsibility Margin | 24 | 13 | 11 |
| Net Shared Resources | (9) | (10) | (1) |
| Shared Resource Margin | 15 | 3 | 12 |
| Net Revenues | 100.0% | 100.0% | 0.0% |
| Cost of Revenues | 23.1 | 25.1 | 2.0 |
| Controllable Expenses | 37.8 | 44.3 | 6.5 |
| Responsibility Margin | 39.1 | 30.6 | 8.5 |
| Net Shared Resources | (15.4) | (22.3) | (6.9) |
| Shared Resource Margin | 23.6% | 8.2% | 15.4% |

Q94-1

Net Revenue

- Far East net revenues exceeded plan by \$14.3 million. Japan exceeded plan by \$7.0 million largely due to the release of Word 5.0J. Strong Office sales in Taiwan contributed to results \$3.2 million above plan. Korea's strong Excel and Word revenues enabled the subsidiary to exceed plan by \$2.9 million.
- Significant positive variances in gross revenues from products included: led by Processional C, Database and Development Tools were \$5.4 million over plan; healthy Excel and Office sales contributed to Desktop Applications' revenues \$4.7 million above plan; and Windows NT results accounted for Advanced Systems results of \$2.2 million above plan. Windows was under plan by \$2.5 million during Q94-1.
- Favorable foreign exchange rate movements contributed \$3.5 million of the \$14.3 million positive revenue variance for the quarter, with the balance of the variance (\$10.8 million) coming from operations.

Cost of Revenue

- An increased sales mix of applications (compared with plan), which have lower product costs than systems, was a favorable factor in cost of revenues.
- Weighted product cost of revenues for applications and for systems were below plan, as a percent of revenues, by 0.5% each.

Controllable Expenses

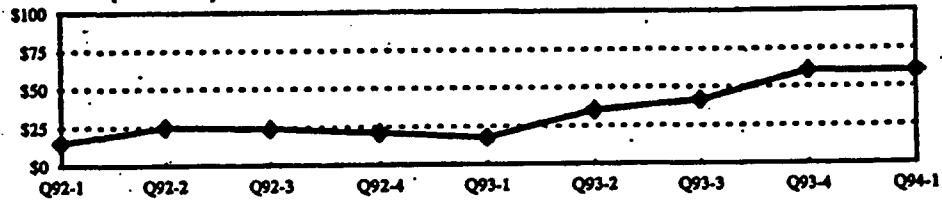
- Marketing expenses were above plan because of expenses incurred during the Q93-4 launch of Windows 3.1J.

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FAR EAST FINISHED GOODS

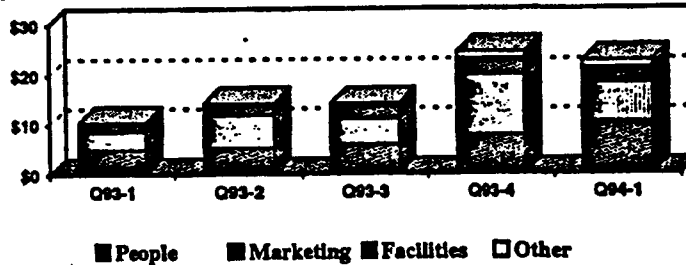
TREND ANALYSES

Net Revenue (in millions)



- Net revenues for Q94-1 (\$60.3 million) were virtually unchanged from Q93-4 (\$60.6 million).
- The increase in revenues during Q93-4 was largely due to the release of Windows 3.1 Japanese, Chinese, and Hangeul. During Q94-1, sales momentum was maintained and revenues exceeded plan by \$14.3 million.
- Strong sales of Office (\$1.9 over plan), Excel (\$1.9 million over plan), and Professional C (\$3.0 above plan) were primary reasons for strong Q94-1 revenues.
- WinWord 5.0 was launched in Japan in Q94-1, leading to a surge in Word upgrades from Q93-4 to Q94-1; this launch, combined with scheduled launches of new versions of Word in Chinese and Hangeul, and of Access, should produce results slightly above plan for Q94-2.

Controllable Expenses (in millions)



- Marketing expenses, which comprise 49% of Q94-1 total controllable expenses, were lower than the prior quarter but above plan. The high marketing expenditures during Q93-4 were due to the launch of Windows 3.1J.
- Facility expenses have remained relatively flat since the new office building was occupied in Tokyo in Q93-3.
- People expenses doubled from Q93-1 to Q94-1, which was roughly proportional to increases in headcount. Recent headcount increases have been concentrated in PSS.

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FAR EAST FINISHED GOODS

REVENUE SUMMARY (REVENUE IN MILLIONS, UNITS IN THOUSANDS)

Q94-1

| | Revenue | | | Licenses | | | \$/License | | |
|----------------------------|----------|----------|--------|----------|---------|--------|------------|-------|-------|
| | Actual | Plan | % Var | Actual | Plan | % Var | Actual | Plan | % Var |
| WIN Office | \$8,649 | \$7,337 | 18% | 24,314 | 18,892 | 29% | \$356 | \$388 | (8%) |
| MAC Office | 120 | 83 | 44% | 330 | 316 | 4% | 363 | 263 | 38% |
| Excel PU* | 9,776 | 8,039 | 22% | 45,811 | 43,546 | 5% | 213 | 185 | 16% |
| Graphics PU* | 241 | 409 | (41%) | 938 | 1,774 | (47%) | 257 | 231 | 11% |
| Project PU | 359 | 168 | 113% | 936 | 492 | 90% | 384 | 342 | 12% |
| Word PU* | 6,227 | 7,251 | (14%) | 31,623 | 49,916 | (37%) | 197 | 145 | 36% |
| DAD BU New Users** | \$25,372 | \$23,288 | 9% | 103,952 | 114,936 | (10%) | \$244 | \$203 | 20% |
| WIN Office | \$646 | \$39 | 1543% | 2,036 | 168 | 1112% | \$317 | \$234 | 36% |
| MAC Office | 40 | 0 | - | 200 | 0 | - | 200 | - | - |
| Excel PU* | 291 | 133 | 118% | 1,679 | 1,655 | 1% | 173 | 80 | 115% |
| Graphics PU* | 21 | 6 | 272% | 313 | 85 | 268% | 68 | 67 | 1% |
| Project PU | 11 | 11 | 1% | 103 | 108 | (5%) | 108 | 104 | 4% |
| Word PU* | 4,020 | 2,272 | 77% | 34,537 | 20,804 | 66% | 116 | 109 | 7% |
| DAD BU Existing Users** | \$5,028 | \$2,462 | 104% | 38,869 | 22,820 | 70% | \$129 | \$108 | 20% |
| Basic PU | \$3,416 | \$2,073 | 65% | 28,301 | 12,310 | 130% | \$121 | \$168 | (29%) |
| Database Mgmt (Access) PU* | 211 | 169 | 25% | 2,119 | 921 | 130% | 99 | 184 | (46%) |
| Fox Database PU* | 1,834 | 600 | 206% | 7,752 | 3,046 | 154% | 237 | 197 | 20% |
| Languages PU's | 4,619 | 1,803 | 156% | 18,366 | 7,993 | 130% | 251 | 226 | 11% |
| DBDT BU* | \$10,080 | \$4,645 | 117% | 56,538 | 24,270 | 133% | \$178 | \$191 | (7%) |
| Entry PU | \$973 | \$742 | 31% | 17,080 | 13,602 | 26% | \$57 | \$55 | 5% |
| MM Pubs | 93 | 0 | - | 1,614 | 0 | - | 58 | - | - |
| Works PU | 1,709 | 1,407 | 21% | 13,790 | 13,120 | 5% | 124 | 107 | 16% |
| Consumer BU | \$2,776 | \$2,149 | 29% | 32,484 | 26,722 | 22% | \$85 | \$80 | 6% |
| MS-DOS BU | \$2,534 | \$733 | 246% | 47,531 | 15,009 | 217% | \$53 | \$49 | 9% |
| Hardware BU | \$3,442 | \$3,233 | 6% | 59,101 | 33,641 | 76% | \$58 | \$96 | (39%) |
| Windows | \$4,780 | \$7,310 | (35%) | 55,199 | 101,805 | (46%) | \$87 | \$72 | 21% |
| Win NT | \$2,277 | \$186 | 1127% | 8,938 | 1,087 | 722% | \$255 | \$171 | 49% |
| Win NT Adv. Server | 159 | 195 | (18%) | 197 | 185 | 6% | 808 | 1,053 | (23%) |
| Other Server (SQL, SNA) | 214 | 169 | 26% | 789 | 135 | 484% | 271 | 1,252 | (78%) |
| Other Operating Systems PU | 464 | 347 | 34% | 2,803 | 3,228 | (13%) | 166 | 107 | 54% |
| Adv. Systems | \$3,114 | \$896 | 247% | 12,727 | 4,635 | 175% | \$245 | \$193 | 27% |
| Workgroups BU* | \$362 | \$366 | (1%) | 8,001 | 3,904 | 105% | \$45 | \$94 | (52%) |
| Digital Office Systems | \$5 | \$17 | (68%) | 49 | 205 | (76%) | \$111 | \$82 | 35% |
| ACT and APD PU's | 54 | 0 | - | 669 | 0 | - | 81 | - | - |
| Other PU's | 0 | 1,018 | (100%) | 0 | 6,826 | (100%) | - | 149 | - |
| Other | \$60 | \$1,035 | (94%) | 718 | 7,031 | (90%) | \$83 | \$147 | (43%) |
| Total FG Revenue | \$57,548 | \$46,116 | 25% | 415,119 | 354,773 | 17% | \$139 | \$130 | 7% |
| Other Materials | \$2,689 | \$0 | - | - | - | - | - | - | - |
| Total | \$60,237 | \$46,116 | 31% | 415,119 | 354,773 | 17% | - | - | - |

*excludes allocation from sales of Office bundles

** includes database and MS Mail products sold through Office bundles

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FAR EAST FINISHED GOODS

Q94-1

- Finished goods gross revenues were \$60.2 million during Q94-1, \$14.1 over plan. The largest contribution to this favorable variance was Database and Development Tools (DBDT), which was \$5.4 million over plan.
- DBDT unit sales were 133% above the budgeted amount. Approximately 55% of both the above-plan unit sales and gross revenues were in Japan. Professional C accounted for 54% of the revenue variance, and 23% of the units variance.
- Unit sales of desktop applications (DAD) to existing users, led by Word upgrades in Japan, were 70% above plan; and revenue per license was 20% above plan. This combination yielded revenues for new and existing users of \$4.7 million over a planned amount of \$30.4 million.
- Gross revenues from Windows were 35% below plan, despite revenues per license which were 21% greater than plan. Windows sales in Japan were planned to be 73% of Far East Windows revenues during Q94-1, but were in fact only 40% of the region's Windows sales. Windows 3.1J is a significant product in Japan because it is compatible with multiple operating systems, which are a unique feature of the Japanese PC industry where MS-DOS is not the de facto standard.
- Pricing variances were generally favorable during the quarter. Desktop applications and Windows revenues per license were 20% and 21% above plan, respectively. Hardware pricing was 39% below plan, and Windows NT, which had strong unit sales, experienced pricing 49% better than plan.

Significant Customers in Major Subsidiaries (in millions)

| | Q92-4 | Q93-1 | Q93-2 | Q93-3 | Q93-4 | Q94-1 |
|---------------------------------|------------------|------------------|------------------|------------------|------------------|------------------|
| Japan | | | | | | |
| Soft Bank | \$ 3,308 | \$ 1,109 | \$ 7,230 | \$ 7,119 | \$ 11,554 | \$ 9,316 |
| Software Japan | 2,990 | 1,388 | 3,317 | 3,457 | 5,087 | 6,150 |
| Soft Wing | 1,864 | 885 | 3,494 | 3,093 | 4,500 | 3,960 |
| NEC | 1,267 | 1,249 | 978 | 1,211 | 2,395 | 2,301 |
| Canon Sales | 1,798 | 2,078 | 1,155 | 2,329 | 1,724 | 2,041 |
| Taiwan | | | | | | |
| Eten | 315 | 846 | 475 | 926 | 1,943 | 2,393 |
| Acer Sertek | 640 | 832 | 806 | 583 | 1,276 | 2,324 |
| Korea | | | | | | |
| Infotech | 486 | 2,320 | 594 | 353 | 571 | 2,966 |
| | <u>\$ 12,668</u> | <u>\$ 10,707</u> | <u>\$ 18,049</u> | <u>\$ 19,071</u> | <u>\$ 29,050</u> | <u>\$ 31,451</u> |
| Percent of Gross Revenue | <u>60%</u> | <u>60%</u> | <u>52%</u> | <u>46%</u> | <u>48%</u> | <u>52%</u> |

- Significant customers in the Far East (identified as those with Q94-1 sales in excess of \$2.0 million) are eight in number and account for 52% of gross revenues in the region, which represents a decrease from 60% one year ago. This trend implies increasing reliance on more and smaller customers.
- Combined sales to the significant customers in Taiwan and Korea increased at a compound quarterly growth rate of 40%, while the combined sales of Japan's significant customers increased at a relatively slow 16% rate compounded quarterly. For Japan, the significance of this trend is that other, smaller customers are comprising an increasing share of the subsidiary's sales.

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OEM

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Results of Operations (in millions)

| | Q94-1 | | |
|------------------------|--------|--------|----------|
| | Actual | Plan | Variance |
| Net Revenues | \$255 | \$180 | \$75 |
| Cost of Revenues | 11 | 8 | (3) |
| Gross Profit | 244 | 172 | 72 |
| People Expenses | 4 | 5 | 1 |
| Facilities Expenses | 1 | 1 | 0 |
| Marketing Expenses | 0 | 1 | 1 |
| Other Expenses | 14 | 7 | (7) |
| Controllable Expenses | 19 | 14 | (5) |
| Responsibility Margin | 225 | 158 | 77 |
| Net Shared Resources | 6 | 10 | 4 |
| Shared Resource Margin | \$219 | \$148 | \$71 |
| Net Revenues | 100.0% | 100.0% | 0.0% |
| Cost of Revenues | 4.3 | 4.4 | 0.1 |
| Controllable Expenses | 7.5 | 7.8 | 0.3 |
| Responsibility Margin | 88.2 | 87.8 | 0.5 |
| Net Shared Resources | 2.4 | 5.6 | 3.2 |
| Shared Resource Margin | 85.8% | 82.2% | 3.6% |

Q94-1

Net Revenue

- OEM net revenues were 26.3% of corporate net revenues and contributed 43.4% of the shared resource margin and 47.5% of the consolidated contribution margin.
- Of the \$75 million positive variance, one-third was generated by the "Big Six" (IBM, Compaq, Gateway 2000, Dell, Packard Bell, AST), one-third primarily by other U.S. and Japanese OEMs, and one-third by normally recurring revenue adjustments (GAAP accrual).

Cost of Revenue

- Cost of revenue was higher than plan due to higher mouse sales than budgeted but was at plan as a percentage of net revenues.

Controllable Expenses

- As the PC price wars continue to exert margin pressure on the OEMs, MS has identified a number of OEMs that are financially at risk. In addition to the standard allowance for doubtful accounts, billings related to these high-risk companies are reserved for 100%, resulting in \$6 million of the Other Expenses variance. A \$25 million allowance for doubtful accounts covers \$14 million in revenues identified as high risk and a portion of \$17 million identified as moderate risk. During Q94-1, the Company wrote off \$6 million of receivables.

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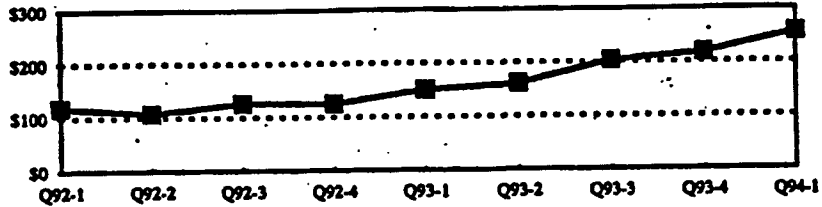
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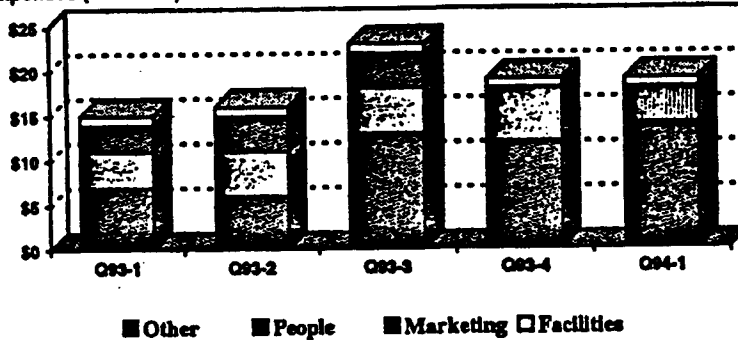
TREND ANALYSIS

Net Revenue (in millions)



- Higher unit sales by established OEMs resulting from the PC price wars, higher revenue per PC resulting from Windows, Mouse, and applications licenses, and success in the lower tier "new business" market all contributed to OEM's steady growth over the past two years.

Controllable Expenses (in millions)



- Other Expenses grew because of bad debt provisions for high risk OEMs.
- Q94-1 marketing expenses were \$447 thousand. OEM has shifted its historical sales model of noninvolvement with customer sales initiatives to working closely with OEMs to develop joint sales and marketing programs, thereby leveraging MS marketing funds. During Q94-1, domestic expenditure of \$150 thousand in marketing funds helped to secure additional OEM business for MS worth approximately \$15 million and contributed to OEM advertising that prominently displayed MS products and logos.
- Strict expense policies and close monitoring of expenses reduced employee fringes, travel and entertainment, causing the reduction in People expenses in Q94-1.

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Product Mix (units in thousands, revenues in millions)

| | Q94-1 | | | Q94-1 Plan | | | Variance | | |
|---------------------|-------|--------|---------|------------|--------|---------|----------|--------|---------|
| | Units | Revs | \$/Unit | Units | Revs | \$/Unit | Units | Revs | \$/Unit |
| MS-DOS | 5,824 | \$ 91 | \$ 16 | 5,192 | \$ 92 | \$ 18 | 632 | \$ (1) | \$ 1 |
| Windows | 4,300 | 76 | 18 | 3,107 | 52 | 17 | 1,193 | 24 | 1 |
| Advanced Systems | 679 | 17 | 25 | 411 | 9 | 22 | 268 | 8 | 1 |
| Hardware | 960 | 13 | 14 | 594 | 7 | 12 | 366 | 6 | 2 |
| Consumer | 1,067 | 9 | 8 | 703 | 6 | 9 | 364 | 3 | - |
| Desktop | 138 | 6 | 43 | 264 | 10 | 38 | (126) | (4) | 6 |
| Other | 1,254 | 18 | N/A | 64 | 4 | N/A | 1,190 | 14 | N/A |
| | | 230 | | | 180 | | | 50 | |
| Revenue Adjustments | | 25 | | | - | | | 25 | |
| Net Revenues | | \$ 255 | | | \$ 180 | | | \$ 75 | |

- OEM is currently working to convert OEMs from Windows 3.x to Windows for Workgroups 3.11. Windows remained strong in the OEM channel.
- Desktop applications were under budget due to lower than planned sales by Gateway 2000 and Hewlett Packard.
- Response to aggressive campaigns by competitors such as Lotus and Borland this quarter led to the signing of a significant number of high-end applications bundle licenses in both the OEM and Finished Goods channels. In the OEM channel, licenses that bundled desktop applications included Vobis, Escom, Compunet, and Peacock.
- Unbudgeted mouse sales in addition to a \$2 million positive variance by Gateway 2000 created the mouse variance. \$/Unit on Mice is lower than in prior quarters due to inclusion of royalty units and revenue in the category.
- Piracy of MS-DOS 6.0 appeared almost nonexistent during Q94-1, although unbundling continued to be a problem. Tracing of Certificates of Authenticity on unbundled product pinpointed noncompliant OEMs, and audits identified other examples of noncompliance. IBM PC-DOS is now being counterfeited. MS is working with IBM to help them counter this piracy.

Net Revenues (in millions)

| | Q94-1 | Q94-1 Plan | Variance |
|-----------------------|--------------|--------------|-------------|
| North America | | | |
| United States | \$ 134.4 | \$ 100.7 | \$ 33.7 |
| Canada | 3.1 | 2.7 | 0.4 |
| | <u>137.5</u> | <u>103.4</u> | <u>34.1</u> |
| International | | | |
| Far East | 44.9 | 32.8 | 12.1 |
| Europe | 39.0 | 37.4 | 1.6 |
| Asia Pacific | 6.5 | 4.5 | 2.0 |
| Latin America | 1.2 | 1.4 | (0.2) |
| AIME | 1.0 | 0.8 | 0.2 |
| | <u>92.6</u> | <u>76.9</u> | <u>15.7</u> |
| Revenue adjustments | 25.0 | - | 25.0 |
| Net Worldwide Revenue | <u>255.1</u> | <u>180.3</u> | <u>74.8</u> |

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- In North America, \$28 million of the \$34 million variance came from strong performances by the "Big Six," Hewlett Packard, and DEC.
- Although Compaq, IBM, and Hewlett Packard all increased market share in Europe recently, price wars and slowing European economies have depressed the European market for most PC manufacturers. --
- The Far East's positive variance was driven by NEC and Toshiba.

Significant Customers (in millions)

| | Q94-1 | | |
|-------------------------------|-----------------|-----------------|----------------|
| | Q94-1 | Q94-1 Plan | Variance |
| Large Accounts | | | |
| IBM | \$ 22.2 | \$ 6.1 | \$ 16.1 |
| Compaq | 20.7 | 17.2 | 3.5 |
| Gateway 2000 | 14.4 | 14.1 | 0.3 |
| Dell | 10.6 | 7.3 | 3.3 |
| AST | 7.0 | 5.4 | 1.6 |
| Packard Bell | 5.9 | 5.4 | 0.5 |
| Solution Providers | | | |
| Hewlett Packard | 4.7 | 2.7 | 2.0 |
| DEC | 3.9 | 3.0 | 0.9 |
| NCR | 3.4 | 2.8 | 0.6 |
| Other | 5.3 | 3.6 | 1.7 |
| Named Accounts | | | |
| SCO | 2.3 | 1.9 | 0.4 |
| Zenith | 1.9 | 3.0 | (1.1) |
| Tandy | 1.9 | 2.5 | (0.6) |
| Other | 9.6 | 7.2 | 2.4 |
| New Business Accounts | 22.5 | 21.1 | 1.4 |
| International Accounts | | | |
| NEC | 9.5 | 3.5 | 6.0 |
| Toshiba | 5.7 | 0.3 | 5.4 |
| Vobis | 4.2 | 2.4 | 1.8 |
| Escom | 3.4 | 1.4 | 2.0 |
| Olivetti | 3.0 | 3.0 | - |
| Acer | 3.0 | 2.8 | 0.2 |
| SNI (Siemens) | 2.6 | 3.0 | (0.4) |
| Other | 61.2 | 60.5 | 0.7 |
| Other Accounts | 1.2 | 0.1 | 1.1 |
| Gross Revenue | <u>230.1</u> | <u>180.3</u> | <u>49.8</u> |
| Revenue adjustments | <u>25.0</u> | <u>-</u> | <u>25.0</u> |
| Net revenue | <u>\$ 255.1</u> | <u>\$ 180.3</u> | <u>\$ 74.8</u> |

- The "Big Six" OEMs (Large Accounts) continue to pick up market share worldwide, while the middle and lower tiers of the PC industry experience margin pressure and are likely either to consolidate or shift their business focus. Interest in Windows for Workgroups 3.11 is strong in the OEM channel.

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OEM

- IBM was the top OEM in Q94-1 (\$22 million). The Joint Development Agreements with IBM expired on September 16, 1993, ending the requirement to supply code to IBM and opening the way for new agreements. Microsoft's relationship with the Personal Computer Company continued to strengthen, and Windows and MS-DOS penetration in IBM products grew. IBM's decision to market a Window-less version of OS/2 could significantly reduce MS WABCC (the Windows code that permits OS/2 to run Windows applications) royalties in FY94.
- Gateway 2000 entered the UK market this quarter and will enter France and Germany within the next nine months. Expanding its initial distribution, Gateway is also entering the Consumer market and now derives 50% of its sales from Fortune 1000 companies. The applications mix shifted from Desktop to Consumer products this quarter, reducing average royalty per system by \$9.
- Despite being hurt by loss of its Notebook business and decline in European sales, Dell was \$3 million over plan this quarter due to higher run rates. Dell will support the MS at Home campaign by including a MS at Home sampler with every CD-ROM-capable machine. The Notebook recall announced this month will not impact Microsoft.
- Packard Bell continued to be a strong player in the Consumer channel. They are shipping multimedia machines and will introduce a line of notebooks next quarter. Zenith, which will supply the Notebook technology, purchased a 20% interest in them last quarter.
- New Business launched the Delivery Service Partner (DSP) program domestically, whereby TechData, Merisel, and Ingram will distribute 5-paks of OEM versions of MS-DOS 6.0 to small OEMs. Windows, Windows for Workgroups, and a combination MS-DOS/Windows product will be added in Q94-2.
- NEC and Toshiba results created a strong quarter in Japan. In addition to a \$/per system increase as they ship more 486 PCs, NEC benefited from the price wars among the other operating systems, including MS-DOS/V. Toshiba has again gained a strong position in the U.S. Notebook market.

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PSS

Highlights:

- During Q94-1, PSS announced the Microsoft Support Network (MSN). The formal announcement was made on September 10, and the official launch was October 1. In conjunction with the announcement, Industry Analyst immersions and press tours were conducted to address and position the new policy and develop focus on evaluating support on a "cost of ownership" basis.
- Regular staffing leveled off in Q94-1 relative to the staffing ramp-up realized through FY93. Additional outsourcing and variable staffing have been utilized to address future demand spikes for new product releases in Q94-2.
- During the quarter, WordPerfect announced new Fee-based Platinum and Gold support programs, Oracle announced a new customized "Oracle Customer Care" program, and Borland announced the "Borland Assist" program. Lotus announced their new support program "Lotus Flex" in the second half of FY93.
- Support to Solution Provider Partners (SP) continued to increase through the quarter as a result of the Solution Provider campaign. In addition, Microsoft increased the number of Authorized Support Centers (ASC's) during the quarter.
- Build out of the Dallas-Hilltop facility continues and is expected to be completed in late October. This facility will house up to approximately 700 employees and the schedule for occupancy will be determined by call demand.

Domestic Controllable Expenses (in millions)

| | Q94-1 | |
|---------------------|---------------|-------------|
| | Actuals | % of Plan |
| People | \$25.5 | 86.4 |
| Facilities | 8.0 | 87.0 |
| Other | 3.2 | 105.8 |
| Paid Support Offset | (3.1) | 92.5 |
| | <u>\$33.6</u> | <u>87.5</u> |

- The total controllable expenses in Q94-1 were 12.5% less than plan primarily due to the below plan cost per head of \$1.5 million and savings from below plan headcount of \$3.3 million. Other expenses were 5.8% greater than plan due above plan cost of paid support to the domestic and international sectors.
- Paid support offset (PSS revenue), was \$3.1 million and was 7.5% less than planned. With the launch of MSN in Q94-2, PSS revenue is planned to be \$3.2 million, \$3.8 million, and \$5.6 million in Q94-2 through Q94-4 respectively.

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Channel Reporting

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Domestic PSS Cost Distribution by Channel (in millions)

| | Q94-1 | |
|-------------------|---------------|-------------|
| | Actuals | % of Plan |
| USFG | \$27.5 | 85.6 |
| US-OEM | 3.5 | 92.1 |
| Domestic Channels | \$31.0 | 87.1 |
| International | 2.6 | 92.0 |
| | <u>\$33.6</u> | <u>87.5</u> |

- Q94-1 PSS support costs were distributed 89% to the USFG channel and 11% to US-OEM channel with total domestic costs below plan by 12.9%. The total PSS cost, which includes domestic support to international, was below plan by 12.5%. Within the Activity Based Costing system (ABC), product support costs were allocated to USFG and US-OEM channels based on perceived use of PSS service between these two channels. Once the channel split was completed, PSS support costs are then distributed to the product units.
- US PSS agreed to provide subsidiary PSS organizations Premier-Support Partner level backup support as well as delivering direct support to 28 international ASC's. The \$2.6 million represent the domestic PSS support costs to the international subs.

Domestic PSS Cost Distribution by Product Unit (in millions)

| | Q94-1 | |
|---------------------|---------------|-----------|
| | Actual | % of Plan |
| Windows | \$6.4 | 90 |
| Word | 4.6 | 76 |
| Excel | 3.1 | 74 |
| MS-DOS | 2.5 | 145 |
| DBM | 2.5 | 96 |
| Win NT | 2.3 | 63 |
| Fox | 2.4 | 99 |
| Other Operating Sys | 1.7 | 79 |
| Messaging | 1.4 | 103 |
| C++ | 1.1 | 109 |
| Works | 0.9 | 135 |
| Entry | 0.5 | 74 |
| Basic | 0.4 | 114 |
| Project | 0.4 | 125 |
| Graphics | 0.4 | 55 |
| Other | 0.3 | 58 |
| Total | <u>\$31.0</u> | <u>87</u> |

- Domestic PSS cost for support to the product units was 13% lower than planned. A portion of this decrease was due to lower than planned call volumes for the release of Win-NT and no other new product releases within the Q94-1.
- Product support costs are offset by PSS revenue. The allocation of revenue is driven by percentages based off service requests for the product. The product units' costs above include their individual offset of revenue.
- In Q94-1, MS-DOS was 45% over plan, due to higher than budgeted call volumes.

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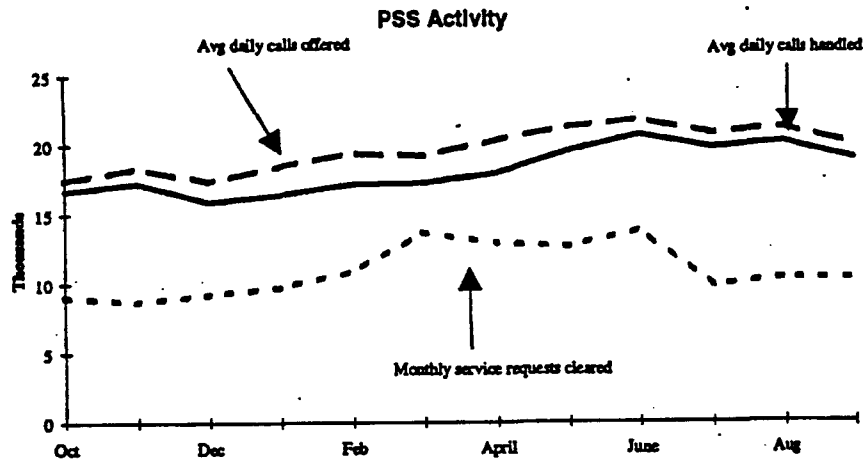
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PSS Cost Mix by Product Unit

| | Q94-1 | |
|---------------------|-------------|------------|
| | Actual | % pts Var |
| Windows | 21% | (2) |
| Word | 15 | 0 |
| Excel | 10 | 0 |
| MS-DOS | 8 | 1 |
| DBM | 8 | 0 |
| Win NT | 7 | 1 |
| Fox | 8 | 0 |
| Other Operating Sys | 6 | 0 |
| Messaging | 5 | 0 |
| C++ | 4 | 0 |
| Works | 3 | 0 |
| Entry | 2 | 0 |
| Basic | 1 | 0 |
| Project | 1 | 0 |
| Graphics | 1 | 0 |
| Other | 1 | 1 |
| Total | 100% | (2) |

- Windows, Word, Excel, MS-DOS, DBM, Fox, Win-NT contributed 77% of all product cost for Q94-1.

Average Daily Calls

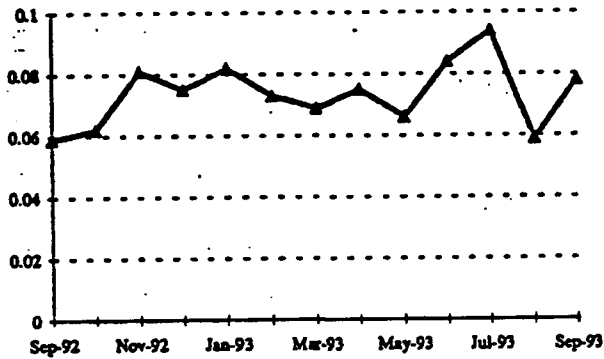


- Total average daily calls offered decreased 2%, while handled increased 1% over Q93-4 volumes. Calls offered for the quarter decreased primarily due to no new product releases other than Win-NT. Calls handled increased due to hiring of variable support engineers.
- With the variable support engineers, PSS was able to handle 95% of calls offered throughout Q94-1. This increased 3% from Q93-4, PSS target rate is 95%.
- Average monthly service requests cleared decreased 23% to 10,132 in Q94-1 from 13,097 in Q93-4. This decrease can also be attributed to no new product releases in the quarter.

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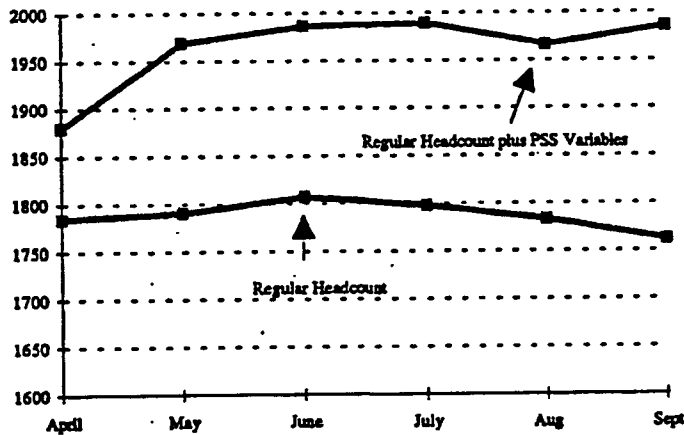
TREND ANALYSIS

Domestic PSS Cost as a Percent of US Net Revenues



- In the chart above, PSS cost is displayed as a percent of net revenue. For Q94-1, PSS cost as a percent of net revenue actual was 7.4% versus the plan of 10.1%.

PSS Headcount



- PSS regular FTE headcount has fallen slightly from Q93-4 levels primarily due to attrition. However, this was offset by the increase in variable staffing in Q93-4 and Q941-1 due to PSS' changing business model which now includes the use of variables and outsourcing. Initially, variable resources were used for Windows and MS-DOS 6.0, and will also be used for upcoming launches of Excel, Word and MS-DOS 6.2.

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Product Group Reporting

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WORLDWIDE PRODUCT GROUPS SUMMARY

Q94-1

| | Net Revenue | | Cost of Revenue | | Controllable Expense | | Responsibility Margin | |
|-----------------------|--------------|-------------|-----------------|-------------|----------------------|------------|-----------------------|-------------|
| | Actual | % of Plan | Actual | % of Plan | Actual | % of Plan | Actual | % of Plan |
| Desktop Applications | \$381 | 115% | \$59 | 104% | \$86 | 85% | \$237 | 137% |
| Database & Dev. Tools | 80 | 94 | 21 | 132 | 36 | 79 | 23 | 99 |
| Consumer | 54 | 125 | 11 | 120 | 24 | 72 | 20 | 1,275 |
| Workgroup | 20 | 117 | 3 | 92 | 14 | 81 | 3 | 200 |
| Systems | 392 | 115 | 55 | 112 | 100 | 83 | 237 | 137 |
| Advanced Technology | 2 | 92 | 1 | 168 | 9 | 50 | (8) | 48 |
| Other | 54 | 664 | 10 | 412 | 29 | 1,119 | 15 | 469 |
| | <u>\$983</u> | <u>119%</u> | <u>\$159</u> | <u>117%</u> | <u>\$297</u> | <u>88%</u> | <u>\$526</u> | <u>149%</u> |

| | Net Revenue Mix | | Cost of Revenue | | Controllable Expense | | Responsibility Margin | |
|-----------------------|-----------------|-----------|-----------------|-----------|----------------------|-----------|-----------------------|-----------|
| | Actual | % pts Var | % Net Rev | % pts Var | % Net Rev | % pts Var | % Net Rev | % pts Var |
| Desktop Applications | 39% | (1) | 15% | 2 | 23% | 8 | 62% | 10 |
| Database & Dev. Tools | 8 | (2) | 26 | (8) | 45 | 9 | 29 | 1 |
| Consumer | 6 | 0 | 20 | 1 | 44 | 32 | 36 | 33 |
| Workgroup | 2 | 0 | 13 | 4 | 70 | 31 | 17 | 35 |
| Systems | 40 | (1) | 14 | 0 | 26 | 9 | 60 | 10 |
| Advanced Technology | 0 | 0 | 36 | (16) | 447 | 375 | (383) | 359 |
| Other | 5 | 4 | 19 | 11 | 53 | (22) | 28 | (11) |
| | <u>100%</u> | <u>0</u> | <u>16%</u> | <u>0</u> | <u>30%</u> | <u>11</u> | <u>54%</u> | <u>11</u> |

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Product Group Reporting

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WORLDWIDE PRODUCT GROUPS SUMMARY

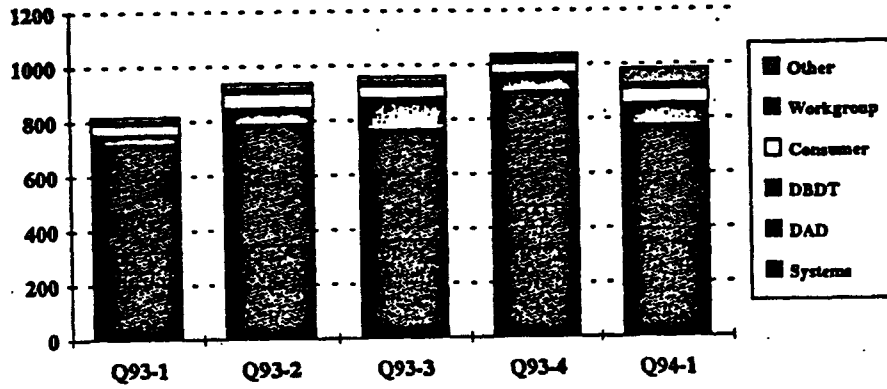
Headcount Summary

| | Q94-1 | | | FY94 |
|---------------------------------|--------|------|----------|------|
| | Actual | Plan | Variance | Plan |
| Excel PU | 218 | 233 | 15 | 217 |
| Graphics PU | 66 | 73 | 7 | 77 |
| Project PU | 75 | 85 | 10 | 79 |
| Word PU | 243 | 256 | 13 | 245 |
| Other Desktop | 244 | 275 | 31 | 306 |
| Desktop Applications | 846 | 922 | 76 | 924 |
| Applications Programmability PU | 126 | 135 | 9 | 136 |
| Database Mgmt PU | 203 | 223 | 20 | 224 |
| Fox Database PU | 66 | 65 | -1 | 65 |
| DDT Management | 70 | 99 | 29 | 117 |
| C++ | 182 | 200 | 18 | 190 |
| Scientific & Engineering Tools | 59 | 65 | 6 | 65 |
| Database and Development Tools | 706 | 787 | 81 | 797 |
| Works PU | 119 | 118 | -1 | 116 |
| MM Pubs | 111 | 119 | 8 | 143 |
| Entry PU | 179 | 194 | 15 | 193 |
| Other Consumer | 62 | 66 | 4 | 92 |
| Consumer | 471 | 497 | 26 | 544 |
| Workgroup | 379 | 402 | 23 | 393 |
| MS-DOS | 36 | 38 | 2 | 39 |
| Windows | 349 | 410 | 61 | 420 |
| Advanced Systems | 599 | 670 | 71 | 631 |
| Hardware | 80 | 100 | 20 | 103 |
| Digital Office Systems | 137 | 157 | 20 | 183 |
| Systems Marketing | 103 | 103 | 0 | 103 |
| Other Systems | 144 | 182 | 38 | 208 |
| Systems | 1448 | 1660 | 212 | 1687 |
| Advanced Consumer Technology | 190 | 256 | 66 | 309 |
| Broadband Applications | 13 | 13 | 0 | 20 |
| Advanced Product Development | 42 | 50 | 8 | 60 |
| On-Line Services | 25 | 45 | 20 | 68 |
| Advanced Technology | 270 | 364 | 94 | 457 |
| Other WPG | 227 | 259 | 32 | 480 |
| International R&D | 23 | 63 | 40 | 68 |
| Subtotal | 4370 | 4954 | 584 | 5350 |
| MSU | 108 | 142 | 34 | 140 |
| Books | 44 | 46 | 2 | 51 |
| Other Product Groups | 152 | 188 | 36 | 191 |
| Total Product Groups | 4522 | 5142 | 620 | 5541 |

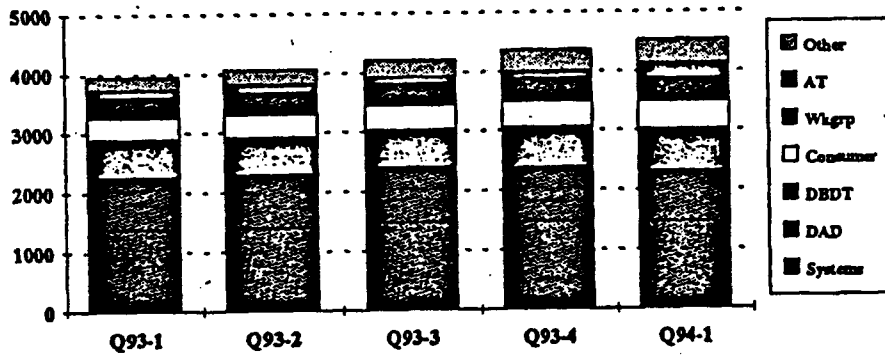
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WORLDWIDE PRODUCT GROUPS SUMMARY

Net Revenue by Business Unit (in millions)



Headcount by Business Unit



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DESKTOP APPLICATIONS SUMMARY

DESKTOP APPLICATIONS SUMMARY

Key Product Releases

| Product | RTM Date | | Revenue in millions * | | | |
|---|----------|--------|-----------------------|-------|----------|-------------|
| | Act/Est | Plan | Actual | Plan | Variance | FY94 Budget |
| Win Word 6.0 (and Win Office 4.0) | Oct-93 | Sep-93 | \$141 | \$123 | \$18 | \$736 |
| Mac Word 6.0 (and Mac Office 4.2) | Mar-94 | Mar-94 | \$25 | \$23 | \$2 | \$133 |
| Win Excel 5.0 | Nov-93 | Oct-93 | \$132 | \$111 | \$21 | \$661 |
| Mac Excel 5.0 (and Mac Office 4.1) | Mar-94 | Nov-93 | \$23 | \$20 | \$3 | \$116 |
| Win Project 4.0 | Jan-94 | Jan-94 | \$20 | \$19 | \$1 | \$95 |
| Mac Project 4.0 | May-94 | Apr-94 | \$3 | \$2 | \$1 | \$12 |
| Win PowerPoint 4.0 (and Win Office 4.2) | Dec-93 | Jan-94 | \$27 | \$24 | \$3 | \$126 |
| Mac PowerPoint 4.0 | Feb-94 | Feb-94 | \$5 | \$4 | \$1 | \$23 |

*Total all versions sold in FY94. Includes MS Office allocation.

- The launch of MS Office 4.0 is contingent upon the release of Win Word 6.0. At the time of this report, the latest estimate for release to manufacturing (RTM) for Win Word 6.0 is the week of October 25. Revenues were budgeted for October, so it is hoped that strong sales in November and December will make up for an expected October shortfall in revenues.
- Win Excel's latest estimate for RTM is late November, but it could slide to early December. Revenue had been budgeted for October, so there is a good chance that Excel revenues for Q94-2 will fall short of plan.
- Win Project and Win PowerPoint RTMs have slid to January and December respectively. Revenue was conservatively budgeted to "spike" in January for these two products.

Desktop Applications Key Business Issue: Product Localization

Foreign Language Business

Foreign language products are a big part of the Desktop Applications Division's (DAD) business. Approximately 40% of DAD revenue results from the sale of non-English version products (almost \$700 million in FY93). A recent study estimated that Microsoft spends over \$1 million to localize a major product into a major language (German MS Word for example).

Localization Strategies

During the last two years, the product localization function has been brought within DAD. Individuals responsible for localizing product into German, French, Spanish and Portuguese now work for DAD business units in Redmond. In addition, other European languages are localized by 100 people at DAD Ireland in Dublin, while most Asian language localization is the responsibility of the product development group in Japan. All three locations utilize contractors and vendors to varying degrees to perform some localization functions. The intended goals in bringing the localization function closer to product development were to improve the speed of the localization process and to make the original product easier to localize.

Localization Business Issues

The consensus is that great progress has been made in achieving the original goals. The "delta" between English language products and major foreign language products has decreased from over 90 days to 30 days. There is also evidence that DAD applications are now easier to localize into other languages. However, there are still major improvements to be made in process and cost:

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DESKTOP APPLICATIONS SUMMARY

- **Size:** Over time, the size of DAD applications, including documentation and on-line help, has grown. The Excel product now includes 1.4 million words which have to be localized. For each word of English documentation, Microsoft spends an estimated \$10 to \$20 localizing it into other languages throughout the world. Smaller, more concise books and on-line "docs" could help reduce localization costs, as well as cost of goods sold.
- **Speed:** It's clear that reducing the "delta" between English and foreign language products results in a more expensive localization process. Due to lead times, it's necessary to begin localizing a product before the English version is final. The result is expensive rework. Management is therefore, re-evaluating the 30-day delta goal. Also, efforts are being made to shorten the localization process so that it can commence later in the product development cycle.
- **Location:** Cost structures at Microsoft locations vary. Microsoft may reduce costs and improve efficiencies by consolidating localization functions in fewer locations and by out-sourcing some functions.
- **Process:** Various localization processes are utilized by each of the DAD business units. The Graphics Business Unit in Menlo Park, for example, utilizes vendors to perform the entire localization function (as well as write the English documentation). Evaluation of processes throughout the Division will help identify best practices, which can then be applied across all business units.
- **Tools:** There is a lack of consistency in the set of automated localization tools that are used by various business units in various locations. Efficiencies can be achieved by standardizing on tools for internal and external localization.

Looking Ahead

A task force within Desktop Applications has been studying all of these issues. Division management is currently reviewing the results of this study, and will seek to achieve further improvements in the areas of: common best practices, standardized-automated tools, human resource deployment, vendor strategies and improved communication with the Microsoft subsidiaries who sell and support foreign language products. One of the early recommendations has been to move French, Spanish and Portuguese localization from Redmond to Ireland. The Systems Division is also pursuing a similar strategy.

The intent is to keep one European language (German) in Redmond, in the interest of maintaining good communications between development and localization. All other European languages would be moved to Ireland where the core competency of localizing software would be further refined.

Results of Operations (in millions)

Q94-1

| | Net Revenue | | Cost of Revenue | | Controllable Expense | | Responsibility Margin | |
|----------------------|--------------|-------------|-----------------|-------------|----------------------|------------|-----------------------|-------------|
| | Actual | % of Plan | Actual | % of Plan | Actual | % of Plan | Actual | % of Plan |
| Desktop Applications | | | | | | | | |
| Excel PU | \$152 | 119% | \$24 | 107% | \$35 | 88% | \$93 | 143% |
| Graphics PU | 31 | 114 | 5 | 105 | 8 | 73 | 19 | 157 |
| Project PU | 22 | 105 | 2 | 114 | 5 | 83 | 15 | 116 |
| Word PU | 175 | 113 | 28 | 101 | 38 | 85 | 109 | 137 |
| | <u>\$381</u> | <u>116%</u> | <u>\$59</u> | <u>106%</u> | <u>\$86</u> | <u>85%</u> | <u>\$277</u> | <u>137%</u> |

| | Net Revenue Mix | | Cost of Revenue | | Controllable Expense | | Responsibility Margin | |
|----------------------|-----------------|-----------|-----------------|-----------|----------------------|-----------|-----------------------|-----------|
| | Actual | % of Plan | % of Net Rev. | % of Plan | % of Net Rev. | % of Plan | % of Net Rev. | % of Plan |
| Desktop Applications | | | | | | | | |
| Excel PU | 40% | 1 | 16% | 2 | 23% | 8 | 61% | 10 |
| Graphics PU | 8 | 0 | 16 | 1 | 26 | 14 | 61 | 18 |
| Project PU | 6 | (1) | 9 | (1) | 23 | 6 | 69 | 5 |
| Word PU | 46 | (1) | 16 | 2 | 22 | 7 | 62 | 9 |
| | <u>100%</u> | <u>0</u> | <u>15%</u> | <u>2</u> | <u>23%</u> | <u>8</u> | <u>62%</u> | <u>10</u> |

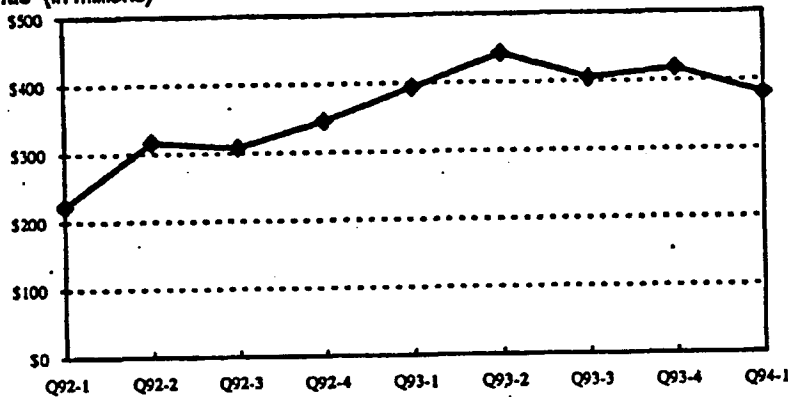
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DESKTOP APPLICATIONS SUMMARY

- The Desktop Applications Division finished the quarter above plan in all respects. Revenues for all product groups exceeded plan. Cost of goods as a percent of revenue was below plan and operating expenses were below plan, resulting in higher than planned margins.
- On the negative side, almost all performance metrics were below levels one year ago in Q93-1. Revenues were \$13 million less this quarter than in Q93-1, due mainly to continuing strong Excel sales at that time. Cost of goods has remained relatively constant, but controllable expenses were \$18 million higher this quarter than in Q93-1. This was due primarily to higher marketing expenditures in association with product launches this year, and higher product support costs.

TREND ANALYSES

Net Revenue (in millions)

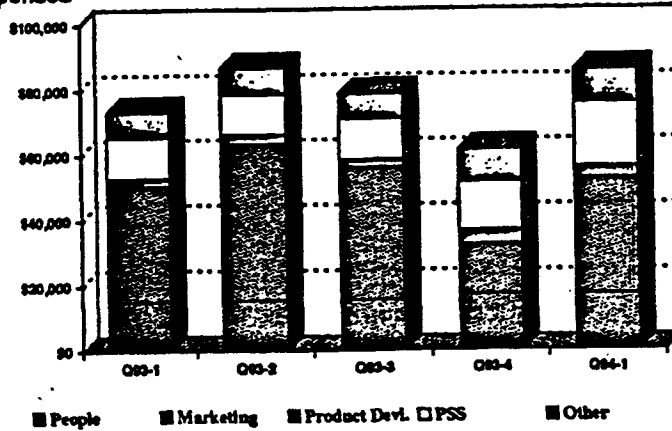


FY92 is stated as reported in FY92 and has not been restated for product reclassifications which are deemed to be immaterial for the purposes of this graph.

- The revenue trend for Desktop Applications shows a peak in Q93-2, when seasonal sales were strong, and Microsoft was enjoying very favorable foreign exchange rates with countries in which our larger subsidiaries do business. Revenues dipped in Q94-1 as planned. The expected surge from the introduction of MS Office 4.0, Word 6.0, and Excel 5.0 is budgeted to occur in Q94-2 and Q94-3. Over 83% of FY94 revenue is budgeted to occur in the last three quarters of the year with Q94-2 and Q94-3 planned revenues of \$532 million and \$524 million respectively.

Controllable Expenses

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• Comments on operating expenses are addressed in the individual product sections.

OFFICE

OFFICE

Highlights

- The Desktop Applications Division is in the process of executing Microsoft's biggest-ever application product launch, with the announcement of Office 4.0 in New York on October 19th. There will be a three to four week gap between the announcement and the availability of Office 4.0. This means advertising will hit before the product is in the channel. To address this, the channel is being encouraged to pre-book orders.
- MS Office 4.0 and MS OfficePro 4.0 for Windows will ship in early November with Win Word 6.0, and current versions of Excel and PowerPoint. Win Office version 4.2 is expected to ship in late January with the new Win Excel 5.0 and Win PowerPoint 4.0. The SRP for MS Office will be \$750; MS OfficePro 4.0, \$899.
- Competitive upgrades of MS Office will carry an SRP of \$299, while the SRP for upgrades from Microsoft products will be \$249. In addition, purchasers of MS Office upgrades will qualify to trade up to OfficePro with Access for \$99. (They will pay \$129 for the trade up and receive a \$30 rebate.)
- Microsoft Office cumulative shipments exceeded two million units worldwide in the month of September.
- The Software Publishers' Association (SPA) began tracking integrated application suites as a distinct market category in May of 1993. SPA only reports category information when there are at least three reporting competitors. The introduction of the Borland Office brought the suite total to three with Lotus SmartSuite and Microsoft Office. The first three months of SPA data provided the following market share information for MS Office in North America:

| | May | June | July |
|---------|-----|------|------|
| Units | 63% | 82% | 84% |
| Revenue | 66% | 81% | 82% |

The lower May share was a result of sell-in of the Borland Office.

- OfficePro has not achieved the expected momentum in the US finished goods channel. The FY94 revenue budget assumes that OfficePro will comprise 25% of total MS Office sales. A much lower actual mix, in combination with the budgeted higher revenue per unit versus the standard MS Office, causes concern about reaching the combined MS Office revenue goal.

Competition

- Lotus announced SmartSuite 2.1 for Windows. The new suite now includes Approach 2.1 (a relational database) along with Lotus 1-2-3 Release 4, Ami Pro 3.01, Freelance Graphics 2.01 and Lotus Organizer 1.1. The new version of SmartSuite will no longer include the license option of cc:Mail that was offered in previous SmartSuite releases. There is a special upgrade price of \$299 for existing SmartSuite users until December 31, 1993. Starting January 1st, the upgrade price will be \$595. The suggested retail price for the standard edition of SmartSuite 2.1 is \$795.
- The Borland Office for Windows shipped with QuattroPro for Windows 1.0, WordPerfect 5.2 for Windows and Paradox for Windows 1.0. Introductory pricing is \$399.95 (SRP). In addition, there is a 90 day special upgrade price of \$299.95 for users of any DOS or Windows word processor, database, spreadsheet or presentation package. Later in 1993, the Workgroup Extension Pack is scheduled to be available with electronic mail, scheduling, calendaring, forms and presentation graphics.

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OFFICE

Revenue by Channel Results (in millions)

| | Q94-1 | | |
|-------------------------|----------------|----------------|---------------|
| | Actual | Plan | Variance |
| Win Office * | | | |
| North America FG | \$53.1 | \$52.1 | \$1.0 |
| Europe FG | 86.1 | 66.4 | 19.7 |
| ICON FG | 18.4 | 15.2 | 3.2 |
| Far East FG | 9.3 | 7.4 | 1.9 |
| WW OEM | 0.1 | 0.0 | 0.1 |
| Total Win Office | \$167.0 | \$141.1 | \$25.9 |
| Mac Office | | | |
| North America FG | \$13.4 | \$11.7 | \$1.7 |
| Europe FG | 4.8 | 3.8 | 1.0 |
| ICON FG | 1.2 | 1.3 | (0.1) |
| Far East FG | 0.2 | 0.1 | 0.1 |
| WW OEM | 0.0 | 0.0 | 0.0 |
| Total Mac Office | \$19.6 | \$16.9 | \$2.7 |

(Refer to Channel Section for discussion of revenue variances.)

Revenue by Channel Trend (in millions)

| | Q93-1 | Q93-2 | Q93-3 | Q93-4 | Q94-1 |
|-------------------------|---------------|----------------|----------------|----------------|----------------|
| Win Office * | | | | | |
| North America FG | \$40.9 | \$49.8 | \$59.7 | \$73.9 | \$53.1 |
| Europe FG | 26.8 | 60.0 | 74.1 | 74.9 | 86.1 |
| ICON FG | 7.4 | 10.8 | 10.4 | 15.6 | 18.4 |
| Far East FG | 0.5 | 0.7 | 0.5 | 2.2 | 9.3 |
| WW OEM | 0.1 | 0.0 | 0.0 | 0.0 | 0.1 |
| Total Win Office | \$75.7 | \$121.3 | \$144.7 | \$166.6 | \$167.0 |
| Mac Office | | | | | |
| North America FG | \$11.3 | \$15.0 | \$12.1 | \$18.8 | \$13.4 |
| Europe FG | 1.1 | 2.9 | 3.4 | 4.8 | 4.8 |
| ICON FG | 1.4 | 0.6 | 0.9 | 0.8 | 1.2 |
| Far East FG | 0.1 | 0.0 | 0.1 | 0.1 | 0.2 |
| WW OEM | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Total Mac Office | \$13.9 | \$18.5 | \$16.5 | \$24.5 | \$19.6 |

* Win Office includes MS Office and MS OfficePro.

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EXCEL

EXCEL

Highlights

- The testing release II (beta II) of Win Excel 5.0 was released on September 15th to about 200 external sites as well as the Microsoft Excel product support group. Work is progressing towards a Thanksgiving RTM date.
- The delta between Windows and Mac versions of Excel has increased to keep the Windows ship date as close to projection as possible. Within two weeks of releasing Win Excel, the schedules for subsequent versions will be reassessed and real dates will be set.
- In August, worldwide shipments of Excel (Windows, Macintosh and DOS versions) surpassed those of any other vendor including Lotus.
- French, German, Swedish and Italian Win Excel 5.0 will be released within 30-days of the English language version.
- Mac Excel received a MacWEEK Editors' Choice Diamond Award and MacWorld magazine's World-Class Award for spreadsheet categories.

Competition

- Lotus 1-2-3 Release 4 for Windows received InfoWorld magazine's highest rating for a windows spreadsheet by scoring 7.8, Excel 4.0 scored 6.9 and Quattro Pro for Windows Version 1 scored 6.5. In PC Computing's spreadsheet review, Borland's Quattro Pro for Windows Version 5.0 received the highest rating, with a score of 86.2. Excel 4.0 placed second with a score of 82.9, beating Lotus 1-2-3 Version 4 which received a score of 74.8.
- Lotus 1-2-3 Release 4.01 for Windows, a free maintenance release, enhanced Lotus Notes integration and updated database drivers.
- Borland International and Lotus Development Corp. announced July 6, that the two companies will work together to integrate a forthcoming release of Borland's Quattro Pro for Windows with Lotus Notes.
- Borland has set a goal of selling 500,000 units of Quattro Pro by January 15, 1994. To help them reach this goal, they have established the most aggressive introductory pricing in the history of the spreadsheet industry. Through January 15, 1994, the price of Quattro Pro for Windows 5.0, and Quattro Pro 5.0 for DOS will be \$49.95, Quattro Pro for Windows Workgroup Edition will be available for \$99. Current owners of Quattro Pro will be able to upgrade to Quattro Pro for Windows 5.0 for just \$39.95 or upgrade to the Workgroup Edition for \$79.95.
- Borland International announced Quattro Pro 5.0 for Windows and Quattro Pro 5.0 Workgroup Edition on August 25th. Quattro Pro 5.0 for Windows is designed to be easier to use than Excel and Lotus 1-2-3.

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EXCEL

Results of Operations (in millions)

| | Q94-1 | | |
|-----------------------------|---------|---------|----------|
| | Actual | Plan | Variance |
| Net Revenue | \$152.3 | \$127.2 | \$25.1 |
| Cost of Revenues | 23.6 | 22.5 | (1.1) |
| Gross Profit | 128.7 | 104.7 | 24.0 |
| People | 4.2 | 4.3 | 0.1 |
| Facilities | 0.8 | 0.9 | 0.1 |
| Marketing | 16.0 | 17.0 | 1.0 |
| Product Dev | 1.0 | 1.2 | 0.2 |
| PSS | 7.6 | 9.4 | 1.8 |
| Other | 1.0 | 1.4 | 0.4 |
| Shared Resources | 4.4 | 5.4 | 1.0 |
| Total Controllable Expenses | 35.0 | 39.6 | 4.6 |
| Responsibility Margin | \$93.7 | \$65.1 | \$28.7 |
| | | | |
| Net Revenue | 100% | 100% | - |
| Cost of Revenues | 15 | 18 | 3 |
| Controllable Expenses | 23 | 31 | 8 |
| Responsibility Margin | 62% | 51% | 11% |

- The positive responsibility margin variance for the Excel business unit was primarily a result of above plan revenues for both Win Excel and Win Office, particularly in the North American FG channel. Q94-1 revenues were budgeted conservatively in anticipation of channel "dry-up" prior to the launch of Win Excel 5.0. Even though Q94-1 revenues were above plan, it was the lowest revenue quarter for the Excel Business Unit since Q92-3 (March 1992), just prior to the launch of Excel 4.0.
- MS Office new license sales represented 56% of all Win Excel new license sales and 48% of Mac Excel new license sales worldwide.
- Cost of Revenues were below plan as a percent of revenues, due in part to lower raw material costs. Controllable expenses were lower than planned, particularly in PSS. Despite the positive variance to plan, PSS costs are still 33% above the spending in Q93-1 of \$5.7 million.

Revenue by Channel Results (in millions)

| | Q94-1 | | |
|------------------|---------|---------|----------|
| | Actual | Plan | Variance |
| Win Excel * | | | |
| North America FG | \$ 23.0 | \$ 9.8 | \$ 13.2 |
| Europe FG | 27.4 | 31.1 | (3.7) |
| ICON FG | 4.2 | 4.6 | (0.4) |
| Far East FG | 6.5 | 4.4 | 2.1 |
| WW OEM | 2.3 | 3.6 | (1.3) |
| Total Win Excel | \$ 63.4 | \$ 53.5 | \$ 10.0 |
| Mac Excel * | | | |
| North America FG | \$ 7.5 | \$ 4.6 | \$ 2.9 |
| Europe FG | 2.7 | 4.0 | (1.3) |
| ICON FG | 0.6 | 0.9 | (0.3) |
| Far East FG | 3.0 | 3.7 | (0.7) |
| WW OEM | 0.0 | 0.0 | 0.0 |
| Total Mac Excel | \$ 13.8 | \$ 13.2 | \$ 0.6 |

(Refer to Channel Section for discussion of revenue variances.)

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EXCEL

Revenue by Channel Trend (in millions)

| | <u>Q93-1</u> | <u>Q93-2</u> | <u>Q93-3</u> | <u>Q93-4</u> | <u>Q94-1</u> |
|------------------------|----------------|-----------------|----------------|----------------|----------------|
| Win Excel * | | | | | |
| North America FG | \$ 26.7 | \$ 25.5 | \$ 24.6 | \$ 31.0 | \$ 23.0 |
| Europe FG | 59.4 | 64.9 | 50.4 | 33.0 | 27.4 |
| ICON FG | 7.2 | 5.4 | 4.5 | 5.6 | 4.2 |
| Far East FG | 2.9 | 9.8 | 10.1 | 7.0 | 6.5 |
| WW OEM | 0.9 | 1.8 | 2.8 | 5.3 | 2.3 |
| Total Win Excel | <u>\$ 97.1</u> | <u>\$ 107.6</u> | <u>\$ 92.4</u> | <u>\$ 81.9</u> | <u>\$ 63.4</u> |
| Mac Excel * | | | | | |
| North America FG | \$ 17.4 | \$ 8.7 | \$ 5.4 | \$ 7.5 | \$ 7.5 |
| Europe FG | 7.5 | 8.6 | 4.9 | 3.4 | 2.7 |
| ICON FG | 1.3 | 0.9 | 0.7 | 0.7 | 0.6 |
| Far East FG | 1.6 | 4.1 | 4.6 | 3.5 | 3.0 |
| WW OEM | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Total Mac Excel | <u>\$ 27.8</u> | <u>\$ 22.3</u> | <u>\$ 15.6</u> | <u>\$ 15.1</u> | <u>\$ 13.9</u> |

* Does not include MS Office revenue allocation.

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Product Group Reporting

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WORD

WORD

Highlights

- The Word development and testing groups are in the final stages of Win Word 6.0 bug fixing. Release to manufacturing (RTM) is scheduled for the week of October 25, 1993. Mac Word 6.0 is scheduled for an RTM of April 1994, the Intel NT version in May 1994 and the RISC NT version in July 1994.
- Work is beginning on the specifications document for Word 7.0.
- InfoWorld and PC Magazine's comparative reviews of word processors are being postponed until after Word 6.0 ships.

Competition

- WordPerfect 6.0 for Windows is expected to ship the week of October 18th. It includes templates and a drawing module from WordPerfect Presentations.
- WordPerfect 6.0 for DOS has been shipping since June. It includes fax and sound support and has spreadsheet capability in tables.
- In October, WordPerfect Corp. released WordPerfect 3.0 for the Macintosh.
- WordPerfect is promoting an advertisement entitled "A Lesson in Proper Form". The advertisement mentions the past, present and future success of WordPerfect across all platforms and lists independent statistics supporting WordPerfect as the leader in word processing.

Results of Operations (in millions)

| | Q94-1 | | |
|-----------------------------|---------|---------|----------|
| | Actual | Plan | Variance |
| Net Revenue | \$174.9 | \$154.5 | \$20.4 |
| Cost of Revenues | 28.5 | 27.6 | (0.9) |
| Gross Profit | 146.4 | 126.9 | 19.5 |
| People | 4.5 | 4.8 | 0.3 |
| Facilities | 0.9 | 1.0 | 0.1 |
| Marketing | 15.4 | 18.1 | 2.7 |
| Product Dev | 0.8 | 0.8 | 0.0 |
| PSS | 9.9 | 12.3 | 2.4 |
| Other | 1.3 | 1.6 | 0.3 |
| Shared Resources | 4.8 | 5.9 | 1.1 |
| Total Controllable Expenses | 37.6 | 44.5 | 6.9 |
| Responsibility Margin | \$108.8 | \$82.4 | \$26.4 |
| Net Revenue | 100% | 100% | - |
| Cost of Revenues | 16 | 18 | .2 |
| Controllable Expenses | 21 | 29 | 7 |
| Responsibility Margin | 62% | 53% | 9% |

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WORD

- The positive responsibility margin variance for the Word Business Unit was primarily a result of above plan revenues for both Win Word and Win Office, particularly in the North American FG channel. Q94-1 was budgeted to be a weak quarter for the Word Business Unit. Revenues are budgeted to exceed \$266 million in Q94-2, with a responsibility margin of 64%.
- MS Office new license sales represented 52% of all Win Word new license sales and 35% of Mac Word new license sales worldwide, much as planned.
- Cost of Revenues were below plan as a percent of revenues, due in part to lower raw material costs. Controllable expenses were lower than planned, particularly in PSS. Despite the positive variance to plan, PSS costs were still almost 50% above the spending in Q93-1 of \$6.7 million.

Revenue by Channel Results (in millions)

| | Q94-1 | | |
|-----------------------|----------------|----------------|-----------------|
| | Actual | Plan | Variance |
| Win Word * | | | |
| North America FG | \$ 21.5 | \$ 11.4 | \$ 10.1 |
| Europe FG | 32.0 | 33.7 | (1.7) |
| ICON FG | 6.7 | 4.8 | 1.9 |
| Far East FG | 9.6 | 9.3 | 0.3 |
| WW OEM | 2.6 | 5.7 | (3.1) |
| Total Win Word | \$ 72.4 | \$ 64.9 | \$ 7.5 |
| Mac Word * | | | |
| North America FG | \$ 10.1 | \$ 9.8 | \$ 0.3 |
| Europe FG | 3.7 | 4.7 | (1.0) |
| ICON FG | 0.9 | 1.0 | (0.1) |
| Far East FG | 0.6 | 0.2 | 0.4 |
| WW OEM | 0.0 | 0.0 | 0.0 |
| Total Mac Word | \$ 15.3 | \$ 15.7 | \$ (0.4) |

(Refer to Channel Section for discussion of revenue variances.)

Revenue by Channel Trend (in millions)

| | Q93-1 | Q93-2 | Q93-3 | Q93-4 | Q94-1 |
|-----------------------|----------------|----------------|---------------|---------------|---------------|
| Win Word * | | | | | |
| North America FG | \$32.1 | \$37.7 | \$16.9 | \$27.1 | \$21.5 |
| Europe FG | 60.3 | 67.3 | 52.2 | 38.3 | 32.0 |
| ICON FG | 7.6 | 4.8 | 4.1 | 5.8 | 6.7 |
| Far East FG | 1.5 | 4.7 | 5.4 | 5.3 | 9.6 |
| WW OEM | 0.9 | 1.8 | 2.8 | 6.1 | 2.6 |
| Total Win Word | \$102.4 | \$116.3 | \$81.4 | \$82.6 | \$72.4 |
| Mac Word * | | | | | |
| North America FG | \$15.2 | \$17.9 | \$7.0 | \$11.0 | \$10.1 |
| Europe FG | 7.8 | 7.7 | 7.0 | 4.5 | 3.7 |
| ICON FG | 1.4 | 0.7 | 0.9 | 1.3 | 0.9 |
| Far East FG | 0.4 | 0.2 | 0.8 | 0.4 | 0.6 |
| WW OEM | 0.0 | 0.0 | 0.1 | 0.0 | 0.0 |
| Total Mac Word | \$24.8 | \$26.5 | \$15.8 | \$17.2 | \$15.3 |

* Does not include MS Office revenue allocation.

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GRAPHICS

GRAPHICS

Highlights

- Work continues on PowerPoint 4.0. Zero bug release (ZBR) is scheduled for Nov. 1st, with a likely release to manufacturing (RTM) of mid-December. New features include: drag and drop, document routing and "Word-like" text handling features. One of the major goals for version 4.0 is to make PowerPoint a good MS Office citizen, with better consistency and inter-operability with Word and Excel.
- In mid-October, PowerPoint launched its first-ever beta program, to the delight of many customers. The beta program was also intended to help identify bugs and provide feedback on new features.
- The PowerPoint 4.0 press tour began in September. The response from the media, resellers and the Microsoft sales force has been very encouraging.
- The release of the Macintosh version of PowerPoint 4.0 has many outside dependencies such as Graph and OLE, which are placing a high degree of risk on the schedule.
- Mac PowerPoint 3.0 has won all three of the top industry trade awards: MacUser Editors' Choice Award, MacWEEK Editors' Choice Diamond Award and the MacWorld World-Class Award.
- The Graphics Business Unit's lease at the Quadras business park in Menlo Park, California is up for renewal negotiation in November 1993 (lease expires in November 1994). Microsoft intends to pursue more favorable terms.

Competition

- Lotus Development Corp's Freelance Graphics for Windows 2.0 (released in Feb, 1993) resoundingly won the following awards for presentation graphics: PC Magazine, PC World, PC/Computing, Software Digest, Windows Sources, InfoWorld and BYTE Magazine.

GBU management believes that PowerPoint 4.0 will match Freelance in many features, but there are rumors that Lotus may introduce an updated version of Freelance in the first quarter of 1994. A Macintosh version is also rumored to be in the works.

- In August, Software Publishing Corp. announced Harvard Graphics for Windows version 2.0, with a new suggested retail price of \$395 and an upgrade price of \$89 until December 31, 1993 (after January 1st the upgrade price will be \$125). This product is the first Windows product to contain on-line content assistance and professional design advice by phone.

Software Publishing, in Mountain View, California recently laid-off 400 people. Many industry insiders question whether the company, a strong player in the DOS presentation graphics business, can survive after its late entry into the Windows market.

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GRAPHICS

Results of Operations (in millions)

| | Q94-1 | | |
|-----------------------------|--------|--------|----------|
| | Actual | Plan | Variance |
| Net Revenue | \$31.3 | \$27.2 | \$4.1 |
| Cost of Revenues | 4.8 | 4.6 | (0.2) |
| Gross Profit | 26.5 | 22.6 | 3.9 |
| People | 1.8 | 2.1 | 0.3 |
| Facilities | 0.7 | 0.7 | 0.0 |
| Marketing | 2.9 | 4.0 | 1.1 |
| Product Dev | 0.4 | 1.0 | 0.6 |
| PSS | 1.1 | 1.6 | 0.5 |
| Other | 0.3 | 0.3 | 0.1 |
| Shared Resources | 0.9 | 1.1 | 0.2 |
| Total Controllable Expenses | 8.1 | 10.9 | 2.8 |
| Responsibility Margin | \$18.4 | \$11.8 | \$6.7 |
| | | | |
| Net Revenue | 100% | 100% | - |
| Cost of Revenues | 15 | 17 | 2 |
| Controllable Expenses | 26 | 40 | 14 |
| Responsibility Margin | 59% | 43% | 16% |

- The higher than planned profitability for the Graphics Business Unit was primarily a result of higher than planned sales of the MS Office worldwide. The mix of Win Office as a percent of Win PowerPoint was approximately 84% in NA FG, and 97% internationally. The worldwide mix of Mac Office as a percent of Mac PowerPoint was approximately 71%.
- A drop in floppy disk prices in July resulted in lower product costs as a percent of revenues for domestic product.

Revenue by Channel Results (in millions)

| | Q94-1 | | |
|----------------------|--------|-------|----------|
| | Actual | Plan | Variance |
| Win PowerPoint * | | | |
| North America FG | \$4.1 | \$3.8 | \$0.3 |
| Europe FG | 1.6 | 2.2 | (0.6) |
| ICON FG | 0.6 | 0.5 | 0.1 |
| Far East FG | 0.2 | 0.4 | (0.2) |
| WW OEM | 1.1 | 0.6 | 0.5 |
| Total Win PowerPoint | \$7.6 | \$7.5 | \$0.1 |
| Mac PowerPoint * | | | |
| North America FG | \$2.2 | \$1.8 | \$0.4 |
| Europe FG | 0.5 | 0.3 | 0.2 |
| ICON FG | 0.1 | 0.1 | 0.0 |
| Far East FG | 0.0 | 0.0 | 0.0 |
| WW OEM | 0.0 | 0.0 | 0.0 |
| Total Mac PowerPoint | \$2.8 | \$2.2 | \$0.6 |

(Refer to Channel Section for discussion of revenue variances.)

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GRAPHICS

Revenue by Channel Trend (in millions)

| | <u>Q93-1</u> | <u>Q93-2</u> | <u>Q93-3</u> | <u>Q93-4</u> | <u>Q94-1</u> |
|-----------------------------|---------------|--------------|--------------|---------------|--------------|
| Win PowerPoint * | | | | | |
| North America FG | \$7.6 | \$4.3 | \$4.3 | \$5.3 | \$4.1 |
| Europe FG | 3.3 | 3.7 | 2.5 | 1.9 | 1.6 |
| ICON FG | 0.9 | 0.6 | 0.4 | 0.6 | 0.6 |
| Far East FG | 0.2 | 0.2 | 0.1 | 0.2 | 0.2 |
| WW OEM | 0.5 | 0.8 | 1.2 | 2.6 | 1.1 |
| Total Win PowerPoint | <u>\$12.5</u> | <u>\$9.6</u> | <u>\$8.5</u> | <u>\$10.6</u> | <u>\$7.6</u> |
| Mac PowerPoint * | | | | | |
| North America FG | \$1.0 | \$3.9 | \$2.8 | \$2.3 | \$2.2 |
| Europe FG | 0.2 | 0.3 | 0.5 | 0.4 | 0.5 |
| ICON FG | 0.0 | 0.1 | 0.1 | 0.2 | 0.1 |
| Far East FG | 0.0 | 0.0 | 0.0 | 0.1 | 0.0 |
| WW OEM | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Total Mac PowerPoint | <u>\$1.2</u> | <u>\$4.3</u> | <u>\$3.4</u> | <u>\$3.0</u> | <u>\$2.8</u> |

* Does not include MS Office revenue allocation.

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PROJECT

PROJECT

Highlights

- Work continues on Project 4.0. The four main objectives in this new release are:
 - Ease of use
 - Consistency with other Microsoft applications
 - Enhanced workgroup features
 - To be better enabled as a component of end-solutions

Win Project reached code complete on August 20th. Zero bug release (ZBR) is scheduled for Thanksgiving. Release to manufacturing (RTM) is planned for January 15, 1994.

- The public relations plan for Project 4.0 is to convince the press that "usable by newcomers" is the criteria for leadership in this category and convince them that Project 4.0 is a breakthrough for this user group.
- Project 4.0 has created great interest among the press due to its compatibility with MS Mail, MS Schedule+ and MS Access. The industry appears to be excited by these developments in workgroup enabling extensions.
- Project 4.0 will be released with an integrated Visual Basic for Applications (VBA) programming language. The integration of VBA and OLE 2.0 will make the application easier to customize for the solution provider and the end user.
- The Project Business Unit is developing a new product called Resource Planning Manager (RPM). RPM is a *work manager*, as opposed to a project manager. It is designed for managers who have to schedule assignments in a way that satisfies deadlines, balance the workload between people in a group, track performance objectives and resolve scheduling conflicts. The Project Business Unit currently has 17 people working on RPM. The first product will be released no earlier than Fall of 1994.

Competition

- Symantec Inc., released TimeLine for Windows in June of 1993. It has not enjoyed the success of their DOS version, due to its positioning as a replacement for their low-end product, OnTarget. A new release (version 6.0), scheduled for November is expected to be a more serious threat. OnTarget is estimated to have a 20% market share.
- Computer Associates' SuperProject continues to be considered the most powerful desktop project management package. A complicated interface has limited its acceptance in the marketplace, but a new version is rumored to be imminent that may simplify their interface. SuperProject's market share is estimated to be 10%.
- The project management category has enjoyed tremendous growth during the last two years. This is believed to be due to the increased power of desktop computers, and the improved ease of use of project management software.
- Sales of Mac Project represent only 16% of Project's revenues, but it is considered key to Microsoft Project's success because it is the only core-code, cross platform solution.

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PROJECT**Results of Operations (in millions)**

| | Q94-1 | | |
|-----------------------------|--------|--------|----------|
| | Actual | Plan | Variance |
| Net Revenue | \$22.3 | \$20.9 | \$1.4 |
| Cost of Revenues | 1.8 | 1.6 | (0.2) |
| Gross Profit | 20.5 | 19.3 | 1.2 |
| People | 1.6 | 1.6 | 0.0 |
| Facilities | 0.2 | 0.3 | 0.1 |
| Marketing | 1.3 | 1.8 | 0.5 |
| Product Dev | 0.1 | 0.2 | 0.1 |
| PSS | 0.9 | 0.9 | 0.0 |
| Other | 0.1 | 0.3 | 0.2 |
| Shared Resources | 0.8 | 0.9 | 0.1 |
| Total Controllable Expenses | 5.0 | 6.0 | 1.0 |
| Responsibility Margin | \$15.5 | \$13.3 | \$2.2 |
| | | | |
| Net Revenue | 100% | 100% | - |
| Cost of Revenues | 8 | 8 | 0 |
| Controllable Expenses | 22 | 29 | 7 |
| Responsibility Margin | 70% | 64% | 6% |

- The Project Business Unit exceeded planned profitability primarily due to slightly higher than planned revenues for both Win and Mac Project. Revenue per unit was maintained in North America FG and Europe FG. In ICON FG, erosion in revenue per unit was offset by very strong unit sales, resulting in higher than planned revenues.
- Also contributing to the positive responsibility margin variance was lower than planned controllable expenses, led by marketing. Cost of Revenues were in line as a percent of revenues.

Revenue by Channel Results (in millions)

| | Q94-1 | | |
|-------------------|--------|--------|----------|
| | Actual | Plan | Variance |
| Win Project | | | |
| North America FG | \$10.8 | \$11.3 | (\$0.5) |
| Europe FG | 6.2 | 6.1 | 0.1 |
| ICON FG | 2.3 | 1.3 | 1.0 |
| Far East FG | 0.3 | 0.2 | 0.1 |
| WW OEM | 0.3 | 0.4 | (0.1) |
| Total Win Project | \$19.9 | \$19.3 | \$0.6 |
| Mac Project | | | |
| North America FG | \$2.5 | \$2.0 | \$0.5 |
| Europe FG | 0.3 | 0.3 | 0.0 |
| ICON FG | 0.1 | 0.0 | 0.1 |
| Far East FG | 0.0 | 0.0 | 0.0 |
| WW OEM | 0.0 | 0.0 | 0.0 |
| Total Mac Project | \$2.9 | \$2.3 | \$0.6 |

(Refer to Channel Section for discussion of revenue variances.)

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PROJECT

Revenue by Channel Trend (in millions)

| | <u>Q93-1</u> | <u>Q93-2</u> | <u>Q93-3</u> | <u>Q93-4</u> | <u>Q94-1</u> |
|--------------------------|---------------|---------------|---------------|---------------|---------------|
| Win Project | | | | | |
| North America FG | \$11.3 | \$10.8 | \$11.6 | \$15.7 | \$10.8 |
| Europe FG | 9.2 | 8.7 | 6.9 | 6.9 | 6.2 |
| ICON FG | 1.8 | 1.3 | 1.4 | 2.0 | 2.3 |
| Far East FG | 0.2 | 0.2 | 0.1 | 0.2 | 0.3 |
| WW OEM | 0.1 | 0.4 | 0.4 | 0.8 | 0.3 |
| Total Win Project | <u>\$22.6</u> | <u>\$21.4</u> | <u>\$20.4</u> | <u>\$25.6</u> | <u>\$19.9</u> |
| Mac Project | | | | | |
| North America FG | \$2.7 | \$2.3 | \$1.7 | \$2.0 | \$2.5 |
| Europe FG | 0.3 | 0.4 | 0.5 | 0.4 | 0.3 |
| ICON FG | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 |
| Far East FG | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| WW OEM | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Total Mac Project | <u>\$3.1</u> | <u>\$2.8</u> | <u>\$2.3</u> | <u>\$2.5</u> | <u>\$2.9</u> |

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DATABASE & DEVELOPMENT TOOLS

DATABASE & DEVELOPMENT TOOLS

Key Product Releases

| Business Unit/Product | RTM Date | | Revenue in millions* | | | |
|---------------------------------------|----------|--------|----------------------|------|----------|-------------|
| | Act/Fcst | Plan | FYTD94 | | Variance | FY94 Budget |
| | | | Actual | Plan | | |
| Database and Development Tools | | | | | | |
| Access 2.0 (and Office allocation) | Feb-94 | Dec-93 | \$25 | \$28 | (\$3) | \$155 |
| SQL Server NT | Sep-93 | Sep-93 | \$1 | \$6 | (\$5) | \$25 |
| Visual C++ 32-Bit Edition | Aug-93 | Aug-93 | \$1 | \$2 | (\$1) | \$14 |
| Visual C++ /J 1.0 | Oct-93 | Oct-93 | \$0 | \$0 | \$0 | n/a ** |
| Visual C++ /Mac SDK (Wings) | Apr-94 | Jan-94 | \$0 | \$0 | \$0 | \$2 |
| FoxPro 2.5 Mac | Dec-93 | Dec-93 | \$0 | \$0 | \$0 | \$6 |
| Fortran PowerStation NT | Oct-93 | Oct-93 | \$0 | \$0 | \$0 | \$2 |
| Delta Version Control System | Aug-93 | Aug-93 | \$0 | \$0 | \$0 | \$2 |

* Total all versions sold in FY94. Includes MS Office allocation (Access).

** Visual C++/Japanese version not broken out (included with regular product for budget purposes).

- Access 2.0, originally scheduled for RTM on December 8, 1993, has slipped to the current RTM of February 24, 1994.
- Visual C++ /Mac SDK was pushed back approximately 3 months to April 22, 1994. This was done in order to synch up with the next version of C++ (code named Dolphin).

Results of Operations (in millions)

Q94-1

| | Net Revenue | | Cost of Revenue | | Controllable Expense | | Responsibility Margin | |
|------------------------------|--------------|------------|-----------------|-------------|----------------------|------------|-----------------------|------------|
| | Actual | % of Plan | Actual | % of Plan | Actual | % of Plan | Actual | % of Plan |
| Database Mgt Systems | \$ 25 | 88% | \$ 6 | 157% | \$ 12 | 69% | \$ 6 | 86% |
| Fox | 19 | 63 | 4 | 82 | 7 | 71 | 9 | 53 |
| Applications Programmability | 19 | 135 | 5 | 188 | 5 | 87 | 9 | 165 |
| C++ | 13 | 139 | 5 | 117 | 9 | 97 | (1) | 15 |
| Scientific and Eng. Tools | 4 | 148 | 1 | 255 | 3 | 90 | 0 | 12 |
| | <u>\$ 80</u> | <u>94%</u> | <u>\$ 21</u> | <u>132%</u> | <u>\$ 36</u> | <u>79%</u> | <u>\$ 23</u> | <u>99%</u> |

| | Net Revenue Mix | | Cost of Revenue | | Controllable Expense | | Responsibility Margin | |
|------------------------------|-----------------|-----------|-----------------|------------|----------------------|-----------|-----------------------|-----------|
| | Actual | % pts Var | % Net Rev | % pts Var | % Net Rev | % pts Var | % Net Rev | % pts Var |
| Database Mgt Systems | 31% | (3) | 26% | (11) | 48% | 13 | 24% | 0 |
| Fox | 24 | (12) | 19 | (5) | 37 | (4) | 45 | (7) |
| Applications Programmability | 23 | 7 | 25 | (7) | 27 | 15 | 49 | 9 |
| C++ | 17 | 5 | 39 | 7 | 63 | 28 | (4) | 35 |
| Scientific and Eng. Tools | 5 | 2 | 27 | (11) | 83 | 54 | (4) | 49 |
| | <u>100%</u> | <u>0</u> | <u>26%</u> | <u>(8)</u> | <u>45%</u> | <u>9</u> | <u>29%</u> | <u>1</u> |

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DATABASE & DEVELOPMENT TOOLS

Highlights

- Access version 1.1 and FoxPro for Windows version 2.5 were rated the two top multi-user databases for Windows in the July 1993 Software Digest Ratings Report. Access received an overall score of 7.7 and FoxPro received a 7.6. Paradox for Windows scored 6.9 and Superbase came in at 6.3.
- SQL Server for Windows NT was released to manufacturing on September 1, 1993. SQL Server is the first database management system that tightly integrates with Windows NT. As more organizations seek to take advantage of client-server computing, SQL Server gives customers a unified client-server architecture that is extremely fast and powerful, yet easy to install, use and manage.
- Visual C++ 32-Bit Edition released to manufacturing on August 11, 1993. This is the first Windows NT-hosted and integrated 32-bit development environment for professional C and C++ developers. It allows professional developers to develop 32-bit applications for the Windows NT operating system.
- In July 1993 the SQL Server group officially became part of the Database & Development Tools Division. Prior to this, it was managed under the Systems group.

Competition

- Borland continues to be the main competitor to the Database and Development Tools Division at Microsoft. In an article which appeared in the August 16th issue of PC Week, it was stated that between September and the end of the year, Borland would be releasing Paradox for Windows 1.1, Paradox for DOS 4.5, a 32-bit upgrade to the dBASE compiler, and SQL Link Workgroup License. Borland officials declined to comment on this article. In September, Borland announced special pricing on Quattro Pro allowing customers to purchase Quattro Pro 5.0 for Windows for \$49.95 and Quattro Pro 5.0 Workgroup Edition for \$99.95. The offer is to extend through January 15, 1994 and Borland is hoping to sell 500,000 units. Though Quattro Pro does not compete directly with any products within the division, it is indicative of a pricing strategy which, if successful, Borland may be willing to adopt in order to gain market share in its other product lines like dBASE and Paradox. Analysts' opinions regarding this move are mixed.
- Powersoft Corporation, with PowerBuilder, has been receiving favorable attention. This is a client-server development product, along the lines of Visual Basic, and with SQL Server "smarts" built in, it makes it attractive to developers due to the ease of development it provides.
- Lotus Development Corp.'s acquisition of Approach Software in June 1993 gave them a desktop database for Windows which they offered for \$99 through September 30, 1993. Approach differs from Access primarily in that it does not have an underlying database engine, rendering it non-programmable.

Divisional Strategy

- Work is in progress to clearly define the strategy for the division. The division is facing numerous challenges, from developing a viable alternative to Lotus Notes to determining how best to manage the Fortran business to deciding how to position FoxPro and Access in the marketplace.

Since the merger with Fox Software in June 1992, it has been a challenge to clearly distinguish the two products (FoxPro and Access) in the minds of the customer. At the FoxPro Developers Conference held in October, it was evident that there is still work to do in this area.

A special team was formed during the quarter to analyze and develop a Notes strategy.

The direction and focus of Visual Basic, with Visual Basic for Applications (VBA) soon to be included in the desktop products, is being evaluated.

A key initiative started by Roger Heinen was the creation of the Developer Brand, whereby the division is promoting the Microsoft "family" of developer products and tools. Its intent is to provide one very clear message to the customer; Microsoft has a complete and robust set of tools for the developer that work together, and that Microsoft's commitment to the developer has never been stronger.

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DATABASE & DEVELOPMENT TOOLS

Results of Operations (in millions)

| | Q94-1 | | |
|-----------------------------|--------|------|----------|
| | Actual | Plan | Variance |
| Net Revenue | \$80 | \$84 | (\$4) |
| Cost of Revenues | 21 | 16 | (5) |
| Gross Profit | 59 | 68 | (9) |
| People | 15 | 16 | 1 |
| Facilities | 2 | 3 | 1 |
| Marketing | 6 | 10 | 4 |
| Product Dev | 2 | 6 | 4 |
| PSS | 9 | 10 | 1 |
| Other | 3 | 1 | (2) |
| Shared Resources | (1) | (1) | 0 |
| Total Controllable Expenses | 36 | 45 | 9 |
| Responsibility Margin | \$23 | \$23 | \$0 |
| | | | |
| Net Revenue | 100% | 100% | -- |
| Cost of Revenues | 26 | 19 | (7) |
| Controllable Expenses | 45 | 54 | 9 |
| Responsibility Margin | 29% | 27% | 2% |

- Net revenues were 94% of plan. With the exception of North America FG, all channels were above plan. North America FG sales of Access and FoxPro were significantly below plan. The Access business unit had sales of \$9 million compared to \$13 million plan. Less than planned sales from the Office Pro bundle (19% of plan in North America FG) was the primary reason behind the lower than planned Access sales. Sales of FoxPro were \$8 million in North American FG compared to a \$21 million plan. The shortfall in this channel is attributable to an overly optimistic plan.
- Product cost of revenues as a percentage of gross revenues were 17% versus a plan of 14% for the division overall. The primary reason was the higher than planned manufacturing allocations and a write-off of the introductory Access promotional SKU.
- Controllable expenses were below plan due to underspending of marketing and product development budgets. The underspending was not limited to any particular business unit.
- The lower than planned gross profit was offset by less than planned controllable expenses, resulting in the responsibility margin equal to plan.

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DATABASE & DEVELOPMENT TOOLS

Revenue by Channel Results (in millions)

| | Q94-1 | | |
|------------------------------|--------------|--------------|---------------|
| | Actual | Plan | Variance |
| Database & Development Tools | | | |
| North America FG | \$ 34 | \$ 48 | \$ (14) |
| Europe FG | 31 | 29 | 2 |
| Far East FG | 10 | 5 | 5 |
| ICON FG | 6 | 5 | 1 |
| WW OEM | 1 | 0 | 1 |
| | <u>\$ 82</u> | <u>\$ 87</u> | <u>\$ (5)</u> |

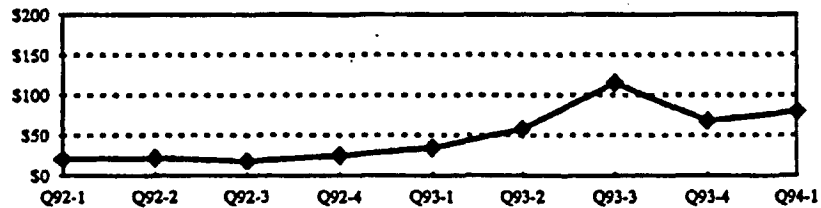
(Refer to Channel Section for discussion of revenue variances.)

TREND ANALYSES

Revenue by Channel (in millions)

| | Q93-1 | Q93-2 | Q93-3 | Q93-4 | Q94-1 |
|------------------------------|--------------|--------------|---------------|--------------|--------------|
| Database & Development Tools | | | | | |
| North America FG | \$ 20 | \$ 37 | \$ 57 | \$ 38 | \$ 34 |
| Europe FG | 9 | 17 | 39 | 20 | 31 |
| ICON FG | 2 | 4 | 9 | 5 | 6 |
| Far East FG | 3 | 5 | 10 | 9 | 10 |
| WW OEM | 1 | 1 | 1 | 1 | 1 |
| | <u>\$ 35</u> | <u>\$ 64</u> | <u>\$ 116</u> | <u>\$ 73</u> | <u>\$ 82</u> |

Net Revenue (in millions)



FY92 is stated as reported in FY92 and has not been restated for product reclassifications which are deemed to be immaterial for the purposes of this graph.

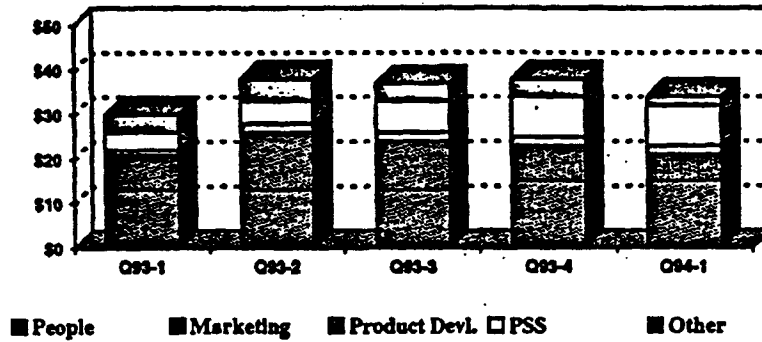
- Prior to Q93-1, revenues came from the Languages products (C, Fortran, Assembler) and Basic, including Visual Basic. With the acquisition of Fox Software at the end of Q92-4, Microsoft entered the desktop database market. Releasing Access in November of Q93-2 sparked sales beyond all expectations as customers snapped up Access at the \$99 introductory price. Sales peaked in Q93-3.

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DATABASE & DEVELOPMENT TOOLS

Controllable Expenses



- Marketing expenses were relatively high in Q93-2 and Q93-3 due to the launch of Access and continuing promotion of Fox products since the acquisition.
- PSS has grown significantly as a proportion of DDT's overall expenses as there are now not only more products to support, but they are generally quite technical in nature.

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CONSUMER

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Key Product Releases

| Business Unit/Product | RTM Date | | Revenue in millions * | | | |
|-----------------------|----------|--------|-----------------------|-------|----------|--------|
| | | | FYTD94 | | FY94 | |
| | Actual | Plan | Actual | Plan | Variance | Budget |
| Consumer | | | | | | |
| Win Dinosaurs | Jul-93 | Jul-93 | 1.0 | 0.2 | 0.8 | 1.2 |
| Publisher 2.0 | Jul-93 | Jul-93 | 10.2 | 5.8 | 4.4 | 19.7 |
| Arcade | Aug-93 | Aug-93 | 1.1 | 0.7 | 0.4 | 2.1 |
| Win Cinemania 1994 | Aug-93 | Aug-93 | 0.6 | 0.3 | 0.3 | 1.8 |
| Flight Simulator 5.0 | Sep-93 | Sep-93 | \$6.6 | \$3.4 | \$3.2 | \$12.8 |
| Win Encarta, 1994 | Sep-93 | Sep-93 | 1.3 | 1.3 | 0.0 | 8.2 |
| Win Works 3.0 | Oct-93 | Oct-93 | 17.8 | 11.6 | 6.2 | 89.6 |
| Creative Artist | Oct-93 | Sep-93 | 0.0 | 0.0 | 0.0 | 4.0 |
| Mac Encarta, 1994 | Dec-93 | Nov-93 | 0.0 | 0.0 | 0.0 | 2.5 |
| Fine Artist | Dec-93 | Nov-93 | 0.0 | 0.0 | 0.0 | 4.0 |
| Money 3.0 | Jan-94 | Oct-93 | 1.0 | 1.3 | (0.3) | 10.0 |
| Mac Works 4.0 | Mar-94 | Feb-94 | 3.2 | 1.7 | 1.5 | 18.2 |

* Total all versions sold in FY94.

- Flight Sim 5.0 was released in September and had 250,000 units on order. This was approximately 66% of the total FY94 plan. Sales to date have already exceeded FY93 total sales, and release 5.0 is already more successful than all previous releases. Another game released this quarter was Arcade, which consists of several games in one package.
- The release date for Money 3.0 slipped to January primarily due to development issues.
- The Win Works 3.0 team conducted a press tour in September to preview the newest release of the product. The product received very positive feedback, particularly on ease-of-use features.
- Win Encarta, 1994 was released on schedule and included information as up to date as the Middle East peace conference which took place in Washington, DC in mid-September. This will be offered at a special price of \$99 until December 31, 1993. Cinemania '94 was also released this quarter. Encarta and Cinemania will now be released as annual updates every Fall.
- Publisher 2.0 was released at the beginning of the quarter and has exceeded its FY94 plan for domestic retail sales in the first quarter as well as its total FY93 domestic retail sales. Worldwide, Publisher has already sold 73% of total FY93 sales.
- Five additional Consumer titles were released this quarter: Stravinsky, Mozart, Publisher Design Pack, Publisher CD and Golf CD. The Consumer Division has announced that it will ship a new title every two weeks for the next eighteen months. Several of these titles will have annual revenues of less than \$1 million, and will be marketed under the Microsoft Home brand.

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Results of Operations (in millions)

Q94-1

| | Net Revenue | | Cost of Revenue | | Controllable Expense | | Responsibility Margin | |
|----------|---------------|---------------|-----------------|---------------|----------------------|--------------|-----------------------|----------------|
| | Actual | % of Plan | Actual | % of Plan | Actual | % of Plan | Actual | % of Plan |
| Consumer | | | | | | | | |
| Works PU | \$27.0 | 113.0% | \$3.6 | 94.7% | \$8.2 | 78.8% | \$15.2 | 156.7% |
| MM Pubs | 5.6 | 147.4 | 1.2 | 120.0 | 6.4 | 63.4 | (2.0) | 27.4 |
| Entry PU | 21.7 | 136.5 | 5.9 | 143.9 | 9.2 | 72.4 | 6.6 | 772.2 |
| | <u>\$54.3</u> | <u>124.5%</u> | <u>\$10.7</u> | <u>120.2%</u> | <u>\$23.8</u> | <u>71.7%</u> | <u>\$19.8</u> | <u>1275.1%</u> |

| | Net Revenue Mix | | Cost of Revenue | | Controllable Expense | | Responsibility Margin | |
|----------|-----------------|------------|-----------------|------------|----------------------|-------------|-----------------------|-------------|
| | Actual | % pts Var | % Net Rev | % pts Var | % Net Rev | % pts Var | % Net Rev | % pts Var |
| Consumer | | | | | | | | |
| Works PU | 49.7% | (5.1) | 13.3% | 2.6 | 30.4% | 13.1 | 56.3% | 15.7 |
| MM Pubs | 10.3 | 1.6 | 21.4 | 4.9 | 114.3 | 151.5 | (35.7) | 156.4 |
| Entry PU | 40.0 | 3.5 | 27.2 | (1.4) | 42.4 | 37.5 | 30.2 | 35.6 |
| | <u>100%</u> | <u>0.0</u> | <u>19.7%</u> | <u>0.7</u> | <u>43.8%</u> | <u>32.3</u> | <u>36.4%</u> | <u>32.8</u> |

Highlights

- The Microsoft Home brand name was introduced nationwide at the end of the quarter. This brand represents a broad range of easy to use software designed for the entire family and will tie consumer products together under a common packaging, distribution and marketing approach.
- Microsoft Works for the Mac has been on the MacWorld best seller list for 78 consecutive months, and remains one of the five best selling Macintosh applications in history.
- As of August, 1993, Works for Windows worldwide installed base passed the 3 million unit mark, with over 1.5 million copies in use in the US.

Competition

- Claris Works announced a cross platform bundle with Intuit's Quicken at an SRP of \$129. To combat this, Microsoft will bundle Money with the release of Win Works 3.0 at an aggressive and highly competitive SRP of \$89, until December 31, 1993. Quicken currently has over 80% of the retail unit share for personal finance software and is picking up the pace with aggressive OEM pricing.
- WordPerfect has formed a new Consumer Products Group which hopes to create, license or acquire a total of approximately 20 products priced between \$29 and \$149.
- Intuit purchased Chip Soft, the largest tax software company on the market. It is expected that they will begin to bundle Turbo Tax with Quicken as a complete solution for small business accounting.
- Comptons' Encyclopedia continues to be bundled on over 40% of the multi-media PC's offered (excluding Apple). They are using aggressive pricing strategies. Microsoft is increasing its market share by bundling Encarta with PC's from several hardware vendors, including AST, Dell, Acer and Gateway. Dell, AST and Acer were shipping Comptons prior to this quarter.

Opportunity

- There has been a tremendous growth in the acceptance of personal computers in the home, as evidenced by the more than 25 million PC's now installed in homes across America, with another 25-30% intending to purchase a computer. With the introduction of Microsoft Home, the Consumer Division is launching a full product line for the entire family, including personal productivity tools for managing tasks at home, multimedia library products which provide reference works with both text and multimedia elements, and home entertainment products.

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In addition, Microsoft will be partnering with several hardware manufacturers to produce complete family computer solutions, shipping hardware with Microsoft Works, Microsoft Encarta and Microsoft Dinosaurs.

Results of Operations (in millions)

| | Q94-1 | | |
|-----------------------------|--------|--------|----------|
| | Actual | Plan | Variance |
| Net Revenue | \$54.3 | \$43.7 | \$10.6 |
| Cost of Revenues | 10.7 | 8.9 | (1.8) |
| Gross Profit | 43.6 | 34.8 | 8.8 |
| People | 9.9 | 10.1 | 0.2 |
| Facilities | 1.6 | 2.0 | 0.4 |
| Marketing | 3.8 | 9.1 | 5.3 |
| Product Dev | 4.2 | 7.6 | 3.4 |
| PSS | 2.5 | 2.7 | 0.2 |
| Other | 0.9 | 0.5 | (0.4) |
| Shared Resources | 0.9 | 1.2 | 0.3 |
| Total Controllable Expenses | 23.8 | 33.2 | 9.4 |
| Responsibility Margin | \$19.8 | \$1.6 | \$18.2 |
| Net Revenue | 100% | 100% | - |
| Cost of Revenues | 20 | 20 | 1 |
| Controllable Expenses | 44 | 76 | 32 |
| Responsibility Margin | 36% | 4% | 32% |

- The Consumer Division had a strong quarter in sales, with North American FG and WW OEM sales accounting for most of the positive revenue variance. The shift to OEM resulted in the number of licenses sold being 60% over plan, while revenue per license was 27% below plan, resulting in total OEM revenues of 44% over plan. Product development and marketing expenses were below plan, primarily due to timing issues.
- Cost of goods sold (COGS) as a percentage of revenue was lower than planned (19.7% versus a plan of 20.4%). This was partially due to Microsoft obtaining a reduced price on the diskettes used in the packages, and partially due to the increase in OEM sales.

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CONSUMER**Revenue by Channel Results (in millions)**

| | Q94-1 | | |
|-------------------------|--------------|--------------|--------------|
| | Actual | Plan | Variance |
| Flight Simulator | | | |
| North America FG | \$5.2 | \$2.7 | \$2.5 |
| Europe FG | 1.1 | 0.4 | 0.7 |
| ICON FG | 0.1 | 0.2 | (0.1) |
| Far East FG | 0.2 | 0.1 | 0.1 |
| WW OEM | 0.0 | 0.0 | 0.0 |
| | <u>\$6.6</u> | <u>\$3.4</u> | <u>\$3.2</u> |

| | Q94-1 | | |
|------------------|---------------|--------------|--------------|
| | Actual | Plan | Variance |
| Publisher | | | |
| North America FG | \$8.0 | \$3.3 | \$4.7 |
| Europe FG | 1.3 | 1.1 | 0.2 |
| ICON FG | 0.8 | 0.5 | 0.3 |
| Far East FG | 0.0 | 0.0 | 0.0 |
| WW OEM | 0.2 | 0.9 | (0.7) |
| | <u>\$10.3</u> | <u>\$5.8</u> | <u>\$4.5</u> |

| | Q94-1 | | |
|--------------------------|---------------|---------------|--------------|
| | Actual | Plan | Variance |
| Works for Windows | | | |
| North America FG | \$3.8 | \$4.3 | (0.5) |
| Europe FG | 5.6 | 5.9 | (0.3) |
| ICON FG | 1.4 | 1.4 | 0.0 |
| Far East FG | 0.0 | 0.0 | 0.0 |
| WW OEM | 7.1 | 4.4 | 2.7 |
| | <u>\$17.9</u> | <u>\$16.0</u> | <u>\$1.9</u> |

(Refer to Channel Section for discussion of revenue variances.)

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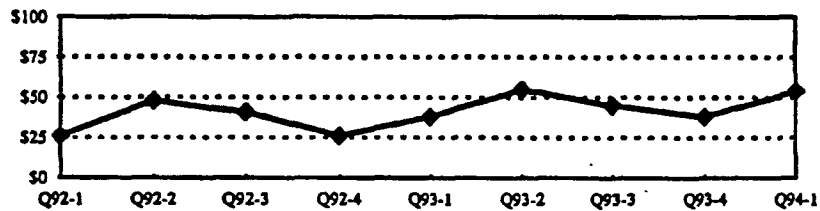
CONSUMER

TREND ANALYSES

Revenue by Channel (in millions)

| | <u>Q93-1</u> | <u>Q93-2</u> | <u>Q93-3</u> | <u>Q93-4</u> | <u>Q94-1</u> |
|----------------------------|---------------|---------------|---------------|---------------|---------------|
| PC Flight Simulator | | | | | |
| North America FG | \$0.9 | \$1.8 | \$1.0 | \$0.4 | \$5.2 |
| Europe FG | 0.3 | 0.7 | 0.7 | 0.3 | 1.1 |
| ICON FG | 0.1 | 0.1 | 0.0 | 0.0 | 0.1 |
| Far East FG | 0.0 | 1.0 | 0.5 | 0.3 | 0.2 |
| WW OEM | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| | <u>\$1.3</u> | <u>\$3.6</u> | <u>\$2.2</u> | <u>\$1.0</u> | <u>\$6.6</u> |
| Publisher | | | | | |
| North America FG | \$1.2 | \$3.3 | \$1.8 | \$1.4 | \$8.0 |
| Europe FG | 0.7 | 1.1 | 1.1 | 0.8 | 1.3 |
| ICON FG | 0.2 | 0.3 | 0.2 | 0.1 | 0.8 |
| Far East FG | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| WW OEM | 0.3 | 0.5 | 0.4 | 0.8 | 0.2 |
| | <u>\$2.4</u> | <u>\$5.2</u> | <u>\$3.5</u> | <u>\$3.1</u> | <u>\$10.3</u> |
| Works for Windows | | | | | |
| North America FG | \$3.7 | \$3.9 | \$3.9 | \$3.9 | \$3.8 |
| Europe FG | 7.2 | 10.3 | 8.9 | 5.7 | 5.6 |
| ICON FG | 1.4 | 1.3 | 1.1 | 1.4 | 1.4 |
| Far East FG | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| WW OEM | 1.3 | 3.4 | 5.4 | 5.3 | 7.1 |
| | <u>\$13.6</u> | <u>\$18.9</u> | <u>\$19.3</u> | <u>\$16.3</u> | <u>\$17.9</u> |

Net Revenue (in millions)



FY92 is stated as reported in FY92 and has not been restated for product reclassifications which are deemed to be immaterial for the purposes of this graph.

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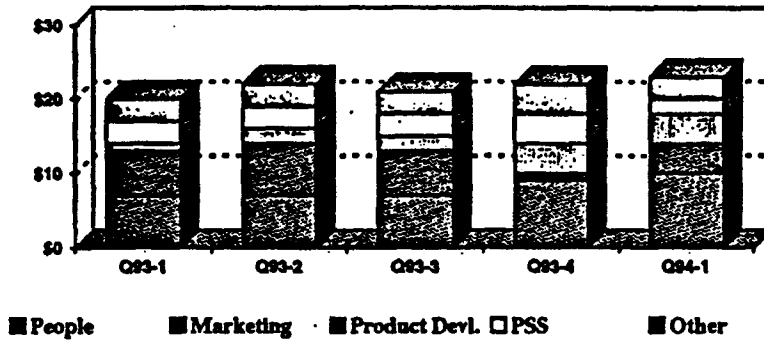
- The Consumer Division had a strong first quarter, finishing 24% ahead of plan and 42% ahead of last quarter.
- International sales accounted for a lower than expected 34% of total revenues, primarily due to large domestic OEM revenues. The greatest disparity between actual and planned revenues between North America and international came from the Entry Business Unit, primarily due to strong Publisher sales in North America.

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CONSUMER

Controllable Expenses (in millions)



- With the exception of a decrease in Marketing, expenses have remained relatively even with FY93 levels. There has been a planned increase in headcount and product development expenses due to increased production levels, resulting in more titles being shipped at an accelerated pace. As the Consumer Division aggressively develops and ships new products and expands into new markets, Marketing expenses will continue to increase.

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WORKGROUP

Key Product Releases

- Workgroup's major FY94 release is the Enterprise Messaging and Information Server (EMS), which is expected to RTM 5/30/94. The street date, however, is forecasted as 7/94, so no FY94 revenue impact was budgeted. EMS is expected to be Microsoft's main competitor to Lotus Notes at that time. Current expectations are for EMS to be significantly better than Notes as a messaging platform and to provide bulletin board services and replication at least equal to Notes. The server will be built on Microsoft Windows NT and the client will be built into Chicago.
- Workgroup will also have a new release of the Shared File System (SFS) for smaller users (MS Mail 4.0), with an RTM date late in Q95-1. Schedule+ 2.0, which includes a Mac client, is expected to RTM 5/30/94, but like EMS will have a Q95-1 street date.

Highlights-

- Microsoft shipped the Microsoft Mail Gateway and the Microsoft Mail Driver to IBM PROFS and OfficeVision version 3.4 on August 23. These two products are significant reasons why users choose MS Mail when down-sizing to a LAN from a mainframe. Schedule+ meeting requests are automatically converted to PROFS and OfficeVision meeting requests and vice versa. The Gateways' suggested retail price is \$4,995.
- Microsoft and Intel introduced the first Windows-based wireless solution for LAN-based e-mail on July 29. The Intel Wireless Modem provides Microsoft Mail Remote for Windows users with the ability to send and receive e-mail messages without connecting to a telephone line. Mail Remote for Windows users can plug the Intel Wireless Modem into their mobile PC to exchange messages with their office Microsoft Mail LAN server over the RAM Mobile Data wireless networks, which cover 6,000 U.S. cities, and reach 90% of the urban population. Microsoft Mail LAN servers can be connected to the RAM networks with Intel Wireless Modems or with X.25 landline connections. The Intel Wireless Modems are priced at \$747 each and can be obtained through Intel retail channels (6,200 outlets). RAM is offering flat-rate, unlimited messaging for \$75 per month, per Intel Wireless Modem, through the end of 1993.
- In August, Microsoft shipped a special edition of Microsoft Mail for PC networks version 3.2. This product incorporates Outside In from Systems Compatibility Corporation; WinRules from Beyond Incorporated; and Absentee Manager from Management Software Limited. It provides users with the freedom to customize their workstations to meet their individual needs, as well as features like rules-based filtering, absentee notification and viewers that enable users to manage their electronic mail more efficiently. This special six-month promotion will retail at a suggested price of \$995 for 10 workstation licenses.
- On August 31, Microsoft announced the Microsoft Workgroup Templates, a set of 13 modifiable templates for developing Workgroup solutions based on MICROSOFT development tools and applications. The Workgroup Templates product are available from resellers and directly from Microsoft at a U.S. suggested retail price of \$39. In addition, they will be made available through the CompuServe service.
- Lotus has been maintaining share of new sales and installed base, while Microsoft's growth has topped that of the entire industry, gaining share worldwide. Microsoft gained on cc:Mail in the United States to reach roughly 25% of new mailboxes in CY92. US installed base share has risen 2% to 19%, while cc:Mail has maintained their share of around 25%. Overseas, data is less available and less accurate. At worst Microsoft and Lotus are even in the international market. IDC reports that Microsoft Mail surpassed cc:Mail's share of both new mailboxes and installed base in 1992. New mailbox share is around 30% for Microsoft in CY92, vs. 20% for Lotus. International installed base share went up a huge 12% to reach 29% share, surpassing Lotus who lost 5% share in international to reach 24%. Office sales have a larger impact on international sales as the e-mail market is much smaller in this region, and push

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Microsoft ahead of Lotus. Increasingly, Microsoft and Lotus are dominating the LAN e-mail market at 46% of the installed base combined, with WordPerfect a distant third (IDC). Microsoft has been dominating e-mail sales according to IDC, receiving a higher proportion of new mailboxes from international, around 32% of new mailboxes, vs. cc:Mail's 22%, and 23% for all market players.

Competition

- On 9/22/93 Lotus announced cc:Mail Post Office Edition, which makes it easier to build an integrated Notes and cc:Mail environment. Lotus also announced cc:Mail Client/Server Edition, which makes it easier to add cc:Mail users in a Notes environment. The cc:Mail Client/Server user interface will be integrated into a future release of Notes as the standard mail user interface. Lotus also announced special editions of cc:Mail designed for use with other vendors' messaging transports, including MCI Mail, CompuServe and other public messaging services. Lotus will also support Microsoft's MAPI. Most of these announced products are not expected to ship for at least 18 months and Microsoft expects to deliver all the functionality Lotus is promising significantly before they are able to.
- Lotus and Attachmate Corp. announced on 9/22/93 that the companies have signed a joint agreement designed to deliver a real-time, bi-directional scheduling connection between Lotus' LAN-based Organizer and IBM's mainframe-based PROFS and Office Vision/VM calendaring system. The product will be called Lotus Organizer Scheduling Connection to OV/VM and PROFS. Lotus is currently shipping LOTUS Organizer 1.1, which enables group scheduling with cc:Mail.
- DaVinci Systems announced on 10/6/93 that, in conjunction with RAM Mobile Data USA Limited Partnership and Business Networks Ltd. (BNL), they will promote a wireless electronic mail solution. The wireless solution is based on the inter-operability of the three companies' respective products and services.

Pricing Study

- Workgroup is currently re-analyzing the way in which all its major products are priced on a worldwide basis. Currently, a typical sale most likely represents a mail server with numerous "bundled" mail clients. The goal of this pricing study is to increase the \$/client that Microsoft receives on each sale, while remaining price competitive vis-à-vis Microsoft's competition.

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WORKGROUP**Results of Operations (in millions)**

| | Q94-1 | | |
|-----------------------------|--------|---------|----------|
| | Actual | Plan | Variance |
| Net Revenue | \$20.0 | \$17.0 | \$3.0 |
| Cost of Revenues | 2.6 | 2.8 | 0.2 |
| Gross Profit | 17.4 | 14.2 | 3.2 |
| People | 6.9 | 8.2 | 1.3 |
| Facilities | 1.5 | 1.5 | 0.0 |
| Marketing | 1.8 | 3.2 | 1.4 |
| Product Dev | 1.9 | 2.4 | 0.5 |
| PSS | 1.9 | 1.9 | 0.0 |
| Other | 0.3 | 0.3 | 0.0 |
| Shared Resources | (0.3) | (0.3) | 0.0 |
| Total Controllable Expenses | 14.0 | 17.2 | 3.2 |
| Responsibility Margin | \$3.4 | (\$3.0) | \$6.4 |
| Net Revenue | 100% | 100% | -- |
| Cost of Revenues | 13 | 17 | 4 |
| Controllable Expenses | 70 | 101 | 31 |
| Responsibility Margin | 17% | (18%) | 35% |

- Higher revenues, which resulted from stronger than planned sales of virtually all major products, together with lower than budgeted controllable expenses, resulted in a \$6.4 million positive variance in responsibility margin.

Revenue by Channel Results (in millions)

| Workgroup | Q94-1 | | |
|------------------|---------|---------|----------|
| | Actual | Plan | Variance |
| North America FG | \$ 11.8 | \$ 9.3 | \$ 2.5 |
| Europe FG | 6.4 | 5.6 | 0.8 |
| ICON FG | 1.7 | 1.8 | -0.1 |
| Far East FG | 0.7 | 0.4 | 0.3 |
| WW OEM | 0.1 | 0.5 | -0.4 |
| Total Workgroup | \$ 20.7 | \$ 17.6 | \$ 3.1 |

(Refer to Channel Section for discussion of revenue variances.)

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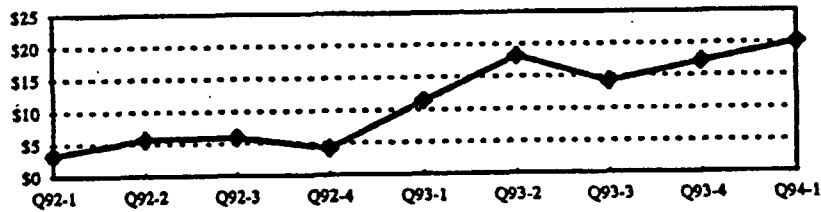
WORKGROUP

TREND ANALYSES

Revenue by Channel (in millions)

| Workgroup | Q92-1 | Q93-2 | Q93-3 | Q93-4 | Q94-1 |
|------------------|----------------|----------------|----------------|----------------|----------------|
| North America FG | \$ 8.0 | \$ 11.5 | \$ 6.8 | \$ 10.3 | \$ 11.8 |
| Europe FG | 2.6 | 5.9 | 6.2 | 5.6 | 6.4 |
| ICON FG | 0.8 | 1.8 | 1.3 | 1.6 | 1.7 |
| Far East FG | 0.0 | 0.1 | 0.1 | 0.1 | 0.7 |
| WW OEM | 0.3 | 0.0 | 0.1 | 0.3 | 0.1 |
| | <u>\$ 11.7</u> | <u>\$ 19.3</u> | <u>\$ 14.5</u> | <u>\$ 17.9</u> | <u>\$ 20.7</u> |

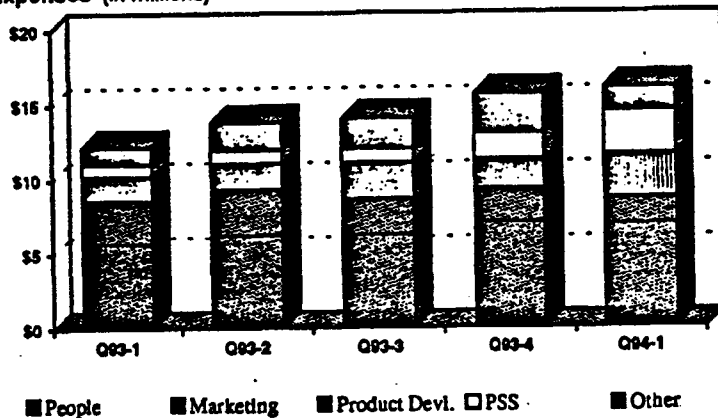
Net Revenue (in millions)



FY92 is stated as reported in FY92 and has not been restated for product reclassifications which are deemed to be immaterial for the purposes of this graph.

- Workgroup's revenues/quarter have increased almost 700% over the past 2 years, from approximately \$3 million in Q92-1 to \$20 million in Q94-1. This is jointly the result of the CSI purchase and the steady growth in market share thereafter.

Controllable Expenses (in millions)



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- Total controllable expenses in Q94-1 were basically flat versus Q93-4.
- Additional product releases in FY93 resulted in growth of PSS expenses. However, PSS usage levels have decreased significantly since Workgroup went to 100% paid support, a trend that is expected to continue.
- Low Q94-1 Marketing expenses are the result of a lack of imminent major releases. This expense item will increase in the latter half of the year as the SFS (Q95-1) and EMS (7/94) ship dates approach.

SYSTEMS SUMMARY

SYSTEMS SUMMARY

Key Product Releases

| Business Unit/Product | RTM Date | | Revenue in millions | | | |
|-----------------------------|-----------|-----------|---------------------|-------|----------|--------|
| | | | FYTD94 | | | FY94 |
| | Act/Est | Plan | Actual | Plan | Variance | Budget |
| Advanced Systems | | | | | | |
| Windows NT | 27-Jul-93 | 30-Jan-93 | \$20 | \$39 | (\$19) | \$174 |
| Advanced Server | 27-Jul-93 | 14-Jul-93 | \$5 | \$8 | (\$3) | \$56 |
| SQL Server for NT | 25-Aug-93 | 21-Jul-94 | \$1 | \$6 | (\$5) | \$24 |
| MS-DOS | | | | | | |
| MS-DOS V6.2 * | 19-Oct-93 | Unplanned | \$109 | \$121 | (\$12) | \$501 |
| Windows | | | | | | |
| Windows for Workgroups 3.11 | 3-Nov-93 | 4-Aug-93 | \$8 | \$11 | (\$3) | \$56 |
| Hardware | | | | | | |
| Charger OEM Mouse | 1-Nov-93 | 1-Jan-94 | \$0 | \$0 | \$0 | \$19 |

* MS-DOS V6.2 was not budgeted. Revenues and budget are associated with MS-DOS V6.0.

- Revenue performance and product release/features information can be found in the individual business sections.

Results of Operations (in millions)

Q94-1

| | Net Revenue | | Cost of Revenue | | Controllable Expense | | Responsibility Margin | |
|------------------|--------------|-------------|-----------------|-------------|----------------------|------------|-----------------------|-------------|
| | Actual | % of Plan | Actual | % of Plan | Actual | % of Plan | Actual | % of Plan |
| MS-DOS | \$109 | 90% | \$5 | 100% | \$18 | 120% | \$86 | 85% |
| Windows | 139 | 143 | 12 | 133 | 31 | 84 | 96 | 188 |
| Advanced Systems | 54 | 75 | 9 | 100 | 37 | 76 | 8 | 57 |
| Hardware | 51 | 111 | 28 | 117 | 8 | 67 | 15 | 150 |
| Other Systems | 39 | 650 | 1 | 50 | 6 | 86 | 31 | (1,033) |
| Systems | \$392 | 115% | \$55 | 112% | \$100 | 83% | \$236 | 136% |

| | Net Revenue Mix | | Cost of Revenue | | Controllable Expense | | Responsibility Margin | |
|------------------|-----------------|-----------|-----------------|-----------|----------------------|-----------|-----------------------|-----------|
| | Actual | % pts Var | % Net Rev | % pts Var | % Net Rev | % pts Var | % Net Rev | % pts Var |
| MS-DOS | 28% | (8) | 5% | 0 | 17% | (4) | 79% | (5) |
| Windows | 35 | 7 | 9 | 1 | 22 | 16 | 69 | 16 |
| Advanced Systems | 14 | (7) | 17 | (4) | 69 | 0 | 15 | (5) |
| Hardware | 13 | 0 | 55 | (3) | 16 | 10 | 29 | 8 |
| Other Systems | 10 | 8 | 3 | 31 | 15 | 101 | 79 | 129 |
| Systems | 100% | 0 | 14% | 0 | 26% | 10 | 60% | 10 |

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SYSTEMS SUMMARY

Results of Operations (in millions)

| | Q94-1 | | |
|-----------------------------|----------------|----------------|---------------|
| | Actual | Plan | Variance |
| Net Revenue | \$391.6 | \$341.6 | \$50.0 |
| Cost of Revenues | 55.0 | 48.6 | (6.4) |
| Gross Profit | 336.6 | 293.0 | \$43.6 |
| People | 33.1 | 36.9 | 3.8 |
| Facilities | 6.3 | 8.6 | 2.3 |
| Marketing | 15.3 | 22.4 | 7.1 |
| Product Dev | 7.5 | 16.8 | 9.3 |
| PSS | 18.1 | 20.3 | 2.2 |
| Other | 14.4 | 9.1 | (5.3) |
| Shared Resources | 5.4 | 6.5 | 1.1 |
| Total Controllable Expenses | 100.1 | 120.6 | 20.5 |
| Responsibility Margin | <u>\$236.5</u> | <u>\$172.4</u> | <u>\$64.1</u> |
| Net Revenue | 100% | 100% | -- |
| Cost of Revenues | 14 | 14 | 0 |
| Controllable Expenses | 26 | 35 | 10 |
| Responsibility Margin | <u>60%</u> | <u>50%</u> | <u>10%</u> |

- Revenues exceeded plan by 15%, the result of strong Windows performance in the OEM (favorable \$26 million variance) and North America FG (\$15 million) channels, and a favorable \$34 million Unspecified Product Billing variance attributed to Systems products. The revenue surpluses offset negative revenue variances in Windows NT (\$19 million) and MS-DOS upgrades (\$12 million).
- The cost of revenues variance was mostly driven by \$2 million in Mouse inventory revaluation charges, \$1 million in MS-DOS inventory adjustments, and a \$1 million manufacturing variance due to under-absorption of manufacturing overhead costs through the burden rate.
- Marketing spending posted a favorable 32% variance, the result of underspending in both US Marketing (\$4 million) and International Marketing (\$3 million). The decreased marketing spending was consistent across all Systems businesses.
- Product Development spending reported a favorable \$9 million variance due to underspending in Advanced Systems, Windows, and Hardware.
- People expenses were 10% below plan due to positive headcount variances in all Systems businesses.

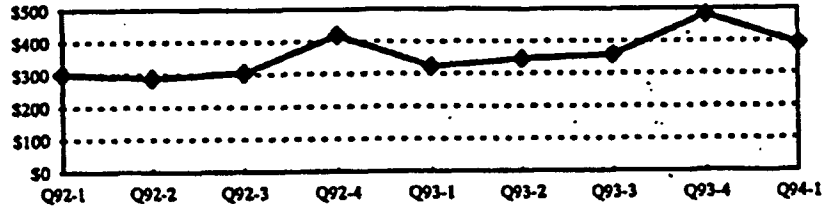
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SYSTEMS SUMMARY

TREND ANALYSES

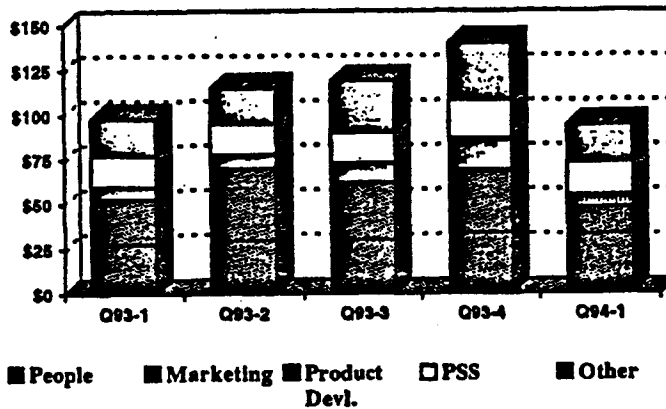
Net Revenue (in millions)



FY92 is stated as reported in FY92 and has not been restated for product reclassifications which are deemed to be immaterial for the purposes of this graph.

- Systems Q94-1 revenue grew \$69 million over Q93-1, a 21% increase over the same quarter last fiscal year.

Controllable Expenses



- People expenses have grown \$5 million over Q93-1, a 15% growth year to year.

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MS-DOS

MS-DOS

Highlights

- MS-DOS V6.2 RTM'd on October 19, 1993. New features include Scandisk, a utility which detects, diagnoses, and repairs disk errors, and DoubleGuard, which verifies data integrity before writing to your disk to ensure protection against data corruption. Current MS-DOS V6.0 users will be able to upgrade to V6.2 by either downloading from CompuServe or buying a one-disk V6.2 Step-Up Product at \$9.95 SRP in the US. US SRP for the MS-DOS V6.2 standard upgrade is set at \$79.95.
- In concert with the V6.2 release, MS-DOS will be packaged with IDG's popular computer book, DOS for Dummies. DOS for Dummies is the top-selling computer book in print, with more than two million copies sold. As part of the IDG agreement, both companies have the right to package the book with MS-DOS V6.2 and sell to their respective channels. MS-DOS is expected to be sold through an additional 12,000 to 15,000 US outlets as a result of this agreement.
- Based on internal Microsoft estimates, MS-DOS (including PC-DOS) is expected to ship on 78% of Intel processors in FY94 with Novell DOS shipments estimated at 2-3%. The remaining processors are expected to run pirated MS-DOS.

Competition

- IBM announced PC DOS 6.1, based on the MS-DOS kernel, on June 29 and shipped the product in late July without the planned data compression software. IBM plans to begin shipping the data compression software over the next few weeks. While PC Week rated MS-DOS V6.0 a 3.7 on a 5.0 scale, PC DOS received a 2.5 rating.
- Novell DOS 7.0, formerly referred to as DR-DOS, was announced in April and is scheduled to hit the market in December. Novell DOS' significant new features are pre-emptive multitasking capabilities for multiple DOS applications and disk compression based upon Stac Electronics' Stacker software. Personal NetWare, a separate product which will also be announced, allows users to manage network connections and administrators to control and gather networked workstation information. The two products will allow users to share system resources across their workgroup. Compatibility problems have been identified with Novell DOS V7; Windows for Workgroups will not run with Novell DOS V7.

MS-DOS V6.0 Inventory Issue

- Microsoft has ceased US order taking on MS-DOS V6.0 upgrade in an attempt to reduce current inventory levels in the channel. Resellers will have the ability to swap remaining MS-DOS V6.0 upgrade inventory for MS-DOS V6.2 product as of November 30. US returns of up to 400,000 units will be donated to charity.

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MS-DOS

Results of Operations (in millions)

| | Q94-1 | | |
|-----------------------------|---------|---------|----------|
| | Actual | Plan | Variance |
| Net Revenue | \$109.0 | \$121.4 | (\$12.4) |
| Cost of Revenues | 4.6 | 4.5 | (0.1) |
| Gross Profit | 104.4 | 116.9 | (12.5) |
| People | 1.0 | 0.9 | (0.1) |
| Facilities | 0.1 | 0.2 | 0.1 |
| Marketing | 2.4 | 2.5 | 0.1 |
| Product Dev | 1.0 | 1.4 | 0.4 |
| PSS | 3.3 | 2.6 | (0.7) |
| Other | 6.9 | 3.9 | (3.0) |
| Shared Resources | 3.6 | 4.1 | 0.5 |
| Total Controllable Expenses | 18.3 | 15.6 | (2.7) |
| Responsibility Margin | \$86.1 | \$101.3 | (\$15.2) |
| | | | |
| Net Revenue | 100% | 100% | - |
| Cost of Revenues | 4 | 4 | (1) |
| Controllable Expenses | 17 | 13 | (4) |
| Responsibility Margin | 79% | 83% | (4%) |

- The 10% negative revenue variance resulted from lower than planned North America FG (\$8 million) and Europe FG (\$6 million) revenues. This can be attributed to the pending MS-DOS V6.2 launch. MS-DOS OEM revenues continue to be strong, posting a \$11 million increase (14%) over Q93-4, and a \$34 million increase (60%) over Q93-1.
- An unplanned \$0.9 million inventory adjustment charge resulted in flat cost of revenues as a percent of net revenues.
- Controllable expenses were on-plan in Q94-1. Bad Debt Expense, included in the Other expense category, drove the \$3.0 million variance.

Revenue by Channel Results (in millions)

| | Q94-1 | | |
|------------------------|--------|-------|----------|
| | Actual | Plan | Variance |
| MS-DOS New Users | | | |
| North America FG | \$ 0 | \$ 0 | \$ 0 |
| Europe FG | 0 | 0 | 0 |
| ICON FG | 0 | 0 | 0 |
| Far East FG | 0 | 0 | 0 |
| WW OEM | 91 | 92 | (1) |
| Total MS-DOS New Users | \$ 91 | \$ 92 | \$ (1) |
| MS-DOS Upgrades | | | |
| North America FG | \$ 2 | \$ 10 | \$ (8) |
| Europe FG | 9 | 15 | (6) |
| ICON FG | 5 | 4 | 1 |
| Far East FG | 2 | 1 | 1 |
| WW OEM | 0 | 0 | 0 |
| Total MS-DOS Upgrades | \$ 18 | \$ 30 | \$ (12) |

(Refer to Channel Section for discussion of revenue variances.)

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MS-DOS

Revenue by Channel Trend (In millions)

| | <u>Q93-1</u> | <u>Q93-2</u> | <u>Q93-3</u> | <u>Q93-4</u> | <u>Q94-1</u> |
|-------------------------------|--------------|--------------|--------------|---------------|--------------|
| MS-DOS New Users | | | | | |
| North America FG | \$ 0 | \$ 0 | \$ 0 | \$ 0 | \$ 0 |
| Europe FG | 9 | 7 | 3 | 0 | 0 |
| ICON FG | 4 | 4 | 3 | 1 | 0 |
| Far East FG | 1 | 1 | 0 | 0 | 0 |
| WW OEM | <u>57</u> | <u>75</u> | <u>79</u> | <u>80</u> | <u>91</u> |
| Total MS-DOS New Users | <u>\$ 71</u> | <u>\$ 87</u> | <u>\$ 85</u> | <u>\$ 81</u> | <u>\$ 91</u> |
| MS-DOS Upgrades | | | | | |
| North America FG | \$ 10 | \$ 11 | \$ 52 | \$ 91 | \$ 2 |
| Europe FG | 6 | 6 | 11 | 56 | 9 |
| ICON FG | 2 | 2 | 3 | 13 | 5 |
| Far East FG | 0 | 0 | 1 | 4 | 2 |
| WW OEM | <u>0</u> | <u>0</u> | <u>0</u> | <u>0</u> | <u>0</u> |
| Total MS-DOS Upgrades | <u>\$ 18</u> | <u>\$ 19</u> | <u>\$ 67</u> | <u>\$ 164</u> | <u>\$ 18</u> |

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ADVANCED SYSTEMS

ADVANCED SYSTEMS

Highlights

- Windows NT and Windows NT Advanced Server RTM'd on July 27, amassing over 85,000 Windows NT and 8,000 Advanced Server licenses in nine weeks. Revenue ramp-up will continue to increase as 32-bit applications become available. To date, 150 32-bit applications are being offered by tool, database, and vertical applications vendors with an average of three new applications being introduced each day. Windows NT is currently available for Intel, Mips, and Alpha-based systems.
- Windows NT announced a change in business practices in September. Previously, client network connection software needed to be purchased to connect MS-DOS or Windows 3.x clients to a Windows NT Advanced Server. This confused customers due to the fact client licenses tend to be included when purchasing servers in most of our competitors' business models. To resolve customer confusion and deliver a price/performance leadership solution to market, a decision was made to provide network clients at no charge to customers purchasing Microsoft Network Servers. The Microsoft Network Client Pack is available on CompuServe, the FTP Server, and MSDN, or an unlimited distribution license can be purchased for \$49.95 to cover product COGS.
- SQL Server for Windows NT, a relational database management system, RTM'd on August 25. Since introduction, more than 20 companies have announced support for the Windows NT version of the database. Additionally, SQL Server for Windows NT will run hundreds of existing applications without any code changes. Additionally, Oracle released Oracle Server V7 to manufacturing this week. This popular client server database product will run on Windows NT and will be available to customers the first week of November. These announcements are a significant step towards delivering client/server solutions on the Windows NT platform.
- The Windows NT, Cairo, and Other Operating Systems groups have been merged into the Advanced Systems organization managed by Jim Allchin. Operations are currently being evaluated to identify redundancies associated with the merger.
- Hermes is a server-based suite of Windows NT tools which performs inventory of hardware and software, installs software on remote systems across a network, and stores client configuration information in an SQL database. Hermes received industry support from 19 vendors pledging to develop or modify existing products which inter-operate with Hermes. Hermes is scheduled to RTM in the second half of FY94.

Competition

- Industry-standard benchmarks have placed Windows NT solutions as price/performance leaders in both the file server and applications server arena.

File Server Benchmark

| | <u>System Cost</u> | <u>Quest- Marks*</u> |
|--------------------------------|------------------------|--------------------------|
| Windows NT Advanced Server 3.1 | \$15,900 | 227 |
| NetWare 4.01 | \$20,273 | 196 |

* QuestMark is a benchmark based upon a repetitive set of Excel instructions.
Source: LANQuest Labs, September 1993

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Application Server Benchmark

Source: LANQuest Labs, September 1993

| <u>Operating System/Database</u> | <u>Hardware</u> | <u>TPS*</u> | <u>5-year System Cost</u> | <u>\$/TPS</u> |
|----------------------------------|--------------------|-------------|---------------------------|---------------|
| Windows NT/SQL Server for NT | Dual Pentium-66 | 226 | \$99,780 | \$441 |
| Sun OS/Sybase SQL | SPARCServer 690 mp | 135 | \$372,832 | \$2,764 |
| IBM AIX/INFORMIX-OnLine | RS/6000-970 | 110 | \$307,639 | \$2,789 |

* Transaction Processing Council TPC-B transaction per second ratings
Source: Published TPC-B Benchmark Summary, September 1993

- Novell announced increasing integration between UNIX and NetWare through its UnixWare Software, which currently provides file system and communication services somewhat consistent with the NetWare 3.x environment. Future integration will enable common network management and systems directories, along with other features which enable NetWare and Unix offerings to be better integrated. Novell plans to offer the UnixWare source code to Unix vendors for integration into their UNIX source code. Sun Microsystems and Santa Cruz Operation (SCO) claim this is a defensive tactic by Novell to maintain NetWare market share and avoid the threat the more powerful UNIX operating systems pose to NetWare.
- Novell has agreed to transfer the UNIX trademark to X/Open, an international open systems consortium, to reinforce the industry's commitment behind a unified UNIX and a common set of APIs agreed to by 75 computer vendors aimed at increasing applications portability across disparate UNIX variants. Open Systems Today, a CMP Publication, speculates the common API set is an effort to thwart the future of Windows NT.

Windows NT Revenue Performance

- Windows NT achieved 51% of its Q94-1 revenue plan while Advanced Server garnered 63% of its plan. Revenue performance can be attributed to an aggressive revenue plan, lack of 32-bit application availability, Novell's refusal to offer Windows NT client support, and customer confusion about the Microsoft Network Client software. Advanced Systems is currently updating the Windows NT forecast. Additionally, Windows NT Marketing has reorganized to focus on Windows NT customer usage models. The new marketing focus will allow for improved market segmentation and positioning against a set of competitors specific to the individual market segment. The first result of this change in focus are advertisements which position Windows NT as both a file server, competing with Novell, and an applications server, competing with Unix.

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ADVANCED SYSTEMS

Results of Operations (in millions)

| | Q94-1 | | |
|-----------------------------|--------|--------|----------|
| | Actual | Plan | Variance |
| Net Revenue | \$54.1 | \$72.2 | (\$18.1) |
| Cost of Revenues | 9.0 | 9.2 | 0.2 |
| Gross Profit | 45.1 | 63.0 | (17.9) |
| People | 14.8 | 16.4 | 1.6 |
| Facilities | 2.8 | 4.1 | 1.3 |
| Marketing | 4.7 | 7.5 | 2.8 |
| Product Dev | 3.1 | 5.8 | 2.7 |
| PSS | 5.3 | 7.4 | 2.1 |
| Other | 1.1 | 1.2 | 0.1 |
| Shared Resources | 5.5 | 6.4 | 0.9 |
| Total Controllable Expenses | 37.3 | 48.8 | 11.5 |
| Responsibility Margin | \$7.8 | \$14.2 | (\$6.4) |
| | | | |
| Net Revenue | 100% | 100% | -- |
| Cost of Revenues | 17 | 13 | (4) |
| Controllable Expenses | 69 | 68 | (1) |
| Responsibility Margin | 14% | 20% | (5%) |

- The revenue shortfall was the result of negative revenue variances in Windows NT (\$19 million), Advanced Server (\$3 million), and SQL Server for Windows NT (\$5 million) sales, and late Windows NT and SQL Server RTMs. The revenue shortfall was slightly offset by stronger than planned Lan Manager sales (\$4 million positive revenue variance).
- Cost of revenues as a percent of revenues exceeded plan due to an under-absorption of manufacturing overhead costs resulting in a \$0.6 million allocation to Advanced Systems. Additionally, Advanced Systems received \$0.2 million in inventory adjustment charges.
- Controllable expenses reported a positive 24% variance resulting from underspending in all controllable categories.

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ADVANCED SYSTEMS

Revenue by Channel Results (in millions)

| | Q94-1 | | |
|------------------------------|--------------|--------------|----------------|
| | Actual | Plan | Variance |
| Windows NT | | | |
| North America FG | \$ 14 | \$ 30 | \$ (16) |
| Europe FG | 3 | 6 | (3) |
| ICON FG | 2 | 3 | (1) |
| Far East FG | 1 | 0 | 1 |
| WW OEM | 0 | 0 | 0 |
| Total Windows NT | <u>\$ 20</u> | <u>\$ 39</u> | <u>\$ (19)</u> |
| Advanced Server | | | |
| North America FG | \$ 3 | \$ 7 | \$ (4) |
| Europe FG | 1 | 1 | 0 |
| ICON FG | 1 | 0 | 1 |
| Far East FG | 0 | 0 | 0 |
| WW OEM | 0 | 0 | 0 |
| Total Advanced Server | <u>\$ 5</u> | <u>\$ 8</u> | <u>\$ (3)</u> |
| Lan Manager | | | |
| North America FG | \$ 2 | \$ 5 | \$ (3) |
| Europe FG | 4 | 1 | 3 |
| ICON FG | 0 | 1 | (1) |
| Far East FG | 0 | 0 | 0 |
| WW OEM | 8 | 3 | 5 |
| Total Advanced Server | <u>\$ 14</u> | <u>\$ 10</u> | <u>\$ 4</u> |

(Refer to Channel Section for discussion of revenue variances.)

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ADVANCED SYSTEMS

Revenue by Channel Trend (in millions)

| | <u>Q93-1</u> | <u>Q93-2</u> | <u>Q93-3</u> | <u>Q93-4</u> | <u>Q94-1</u> |
|------------------------------|--------------|--------------|--------------|--------------|--------------|
| Windows NT | | | | | |
| North America FG | \$ -- | \$ -- | \$ -- | \$ -- | \$ 14 |
| Europe FG | -- | -- | -- | -- | 3 |
| ICON FG | -- | -- | -- | -- | 2 |
| Far East FG | -- | -- | -- | -- | 1 |
| WW OEM | -- | -- | -- | -- | 0 |
| Total Windows NT | <u>\$ --</u> | <u>\$ --</u> | <u>\$ --</u> | <u>\$ --</u> | <u>\$ 20</u> |
| Advanced Server | | | | | |
| North America FG | \$ -- | \$ -- | \$ -- | \$ -- | \$ 3 |
| Europe FG | -- | -- | -- | -- | 1 |
| ICON FG | -- | -- | -- | -- | 1 |
| Far East FG | -- | -- | -- | -- | 0 |
| WW OEM | -- | -- | -- | -- | 0 |
| Total Advanced Server | <u>\$ --</u> | <u>\$ --</u> | <u>\$ --</u> | <u>\$ --</u> | <u>\$ 5</u> |
| Lan Manager | | | | | |
| North America FG | \$ 5 | \$ 4 | \$ 3 | \$ 4 | \$ 2 |
| Europe FG | 5 | 6 | 5 | 4 | 4 |
| ICON FG | 1 | 0 | 1 | 0 | 0 |
| Far East FG | 1 | 1 | 1 | 1 | 0 |
| WW OEM | 5 | 8 | 9 | 7 | 8 |
| Total Lan Manager | <u>\$ 17</u> | <u>\$ 19</u> | <u>\$ 19</u> | <u>\$ 16</u> | <u>\$ 14</u> |

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WINDOWS

WINDOWS

Highlights

- Windows for Workgroups 3.11 is planned to RTM on November 3. The new release improves performance with 32-bit file access and networking software, includes Remote Access Server software to facilitate access to Windows NT servers from home or the road, and improves connectivity for Microsoft and Novell NetWare networks.
- Windows 3.11 is planned to RTM in January 1994. The release will include new print drivers, slimmed-down anti-piracy packaging, and a resolution for NetWare connectivity code. Microsoft is negotiating with Novell over whether to ship full NetWare client code, NetWare Windows support drivers, or no Novell code.
- A second Chicago PDK release is scheduled for the end of October with plans to ship to more than 2,000 customers. Chicago is a 32-bit operating system with integrated networking which will run in 4MB of memory and support existing MS-DOS and Windows 3.1 applications. Chicago will update the Windows user interface, increase support for mobile users, and implement Plug and Play functionality, which is a new standard for auto-configuration of hardware adapters and other peripherals. Chicago plans to release in the first half of FY95.
- The number of life-to-date Windows 3.1 licensed users is estimated at more than 37 million this quarter.
- Based upon internal estimates, Windows 3.1 penetration is estimated at 65% of currently shipping Windows-compatible machines. Penetration continues to increase as OEMs ship Windows 3.1 pre-installed on their hardware. More than 4.3 million Windows OEM units were reported in Q94-1 compared to 1.7 million units in Q93-1, a 153% increase.

Competition

- Lotus continues to make progress with its Notes product, growing its installed base to 500,000, virtually all of which are Windows clients. Notes is a groupware software product for Windows, Macintosh, and Unix clients, with the server portion based on OS/2 V1.3.
- Sun's Windows Applications Binary Interface (WABI) V1.0 is set to release at the end of November. WABI will be co-packaged with Sun's Solaris operating system at no charge through December. Sun claims WABI will allow Solaris users to run certain shrink-wrapped Windows applications without any modifications or performance compromise. WABI packaging will include a compact disc, on-line documentation, and support information. Post-promotion pricing has not yet been announced.
- Santa Cruz Operation (SCO) announced its Windows Friendly strategy aimed at coupling the strengths of Windows desktops with UNIX servers. DXI Limited, a SCO subsidiary, will introduce Win-tif, which SCO will integrate into its Open Server and Open Desktop product offerings. Win-tif will allow customers the option of modifying the appearance of Motif applications, a popular Unix user interface, to the appearance of Windows applications. SCO's strategy, which includes Lan Manager for Unix systems networking, will improve inter-operability between Unix Servers and Windows systems.

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WINDOWS**Results of Operations (in millions)**

| | Q94-1 | | |
|-----------------------------|---------|--------|----------|
| | Actual | Plan | Variance |
| Net Revenue | \$139.3 | \$96.8 | \$42.5 |
| Cost of Revenues | 12.5 | 9.3 | (3.2) |
| Gross Profit | 126.8 | 87.5 | 39.3 |
| People | 7.2 | 8.5 | 1.3 |
| Facilities | 0.9 | 1.9 | 1.0 |
| Marketing | 5.2 | 8.1 | 2.9 |
| Product Dev | 1.2 | 3.2 | 2.0 |
| PSS | 8.5 | 9.5 | 1.0 |
| Other | 5.4 | 2.7 | (2.7) |
| Shared Resources | 2.6 | 2.9 | 0.3 |
| Total Controllable Expenses | 31.0 | 36.8 | 5.8 |
| Responsibility Margin | \$95.8 | \$50.7 | \$45.1 |
| | | | |
| Net Revenue | 100% | 100% | - |
| Cost of Revenues | 9 | 10 | 1 |
| Controllable Expenses | 22 | 38 | 16 |
| Responsibility Margin | 69% | 52% | 16% |

- Windows new license revenues posted positive variances in OEM (\$26 million) and North America FG (\$8 million). Q94-1 Windows new license revenues have grown \$38 million over Q93-1, a 50% increase. OEM revenues have fueled this growth, with Q94-1 revenues growing 245% over Q93-1.
- Controllable expenses reported a positive 16% variance, the result of underspending in all controllable categories.

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WINDOWS**Revenue by Channel Results (in millions)**

| | Q94-1 | | |
|--------------------------------|---------------|--------------|---------------|
| | Actual | Plan | Variance |
| Windows New Users | | | |
| North America FG | \$ 17 | \$ 9 | \$8 |
| Europe FG | 10 | 10 | 0 |
| ICON FG | 7 | 4 | 3 |
| Far East FG | 4 | 6 | (2) |
| WW OEM | 76 | 50 | 26 |
| Total Windows New Users | \$ 114 | \$ 79 | \$35 |
| Windows Upgrades | | | |
| North America FG | \$ 4 | \$ 2 | \$2 |
| Europe FG | 2 | 1 | 1 |
| ICON FG | 0 | 1 | (1) |
| Far East FG | 0 | 2 | (2) |
| WW OEM | 0 | 0 | 0 |
| Windows Upgrades | \$ 6 | \$ 6 | \$0 |
| Windows for Workgroups | | | |
| North America FG | \$ 4 | \$ 2 | \$2 |
| Europe FG | 3 | 7 | (4) |
| ICON FG | 1 | 1 | 0 |
| Far East FG | 0 | 0 | 0 |
| WW OEM | 0 | 1 | (1) |
| Windows for Workgroups | \$ 8 | \$ 11 | \$ (3) |

(Refer to Channel Section for discussion of revenue variances.)

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WINDOWS**Revenue by Channel Trend (in millions)**

| | <u>Q93-1</u> | <u>Q93-2</u> | <u>Q93-3</u> | <u>Q93-4</u> | <u>Q94-1</u> |
|-------------------------------------|--------------|---------------|---------------|---------------|---------------|
| Windows New Users | | | | | |
| North America FG | \$ 16 | \$ 21 | \$ 22 | \$ 33 | \$ 17 |
| Europe FG | 28 | 31 | 20 | 14 | 10 |
| ICON FG | 9 | 6 | 7 | 8 | 7 |
| Far East FG | 1 | 1 | 1 | 15 | 4 |
| WW OEM | 22 | 54 | 65 | 71 | 76 |
| Total Windows New Users | <u>\$ 76</u> | <u>\$ 113</u> | <u>\$ 115</u> | <u>\$ 141</u> | <u>\$ 114</u> |
| Windows Upgrades | | | | | |
| North America FG | \$ 3 | \$ 3 | \$ 2 | \$ 6 | \$ 4 |
| Europe FG | 10 | 6 | 4 | 3 | 2 |
| ICON FG | 1 | 0 | 0 | 0 | 0 |
| Far East FG | 0 | 0 | 0 | 0 | 0 |
| WW OEM | 0 | 0 | 0 | 0 | 0 |
| Total Windows Upgrades | <u>\$ 14</u> | <u>\$ 9</u> | <u>\$ 6</u> | <u>\$ 9</u> | <u>\$ 6</u> |
| Windows for Workgroups | | | | | |
| North America FG | \$ 0 | \$ 25 | \$ (1) | \$ (5) | \$ 4 |
| Europe FG | 0 | 6 | 6 | 3 | 3 |
| ICON FG | 0 | 2 | 1 | 1 | 1 |
| Far East FG | 0 | 0 | 0 | 0 | 0 |
| WW OEM | 0 | 0 | 0 | 1 | 0 |
| Total Windows for Workgroups | <u>\$ 0</u> | <u>\$ 33</u> | <u>\$ 6</u> | <u>\$ 0</u> | <u>\$ 8</u> |

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HARDWARE

HARDWARE

Highlights

- **BallPoint Mouse 2.0** shipped on 9/13/93. It features an enhanced ergonomic design for greater comfort, usability and cursor control. It also includes the Microsoft mouse software version 9.01 for greater efficiency as well as full compatibility with Windows and DOS. Several leading notebook computer manufacturers, including Toshiba America Information Systems, Inc. and Texas Instruments, will include it with QuickPort connection as the premier "integrated" pointing device for their next generation computer systems. Announced in November 1992, QuickPort is the electrical and mechanical interface for a cordless version of the BallPoint Mouse. Suggested U.S. retail price for the Ballpoint Mouse 2.0 is \$125. For a limited time, registered users of BallPoint 1.0 can upgrade to version 2.0 for \$50. In addition, registered users can upgrade to version 9.01 software for \$19.95.
- **Windows Sound System (WSS) 2.0** was announced on 10/5. WSS is available in two versions: WSS software and a microphone; and a WSS audio board and headphones, in addition to the software and microphone. The WSS 2.0 audio board package provides Sound Blaster compatibility under the MS-DOS operating system without requiring Microsoft Windows. The WSS software version 2.0 supports virtually all audio boards and will include drivers for Creative Labs, Media Vision, Microsoft and Microsoft-compatible audio boards. Version 2.0 also incorporates Microsoft's new audio compression technology, Truespeech, developed in conjunction with Microsoft's Digital Signal Processor Group and Compaq Computer Corporation. Version 2.0 is scheduled to be available by the end of October. The software version (including a microphone) is available for a suggested retail price of \$79. The audio board package is available for an SRP of \$219.
- Per Tech Scan, Microsoft Mouse's market share is 32%, based on an assumption that non-measured "other" units account for 30% of retail sales. Logitech's OEM revenue was twice Microsoft's in each company's last fiscal year (\$110M vs. \$51M); however, Logitech outsells Microsoft in OEM units by more than four to one. Q94-1 OEM share is in line with FY93 results and significantly exceeds budget. Microsoft expects to grow share in OEM by being more cost competitive via the addition of new low cost Mouse technology to the product line.
- Many OEMs have committed to purchase Windows Sound System version 2.0 when it is released in late October. Many Far Eastern audio board manufacturers, as well as some CPU manufacturers, are choosing to license Windows Sound System software. Expectations today are to license between 2 and 3 million copies of WSS software per year.

Competition

- Logitech announced on 9/21/93 that it had acquired Simi Valley, California based Gazelle Graphics Systems, pioneers in single-board digitizers and developers of the Logitech cordless digitizing pen. The new Logitech Gazelle Pen Digitizer Business Unit will continue to operate in Simi Valley, where it will conduct advanced pen and digitizer research and develop custom digitizer designs for Logitech's OEM customer programs. Pen development will take place concurrently at Logitech's Fremont headquarters. The two companies have been strategic partners since 1991, when Logitech acquired a 51 percent ownership in Gazelle.

OEM Competitiveness

- The shift in mouse sales from retail to the lower revenue per unit OEM channel has increased dramatically over the past few years (approx. 65% of Microsoft Mouse unit sales occur in the OEM channel). For this reason, the low cost Microsoft OEM Mouse will be released in 1/94. By the end of Q94-3, Hardware will have 600K units per month capacity in this low cost mouse. The cost competitiveness of these mice has prompted Joachim Kempin to declare calendar year 1994 to be the year of the OEM Mouse. This selling campaign escalates selling focus on the OEM Mouse.

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HARDWARE**Results of Operations (in millions)**

| | Q94-1 | | |
|-----------------------------|--------|--------|----------|
| | Actual | Plan | Variance |
| Net Revenue | \$51.1 | \$46.0 | \$5.1 |
| Cost of Revenues | 28.4 | 24.6 | (3.8) |
| Gross Profit | 22.7 | 21.4 | 1.3 |
| People | 2.3 | 2.5 | 0.2 |
| Facilities | 0.3 | 0.6 | 0.3 |
| Marketing | 2.6 | 3.3 | 0.7 |
| Product Dev | 1.1 | 3.1 | 2.0 |
| PSS | 0.8 | 0.9 | 0.1 |
| Other | 0.6 | 0.7 | 0.1 |
| Shared Resources | 0.3 | 0.6 | 0.3 |
| Total Controllable Expenses | 8.0 | 11.7 | 3.7 |
| Responsibility Margin | \$14.7 | \$9.7 | \$5.0 |
| | | | |
| Net Revenue | 100% | 100% | - |
| Cost of Revenues | 56 | 53 | (3) |
| Controllable Expenses | 15 | 26 | 11 |
| Responsibility Margin | 29% | 21% | 8% |

- Higher than planned revenues, which were mainly the result of strong OEM Mouse sales, coupled with slightly lower than budgeted controllable expenses resulted in a 50% positive responsibility margin variance.
- COGS were \$3.8 million higher than budget due mainly to a \$1.6 million inventory adjustment. In order to eliminate obsolescence charges, Hardware is trying to sell out inventory of 1.0 mice (both domestically and internationally) at severely reduced prices (lower than cost). Margins were taken down so that Microsoft's subsidiaries could more aggressively sell these mice.

Revenue by Channel Results (in millions)

| | Q94-1 | | |
|------------------|---------|---------|----------|
| | Actual | Plan | Variance |
| Hardware | | | |
| North America FG | \$ 23.3 | \$ 24.6 | -\$ 1.3 |
| Europe FG | 9.2 | 10.2 | -1.0 |
| ICON FG | 3.2 | 3.3 | -0.1 |
| Far East FG | 3.3 | 2.6 | 0.7 |
| WW OEM | 13.7 | 6.5 | 7.2 |
| Total Hardware | \$ 52.7 | \$ 47.2 | \$ 5.5 |

(Refer to Channel Section for discussion of revenue variances.)

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HARDWARE

Revenue by Channel Trend (in millions)

| | <u>Q93-1</u> | <u>Q93-2</u> | <u>Q93-3</u> | <u>Q93-4</u> | <u>Q94-1</u> |
|------------------|--------------|--------------|--------------|--------------|--------------|
| Hardware | | | | | |
| North America FG | \$ 30 | \$ 29 | \$ 14 | \$ 25 | \$ 23 |
| Europe FG | 20 | 23 | 10 | 12 | 9 |
| ICON FG | 7 | 7 | 5 | 6 | 3 |
| Far East FG | 1 | 1 | 1 | 5 | 3 |
| WW OEM | 7 | 9 | 19 | 13 | 14 |
| Total Hardware | <u>\$ 65</u> | <u>\$ 69</u> | <u>\$ 49</u> | <u>\$ 61</u> | <u>\$ 53</u> |

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ADVANCED TECHNOLOGY

ADVANCED TECHNOLOGY

Key Product Releases

| Business Unit/Product | RTM Date | | Revenue in thousands | | | |
|----------------------------------|-----------|--------|----------------------|-------|----------|--------|
| | Actual | Plan | FYTD94 | | | FY94 |
| | | | Actual | Plan | Variance | Budget |
| Advanced Product Dev | | | | | | |
| Scenes Sierra Club | 18-Aug-93 | Jul-93 | \$369 | \$181 | \$188 | \$779 |
| Scenes Outer Space | 18-Aug-93 | Jul-93 | 357 | 181 | 176 | 779 |
| Scenes Impressionists | 18-Aug-93 | Jul-93 | 344 | 181 | 163 | 779 |
| Word Assistant / Win | 20-Oct-93 | Oct-93 | 0 | 0 | 0 | 2,163 |
| Attache (Office add-on) / Win | 19-Jan-94 | Oct-93 | 0 | 0 | 0 | 1,408 |
| Ink Font Pack / Win | Canceled | Oct-93 | 0 | 0 | 0 | 121 |
| Ink Font Pack / Mac | Canceled | Oct-93 | 0 | 0 | 0 | 70 |
| Word Assistant / Mac | Apr-94 | Jan-94 | 0 | 0 | 0 | 277 |
| TT Master Set / Win | 17-Feb-94 | Jan-94 | 0 | 0 | 0 | 751 |
| Sizzle (PowerPoint add-on) / Win | Canceled | Jan-94 | 0 | 0 | 0 | 251 |
| Sizzle (PowerPoint add-on) / Mac | Canceled | Jan-94 | 0 | 0 | 0 | 101 |
| Attache (Office add-on) / Mac | Mar-94 | Feb-94 | 0 | 0 | 0 | 282 |

- Microsoft Scenes, a new line of screen saver products was announced July 26th. The first three collections available contain photographic images of nature, outer space and art, and include information related to each image provided by experts in the particular field. In addition, users can personalize their workstations through an enclosed offer from Genigraphics Corporation to convert up to three personal photographs into Microsoft Scenes images. SRP is \$29.95 per collection.
- Word Assistant is an add-on product to Microsoft Word 6.0 that includes multiple templates and forms, True Type fonts, a font selector with a WYSIWYG (What You See Is What You Get) display, and clip art. In an upcoming promotion, a free copy of Word Assistant will be given away with every three copies of Word Upgrade purchased. A similar add-on product for Office is being developed. RTM dates for these add-on products are dependent on the release of the next version of the product they support.
- The PowerPoint add-on was canceled upon reexamination of the business case and resources required. Ink Font Pack was postponed due to timing and marketing issues. It will be revisited later in this fiscal year or next.
- Font Pack 2 will be bundled with Office, Excel and Word Upgrades in a direct mailing offer to be mailed the first week of November. There will be a Mac Line Holiday promotion offering a Mac Works/Master Set for the Mac bundle.
- The efforts of the other business units within Advanced Technology (Advanced Consumer Technology, Broad Band Applications and On Line Services) are almost exclusively concentrated on exploration of future technologies, opportunities, alliances and industries. This research and development is not expected to yield revenue bearing products in the present fiscal year.

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ADVANCED TECHNOLOGY

Results of Operations (In millions)

Q94-1

| | Net Revenue | | Cost of Revenue | | Controllable Expense | | Responsibility Margin | |
|------------------------|--------------|------------|-----------------|-------------|----------------------|------------|-----------------------|------------|
| | Actual | % of Plan | Actual | % of Plan | Actual | % of Plan | Actual | % of Plan |
| Advanced Technology | | | | | | | | |
| Advanced Consumer Tech | \$0.0 | - | \$0.0 | 33% | \$5.9 | 51% | (\$5.9) | 52% |
| Advanced Product Dev | 2.1 | 113 | 0.7 | 183 | 2.2 | 58 | (0.9) | 37 |
| On Line Services | 0.0 | - | 0.0 | - | 0.8 | 39 | (0.8) | 39 |
| Broad Band Apps | 0.0 | - | 0.0 | - | 0.3 | 34 | (0.3) | 34 |
| | <u>\$2.1</u> | <u>92%</u> | <u>\$0.7</u> | <u>168%</u> | <u>\$9.2</u> | <u>50%</u> | <u>(\$7.9)</u> | <u>48%</u> |

| | Net Revenue Mix | | Cost of Revenue | | Controllable Expense | | Responsibility Margin | |
|------------------------|-----------------|-----------|-----------------|-------------|----------------------|------------|-----------------------|------------|
| | Actual | % pts Var | % Net Rev | % pts Var | % Net Rev | % pts Var | % Net Rev | % pts Var |
| Advanced Technology | | | | | | | | |
| Advanced Consumer Tech | (1%) | (19) | (74%) | 84 | - | - | - | - |
| Advanced Product Dev | 101 | 19 | 36 | (14) | 108 | 102 | (43) | 88 |
| On Line Services | - | - | - | - | - | - | - | - |
| Broad Band Apps | - | - | - | - | - | - | - | - |
| | <u>100%</u> | <u>0</u> | <u>36%</u> | <u>(16)</u> | <u>446%</u> | <u>375</u> | <u>(383%)</u> | <u>359</u> |

- Advanced Technology's mission is to develop Microsoft's most forward looking technologies with a focus on the consumer and taking advantage of the impact of digital convergence. Most of these technologies are not expected to become reality until 1995 or later. Key areas of development include:
 - Operating system software for the broadband digital information highway and related client/server reference platform.
 - Leading applications for the broadband digital information highway.
 - A Microsoft branded on-line service for personal computers and other narrowband devices that would ship with Chicago and initially offer product/developer support functions. The range of information is expected to expand to include a broad range of services and information.
 - Software and hardware reference designs for wireless personal companions and other consumer mobile devices.
 - Cryptography.
 - Compression technology.
 - Research into other projects including natural language, voice recognition, advanced interfaces and sophisticated agency.
- On August 4th, it was announced that Microsoft agreed to purchase certain technology, research and product development efforts from Continuum Productions Corp. The core business of Continuum is to create a digital archive and media database, including such media types as video footage, photographic images and sound clips. Approximately 55 Continuum staff were offered positions at Microsoft in the Multimedia Publishing and Advanced Technology groups.

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ADVANCED TECHNOLOGY

Results of Operations (In millions)

| | Q94-1 | | |
|-----------------------------|---------|----------|----------|
| | Actual | Plan | Variance |
| Net Revenue | \$2.1 | \$2.2 | (\$0.1) |
| Cost of Revenues | 0.7 | 0.4 | (0.3) |
| Gross Profit | 1.3 | 1.8 | (0.5) |
| People | 6.2 | 10.8 | 4.6 |
| Facilities | 0.9 | 1.5 | 0.6 |
| Marketing | 0.3 | 0.1 | (0.2) |
| Product Dev | 0.6 | 4.9 | 4.3 |
| PSS | - | - | - |
| Other | 0.1 | 0.1 | - |
| Shared Resources | 1.1 | 0.9 | (0.2) |
| Total Controllable Expenses | 9.2 | 18.3 | 9.1 |
| Responsibility Margin | (\$7.9) | (\$16.5) | \$8.6 |
| | | | |
| Net Revenue | 100% | 100% | - |
| Cost of Revenues | 36 | 20 | (16) |
| Controllable Expenses | 450 | 823 | 373 |
| Responsibility Margin | (386%) | (743%) | 357% |

- Product cost of revenues per unit were higher than planned for Font Packs and Microsoft Scenes.
- Despite the additional headcount brought in to Advanced Technology from Continuum, AT's hiring is way below plan, resulting in a positive variance in people expenses.
- Advanced Technology's exploration into certain new technologies is still at a very early stage. As decisions are made and projects take shape the variance in product development will disappear.

Revenue by Channel Results (In millions)

| | Q94-1 | | |
|---------------------|---------------|---------------|-----------------|
| | Actual | Plan | Variance |
| Advanced Technology | | | |
| North America FG | \$ 1.9 | \$ 1.9 | \$ 0.0 |
| Europe FG | 0.2 | 0.5 | (0.3) |
| ICON FG | 0.1 | - | 0.1 |
| Far East FG | 0.0 | - | - |
| WW OEM | 0.0 | - | - |
| | <u>\$ 2.2</u> | <u>\$ 2.4</u> | <u>(\$ 0.2)</u> |

(Refer to Channel Section for discussion of revenue variances.)

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ADVANCED TECHNOLOGY

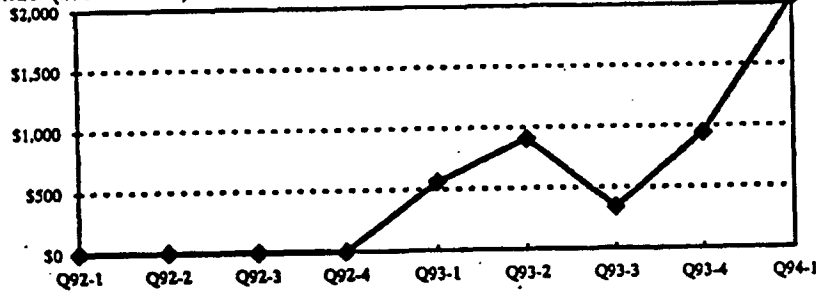
TREND ANALYSES

Revenue by Channel (in millions)

| | Q92-1 | Q92-2 | Q92-3 | Q92-4 | Q93-1 | Q93-2 | Q93-3 | Q93-4 | Q94-1 |
|---------------------|---------------|-------|-------|-------|---------------|-------|---------------|---------------|---------------|
| Advanced Technology | | | | | | | | | |
| North America FG | \$ 0.6 | | | | \$ 0.9 | | \$ 0.3 | \$ 0.9 | \$ 1.9 |
| Europe FG | - | | | | - | | - | - | 0.2 |
| ICON FG | - | | | | - | | - | - | 0.1 |
| Far East FG | - | | | | - | | - | - | 0.0 |
| WW OEM | - | | | | - | | - | - | 0.0 |
| | <u>\$ 0.6</u> | | | | <u>\$ 0.9</u> | | <u>\$ 0.3</u> | <u>\$ 0.9</u> | <u>\$ 2.2</u> |

(FY93 revenues from the following products: Font Pack, Multimedia Viewer, MS-DOS Extensions, MM Developers Kit and Modular Windows.)

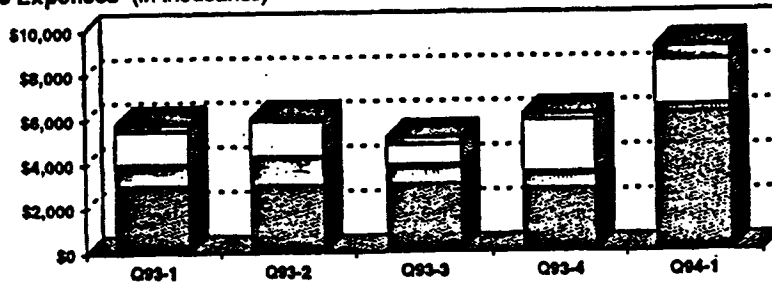
Net Revenue (in thousands)



FY92 is stated as reported in FY92 (as a part of systems) and has not been restated for product reclassifications which are deemed to be immaterial for the purposes of this graph.

- There was a drop in North America FG Font Pack sales in Q93-3.
- The introduction of Microsoft Scenes in Q94-1 more than doubled net revenues over Q93-4 for Advanced Technology.

Controllable Expenses (in thousands)



■ People ■ Marketing ■ PSS □ Other ■ Product Devl.

- Advanced Technology's headcount (excluding research which rolls up under WPG) has increased 117%, to 270 people from 124 at the end of the last fiscal year, causing headcount related expenses to increase proportionately.

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Operations

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OPERATIONS SUMMARY (CONTROLLABLE EXPENSES)

| | Q94-1 | | |
|---|---------------|---------------|--------------|
| | Actual | % of Plan | |
| Corporate Finance | | | |
| People | 4,884 | 81% | |
| Facilities | 1,100 | 91% | |
| Other | 1,723 | 111% | |
| Total Expenses | 7,707 | 88% | |
| Corporate MD&L | | | |
| People | 699 | 61% | |
| Facilities | 123 | 40% | |
| Other | 5 | 100% | |
| Total Expenses | 827 | 57% | |
| Corporate HR & Administration | | | |
| People | 8,261 | 79% | |
| Facilities | 1,492 | 69% | |
| Other | 114 | 18% | |
| Total Expenses | 9,867 | 75% | |
| Corporate ITG | | | |
| People | 10,464 | 90% | |
| Facilities | 1,582 | 78% | |
| Other | 51 | 340% | |
| Total Expenses | 12,097 | 88% | |
| Corporate Legal | | | |
| People | 3,009 | 84% | |
| Facilities | 450 | 96% | |
| Other | 6,416 | 49% | |
| Total Expenses | 9,875 | 57% | |
| Corporate General & Facility Distributions | | | |
| HR & Admin | 21,870 | 79% | |
| ITG | 12,061 | 97% | |
| Other | 15,345 | 83% | |
| Total Expenses | 49,276 | 84% | |
| | Q94-1 | | FY94 |
| Headcount | Act | % Plan | Plan |
| Finance | 248 | 87.6% | 288 |
| MDL | 1,369 | 93.1% | 1,535 |
| HR & Admin | 666 | 88.9% | 765 |
| ITG | 316 | 96.9% | 326 |
| Total Ops Headcount | 2,599 | 90.7% | 2,914 |

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Operations

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OPERATIONS SUMMARY (CONTROLLABLE EXPENSES)

Corporate Finance

- Recruiting expense was below plan by \$651,000 due to a lag in hiring for open positions. This was the significant contributor to the positive people variance.
- The negative variance for other expenses was mainly the result of above planned spending for business insurance (\$120,000).

Corporate MD&L

- The majority of MD&L's lower than planned spending (\$634,000) was due to the following: contingency (\$234,000), depreciation (\$115,000) and distributions (\$154,000). The favorable contingency and depreciation variances were due to timing.

Corporate HR & Administration

- Employee Fringes (captured in People expense) were significantly below plan.
- Miscellaneous Operating expenses were \$578,000 below plan primarily due to withholding payment to the consultants for the Flexible Benefit Plan until specific conditions are met.

Corporate ITG

- Below planned headcount and consulting fees as significant projects (primarily Microsoft Online Services (MOS)) were ramping up behind budget.
- Below planned telecommunications variance of \$494,000 as MOS probably will not see significant telecommunications costs until Q3 of the fiscal year, based upon the current project schedule.

Corporate Legal

- Slower than planned staffing for piracy litigation and federal investigations resulted in a positive Q94-1 variance.

Corporate General & Facility Distributions

- Below planned headcount and the impact of Q94-1 employee bonuses created a \$1.9 million positive variance for payroll taxes. Due to timing, payments for company beverages and cafeteria were also below plan (\$452,000). Favorable headcount also resulted in a \$190,000 positive variance for corporate 401(k) matching.
- The facilities variance was due to several factors. First, delays of a 25,000 square foot campus lease expansion with furnishings budgeted at \$270,000, and a \$132,000 Canyon Park expansion. Additionally, postponed purchases of ergonomically improved furniture (\$51,000) and new lobby furniture for buildings one through six (\$44,000) contributed to the variance.

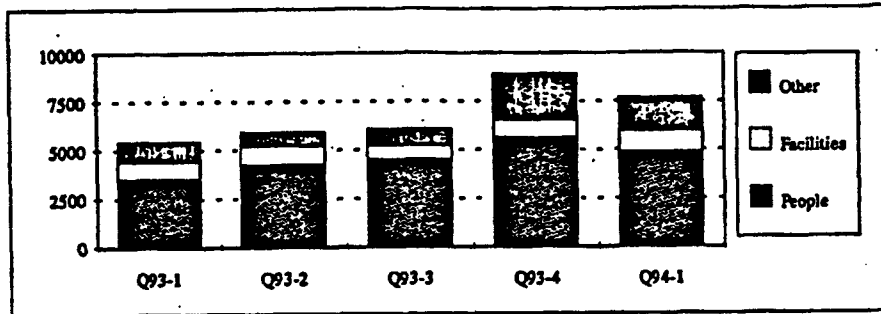
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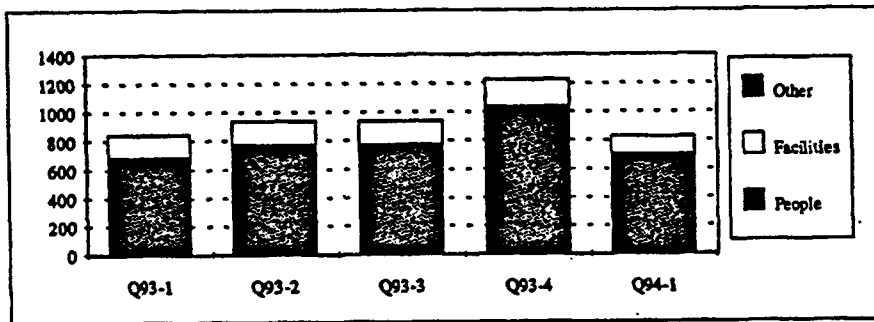
OPERATIONS SUMMARY (CONTROLLABLE EXPENSES)

TREND ANALYSES - CONTROLLABLE EXPENSES

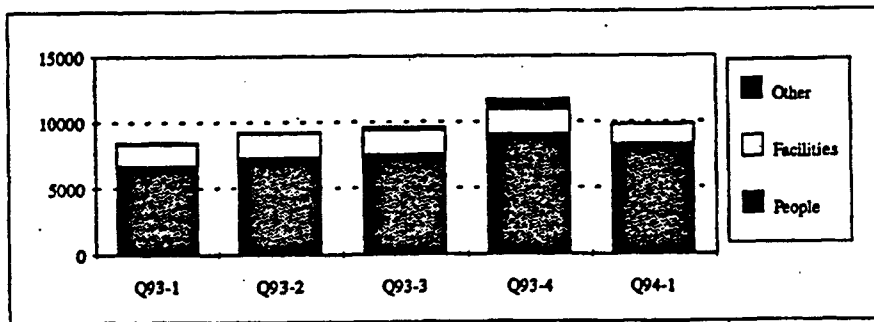
Corporate Finance



Corporate MD&L



Corporate HR & Administration



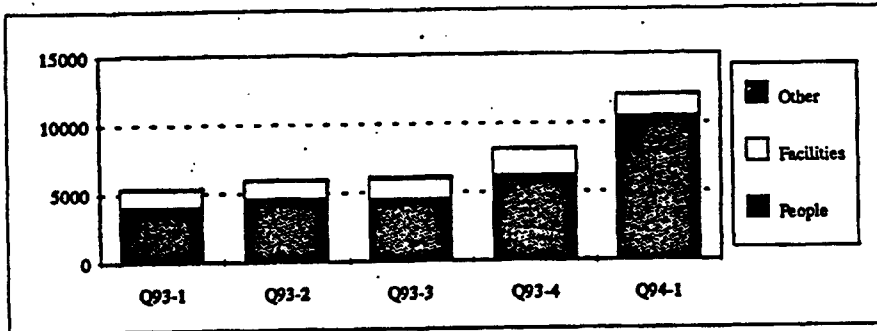
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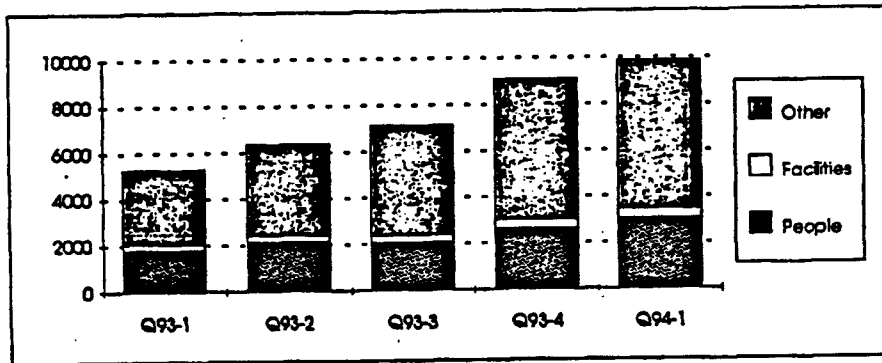
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OPERATIONS SUMMARY (CONTROLLABLE EXPENSES)

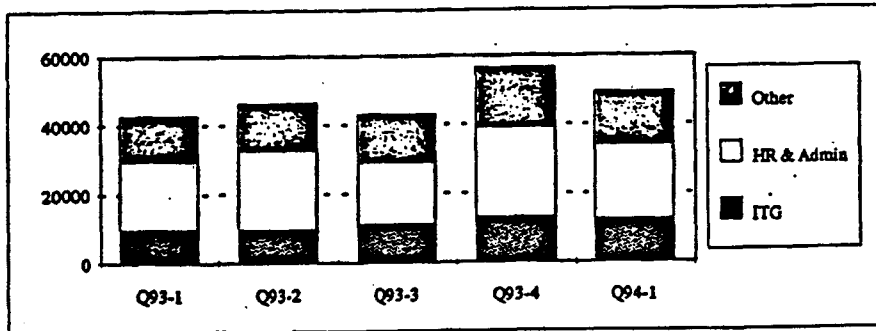
Corporate ITG



Corporate Legal



Corporate General & Facility Distribution



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OPERATIONS SUMMARY (CONTROLLABLE EXPENSES)

Corporate Finance

Controllable Expenses

- Increased use of consultants resulted in the Q93-4 peak in the five quarter trend.

Corporate MD&L

Controllable Expenses

- Distribution expenses for Q93-4 were higher than any other quarter in FY93 and also Q94-1, primarily due to higher overall spending.

Corporate HR & Administration

Controllable Expenses

- Other expense decreased from last quarter due to withholding payment for professional fees related to consulting on the new Flexible Benefit Plan until specific conditions are met.

Corporate ITG

Controllable Expenses

- Increased use of third party developers and project managers resulted in the steep increase in people expenses from Q93-4 to Q94-1.

Corporate Legal

Controllable Expenses

- Significant headcount growth and increased litigation, related to domestic and international piracy issues and the Justice Department investigation, have created the strong increase (87% growth from Q93-1 to Q94-1) to Corporate legal expenses.

Corporate General & Facility Distributions

Controllable Expenses

- Year-end hiring and large insurance claims resulted in increased employee insurance during Q93-4. The timing of payments resulted in high insurance expense during Q94-1. By quarter, starting in Q93-1, employee insurance expense has been \$6.8 million, \$6.9 million, \$6.2 million, \$8.1 million and \$8.0 million.
- Local improvement assessment payments to Redmond of \$906,000 were made in Q93-4. The largest payment related to improvements near N.E. 40th and 156th N.E. of \$589,000.

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Operations

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FACILITIES

FACILITIES

Worldwide Facility Distribution

| Location | September 30, 1993 | | September 30, 1992 | |
|------------------|--------------------|-------------|--------------------|-------------|
| | Square Feet | % of Total | Square Feet | % of Total |
| Corporate Campus | 1,742,000 | 34% | 1,646,000 | 38% |
| Other Domestic | 1,460,000 | 29% | 1,313,000 | 30% |
| International | 1,875,000 | 37% | 1,357,000 | 31% |
| | <u>5,077,000</u> | <u>100%</u> | <u>4,316,000</u> | <u>100%</u> |

- The size of the worldwide portfolio increased 4% and 18% over the past quarter and year, respectively.
- The international portfolio expanded by 518,000 sf (38%) over the past year, and now accounts for more than one third of Microsoft's worldwide space.
- During the remainder of FY94, there will be relatively little increase in the international portfolio, as most expansion will be concentrated at the Corporate Campus.

Domestic Facilities

- During Q94-1, Microsoft achieved significant progress on securing entitlements for the development of 685,000 sf of office space on the 34 acre "Redmond West" property, the purchase of which is contingent upon appropriate entitlements being granted for the land.
- Growth during the remainder of FY94 will be concentrated at the Corporate Campus (Building 25 will add 223,000 sf in Q94-4), several expanded field sites, and additional leased space in the Redmond area to accommodate growth of Advanced Technology.
- Build-out of the PSS Dallas-Hilltop facility continues and is expected to be completed in late October. This facility will house up to approximately 700 employees and the schedule for occupancy will be determined by call demand.
- Leasing space for MS Press and a Latin America sales office in Miami is in process.

International Facilities

- The European portfolio (exclusive of Ireland M&D) increased 46% during the past year, reflecting significant facility additions in France and Holland. The rate of increase during the coming quarters will be negligible.
- Space occupied in ICON and the Far East increased 111,000 sf (26%) since Q93-1, primarily due to expansion in Japan and the addition of new subsidiaries.
- The increase in M&D and R&D space was due exclusively to the addition of the 80,000 sf owned M&D building in Ireland.
- Approval has been given to research lease options for a 70,000 sf office facility in Dublin. The lease will probably be ten years at a value of approximately \$11 million, to begin January 1995. Negotiations should be final by the end of Q94-2. The facility will be built to accommodate the World Product Group in Ireland responsible for localization.

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MANUFACTURING, DISTRIBUTION, & LOGISTICS

MANUFACTURING, DISTRIBUTION, & LOGISTICS

Campus North Component Pieces (in thousands)

| | Q94-1 | | Q93-4 | |
|----------|---------------|--------------|----------------|--------------|
| | Total CP | CP/Build Day | Total CP | CP/Build Day |
| In-house | 73,625 | 1,083 | 95,089 | 1,486 |
| Off-site | 1,640 | 25 | 23,832 | 373 |
| | <u>75,265</u> | <u>1,108</u> | <u>118,921</u> | <u>1,859</u> |

- Total component production decreased 37%, basically as a result of lower demand.
- Extensive plans to produce and distribute new product releases were implemented during the quarter. Domestic products will be built at nine different sites during Q94-2, including Puerto Rico. Six sites will distribute products directly to customers.
- Manufacturing will continue efforts to achieve ISO 9002 certification at Canyon Park and Puerto Rico. Registration audits are planned for Puerto Rico during December and in Canyon Park during June 1994.
- Microsoft Ireland, which provides the majority of packaged products sold by our European subsidiaries, measures production by packages built. Ireland produced 1.3 million units in Q94-1, 43% less than the 2.2 million units during the prior quarter. Q93-4 volumes were high due to MS DOS 6.0.

Backlog

- Buildable backlog occurs when customer demand exceeds forecast or when the plant fails to build to forecasted demand. Non-buildable backlog occurs when orders are placed for products that have not been released to manufacturing.
- Domestic backlog was \$33 million at the end of Q94-1, a 205% increase compared the prior quarter. Non-buildable backlog relating to Office and Word accounts for \$20 million of the total backlog. Most of the buildable backlog relates to Flight Simulator and Windows. Flight Simulator demand has been substantially greater than anticipated, and Windows backlog is being managed in anticipation of the upcoming new version.

International Focused Factory

- International Focused Factory (IFF) is in the process of entering a strategic partnership agreement with RR Donnelley & Sons to single source all of IFF's worldwide outsource requirements.
- RR Donnelley & Sons in Singapore is expanding its product offering. Until recently, only MS DOS and Windows were manufactured.
- IFF plans are underway to outsource duplication and assembly of all MS DOS and Windows products. The change will free up capacity to build other products in-house.
- IFF is assisting Japan (through RR Donnelley & Sons) to reduce product cost of goods sold. Access is expected to be the first product impacted by the program.

MS Ireland

| | Q94-1 | Q93-4 |
|-----------------------|---------------|----------------|
| Buildable backlog | 3,000 | 137,741 |
| Non-buildable backlog | 88,000 | - |
| | <u>91,000</u> | <u>137,741</u> |

- Ireland's manufacturing demand is created by orders from European subsidiaries. While the backlog definition is consistent with that used domestically, backlog is tracked in units rather than dollars. Non-buildable backlog at the end of Q94-1 relates to Access and Word.

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MANUFACTURING, DISTRIBUTION, & LOGISTICS

Headcount

| | <u>Q94-1</u> | <u>Q94-1 Plan</u> | <u>Q93-4</u> | <u>Variance</u> | <u>Change</u> |
|--------------|--------------|-------------------|--------------|-----------------|---------------|
| Campus North | 552 | 594 | 567 | 42 | (15) |
| Ireland | 402 | 409 | 403 | 7 | (1) |
| IFF | 246 | 264 | 252 | 18 | (6) |
| Puerto Rico | 169 | 204 | 177 | 35 | (8) |
| | <u>1,369</u> | <u>1,471</u> | <u>1,399</u> | <u>102</u> | <u>(30)</u> |

- The favorable variance to plan relates to production associates. Ireland's favorable variance relates to delayed hiring for the consolidation of warehouses in Europe.

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INVESTOR RELATIONS / STOCK ACTIVITY

INVESTOR RELATIONS / STOCK ACTIVITY

FY94 Earnings Release

- On October 20, 1993, financial results for Q94-1 were released. Earnings per share were \$0.79 for the quarter. Analysts' earnings projections for the upcoming quarters, updated as of October 22, 1993, are summarized in the table below.

Selected Earnings per Share Estimates, FY94 - FY95

| <u>Analyst</u> | <u>Q94-1A</u> | <u>Q94-2</u> | <u>Q94-3</u> | <u>Q94-4</u> | <u>FY94</u> | <u>FY95</u> |
|-------------------------|---------------|---------------|---------------|---------------|---------------|---------------|
| Alex. Brown | 0.79A | \$0.92 | \$0.97 | \$0.97 | \$3.65 | - |
| Cowen & Co. | 0.79A | 0.92 | 0.95 | 0.99 | 3.65 | 4.40 |
| Dean Witter | 0.79A | - | - | - | 3.70 | 4.50 |
| DLJ Securities | 0.79A | 0.95 | 0.96 | 0.96 | 3.65 | 4.60 |
| Goldman, Sachs | 0.79A | 0.95 | 0.95 | 0.93 | 3.60 | 5.00 |
| Lehman Brothers | 0.79A | 0.92 | 0.99 | 0.95 | 3.65 | 4.75 |
| Merrill Lynch | 0.79A | 0.92 | - | - | 3.60 | - |
| Montgomery | 0.79A | 0.90 | 0.98 | 0.98 | 3.65 | 4.60 |
| Paine Webber | 0.79A | 1.00 | 1.01 | 0.98 | 3.80 | 4.70 |
| Piper Jaffray | 0.79A | 0.92 | 0.95 | 1.00 | 3.67 | - |
| UBS Securities | 0.79A | - | - | - | 3.70 | 4.60 |
| Average -- all analysts | <u>0.79A</u> | <u>\$0.94</u> | <u>\$0.97</u> | <u>\$0.98</u> | <u>\$3.67</u> | <u>\$4.48</u> |

Ownership of Microsoft Stock

- As of September 30, 1993, Microsoft officers and directors held 45% of outstanding Microsoft stock, a decrease from the 47% held as of June 30, 1993.

Stock Ownership Profile, Q94-1

| | <u>Number of Shares</u> | <u>Percent of Total</u> |
|---|-----------------------------|-----------------------------|
| Officers, directors and 5% shareholders | | |
| William H. Gates | 79,087,044 | 28% |
| Paul Allen | 32,166,750 | 11 |
| Steve Ballmer | 14,976,382 | 5 |
| | <u>126,230,176</u> | <u>44</u> |
| Other officers and directors | 2,797,081 | 1 |
| Total officers and directors | 128,027,257 | 45 |
| Other holders (float) | 155,257,165 | 55 |
| Total shares outstanding | <u>283,284,422</u> | <u>100%</u> |

Institutional Shareholders:

- The 15 largest institutional owners of Microsoft stock held 13.6% of outstanding shares at June 30, 1993 (the latest date for which information is available). These same institutions held 12.9% of outstanding shares the prior year.

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INVESTOR RELATIONS / STOCK ACTIVITY

Fifteen Largest Institutional Shareholders

| Institution | June 30, 1993 | | June 30, 1992 | | Change (000) |
|-------------------------------|-------------------|------------------------------|-------------------|------------------------------|--------------|
| | Shares Held (000) | Percent of Total Outstanding | Shares Held (000) | Percent of Total Outstanding | |
| Alliance Capital | 6,321 | 2.2 | 6,224 | 2.3 | 97 |
| Fidelity Management | 4,796 | 1.7 | 5,486 | 2.0 | (690) |
| Provident Investment Counsel | 3,989 | 1.4 | 3,013 | 1.1 | 976 |
| IDS Financial Corp. | 2,676 | 0.9 | 2,185 | 0.8 | 491 |
| Jennison Associates Capital | 2,612 | 0.9 | 2,795 | 1.0 | (183) |
| Kemper Finl Services | 2,212 | 0.8 | 2,033 | 0.7 | 179 |
| College Retire Equities | 2,088 | 0.7 | 2,595 | 1.0 | (507) |
| Morgan JP & Co | 2,044 | 0.7 | 1,976 | 0.7 | 68 |
| Janus Capital Corp | 1,990 | 0.7 | 726 | 0.3 | 1,264 |
| Miller Anderson & Sherrerd | 1,784 | 0.6 | 2,389 | 0.9 | (605) |
| Massachusetts Finl Svcs | 1,749 | 0.6 | 1,463 | 0.5 | 286 |
| Shearson Lehman Brothers | 1,707 | 0.6 | 656 | 0.2 | 1,051 |
| RCM Capital Management | 1,578 | 0.6 | 1,041 | 0.4 | 537 |
| Hellman Jordan Management Co. | 1,499 | 0.5 | 933 | 0.3 | 566 |
| California PER | 1,474 | 0.5 | 1,471 | 0.5 | 3 |
| | <u>38,519</u> | 13.6 | <u>34,986</u> | 12.9 | <u>3,533</u> |

Microsoft Market Capitalization

- Based on market values as of October 21, 1993, total market capitalization for Microsoft equals \$22.4 billion. One Nasdaq company, Intel Corporation, currently appears among the 25 largest issues.

Largest Public Companies (in billions)

| Rank | Company | Market Capitalization |
|------|-------------------------------|-----------------------|
| 1 | General Electric | \$83.1 |
| 2 | Exxon | 80.2 |
| 3 | American Telephone & Telegrap | 79.1 |
| 4 | Wal Mart Stores | 62.1 |
| 5 | Coca Cola | 56.7 |
| 6 | Phillip Morris | 46.2 |
| 7 | GTE | 36.6 |
| 8 | Merck | 36.5 |
| 9 | Procter & Gamble | 35.6 |
| 10 | Shell Transport & Trading | 34.6 |
| 11 | Zeneca Group | 32.5 |
| 12 | Mobil | 32.2 |
| 13 | General Motors | 32.0 |
| 14 | Pepsico | 31.8 |
| 15 | Chevron | 31.2 |
| 16 | DuPont | 31.1 |
| 17 | Bellsouth | 30.8 |
| 18 | Bristol-Myers Squibb | 30.3 |
| 19 | Motorola | 29.7 |
| 20 | Ford Motor | 29.0 |
| 21 | American Internat Group | 28.3 |
| 22 | Intel Corporation | 28.3 |
| 23 | Johnson & Johnson | 27.9 |
| 24 | Amoco | 27.6 |
| 25 | Bell Atlantic | 27.5 |

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INFORMATION TECHNOLOGY (IT)

INFORMATION TECHNOLOGY (IT)

IT Application Development & Maintenance

Key Product Releases

| <u>Business Unit/Product</u> | <u>Release Date</u> | |
|---|---------------------|-------------|
| | <u>Act/First</u> | <u>Plan</u> |
| Finance & Manufacturing/Distribution Projects: | | |
| EOC Design Complete | Oct-93 | Oct-93 |
| MS License 1.0 - Forecasting | Nov-93 | Nov-93 |
| OE Imaging (Chameleon) | Nov-93 | Nov-93 |
| MS License 2.0 -Business Services | Mar-94 | Mar-94 |
| BWB 2.0 | Mar-94 | Mar-94 |
| EDI/EFForms 1.0 | Mar-94 | Mar-94 |
| EOC 1.0 Software Enabled | Mar-94 | Mar-94 |
| EOC 1.0 Customer Conversion Begins | Apr-94 | Apr-94 |
| NGBS - Financial Stream 1.0/DSS 1.0 | May-94 | May-94 |
| Astro-Online Purchase Orders 1.0 | N/A | N/A |
| Mac Pac 7.0 | Released | Aug-93 |
| UPI 1.0 | Released | Aug-93 |
| Human Resource Projects: | | |
| Flex Benefits 1.0 | Oct-93 | Oct-93 |
| HR Vantage 1.0 | Oct-93 | Oct-93 |
| People 1.0 | Jan-94 | Jan-94 |
| MS Manager 1.0 | Released | Jul-93 |
| ERS | Released | Jul-93 |
| Internal IT Projects: | | |
| Desktop VTC | Nov-93 | Nov-93 |
| ISDN Rollout | Nov-93 | Nov-93 |
| EMS MS Mail 4.0 | Dec-93 | Dec-93 |
| Hermes 1.0 | Dec-93 | Dec-93 |
| Rhino(TCP) 1.0 | Jan-94 | Jan-94 |
| Legacy Outsource | Jan-94 | Jan-94 |
| PC Telephone 1.0 | Jan-94 | Jan-94 |
| Email/Vmail Integration 1.0 | Mar-94 | Mar-94 |
| Win NT Migration | July-Dec-93 | July-Dec-93 |
| PSS Projects | | |
| PSS Delta 1.5 Int'l | Dec-93 | Dec-93 |
| PSS WB 2.0 Full Convergence | May-94 | May-94 |
| MOS MSC 1.0 | N/A | N/A |
| PSS Delta 1.5 US | Released | 9/1/93 |
| Sales & Marketing Projects: | | |
| EDI 1.0 Inventory Reporting | Oct-93 | Sep-93 |
| CMS 1.0 | Nov-93 | Nov-93 |
| MS Sales 1.0 Interim | Nov-93 | Nov-93 |
| ISWB 1.5 Amplitude | Jan-94 | Nov-93 |
| MS Sales 2.0 | Mar-94 | Jan-94 |
| WAM 1.0 in Access | Apr-94 | Mar-94 |
| Marketing Exp 1.0 | May-94 | May-94 |
| CMS 2.0 | Jun-94 | Jun-94 |
| ISWB 2.0 | N/A | N/A |
| ISWB 1.0 | Released | Sep-93 |

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INFORMATION TECHNOLOGY (IT)

- Significant development achievements during Q1 include:
 - Enacted European Steering Committee to prioritize application development and strategically align with European customers.
 - Developed Customer Profile through interviews with over 40 IT customers to determine critical success factors.
 - Inventoried all major applications within the Campus area to aid in planning and customer service.
 - Started methodology design to implement common worldwide project development approach.
 - During the quarter IT released the following significant new applications to its customers:
 - o Sales and Marketing: Inside Sales Workbench 1.0
 - o Human Resources: ERS 1.0
 - o Finance: Mac Pak 7.0
 - o PSS: PSS Workbench 1.5.
 - Largest NT/SQL application developed to date.

Applications currently supported

| Client | Applications | % of Total |
|---------------------------|--------------|------------|
| Corporate Services | 14 | 7 |
| Finance | 39 | 18 |
| Human Resources | 15 | 7 |
| Information Technology | 11 | 5 |
| Law & Corporate Affairs | 7 | 3 |
| Microsoft Consulting | 8 | 4 |
| Mfg & Distribution | 26 | 12 |
| Microsoft Press | 2 | 1 |
| Product Service & Support | 16 | 7 |
| Sales & Marketing | <u>77</u> | <u>36</u> |
| | 215 | 100 |

IT Infrastructure

- Migrating servers worldwide from OS/2 to NT.
 - Implementing new NT domain structure - Educating new users regarding NT's highly structured domain versus current OS/2 structure.
 - Completed first phase of protocol migration from XNS to TCP.
 - 375 (approximately 25%) IT controlled servers have been converted to NT. Goal is to convert 90% by December 31st.
- Merged Helpdesk (SW Support) and PC Repair (HW Support) into one organization.
 - Provide higher quality of service by utilizing single source. Increase efficiency in long run through economies of scale. Short run capacity issue as technicians cross train.

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Supplemental Information

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SUPPLEMENTAL INFORMATION

ABBREVIATIONS, ACRONYMS AND TERMS

| | |
|----------|--|
| ABC | Activity Based Costing |
| ABU | Analysis Business Unit |
| ACE | Advanced Computing Environment |
| ACIS | IBM academic pricing program using bundles |
| AED | Authorized Education Dealer |
| AI | Artificial Intelligence |
| AIME | Includes Africa, Israel & Middle East |
| APAC | Australia, Pacific, and Canada |
| Apps | Applications |
| BBS | Bulletin Board System |
| BIDI | Bidirectional |
| CN | Campus North |
| CP | Component Piece |
| CPU | Central Processing Unit |
| CSA | Client Server Applications |
| CSI | Consumer Software, Inc. |
| DABU | Data Access Business Unit |
| DAD | Desktop Applications Division |
| DBCS | Double Type Character Set |
| DBMS | Database Management Systems |
| DDT | Database and Development Tools |
| DK | Dorling Kindersley |
| DLL | Dynamic Load Library |
| DOEM | Domestic Original Equipment Manufacturer |
| Domestic | Includes Redmond, Campus North, Puerto Rico and Workgroup Canada |
| DOS | Disk Operating System |
| DSO | Days Sales Outstanding |
| EBU | Entry Business Unit |
| ECU | European Currency Unit |
| EPS | Earnings Per Share |
| ERISA | Employee Retirement Income Security Act |
| ESPP | Employee Stock Purchase Plan |
| EU | Equivalent Units |
| F&A | Finance and Administrative |
| FG | Finished Goods |
| FX | Foreign Exchange |
| GAAP | Generally Accepted Accounting Principles |
| G&A | General and Administration |
| GBU | Graphics Business Unit |
| GLVR | Government Large Volume Reseller |
| GUI | Graphical User Interface |
| GULP | Global Update License Pack |
| ICON | Intercontinental - Includes Latin America, AIME and APAC regions |
| IFF | International Focus Factory |
| IFG | International Finished Goods |
| IOEM | International Original Equipment Manufacturer |
| IPG | International Product Group |
| IPO | Initial Public Offering |
| IPR | Intellectual Property Rights |
| ISV | Independent Software Vendor |
| ITG | Information Technology Group |
| JIT | Just-in-Time Manufacturing |
| LCA | Law & Corporate Affairs |
| LM2 | Lan Man 2.0 |

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