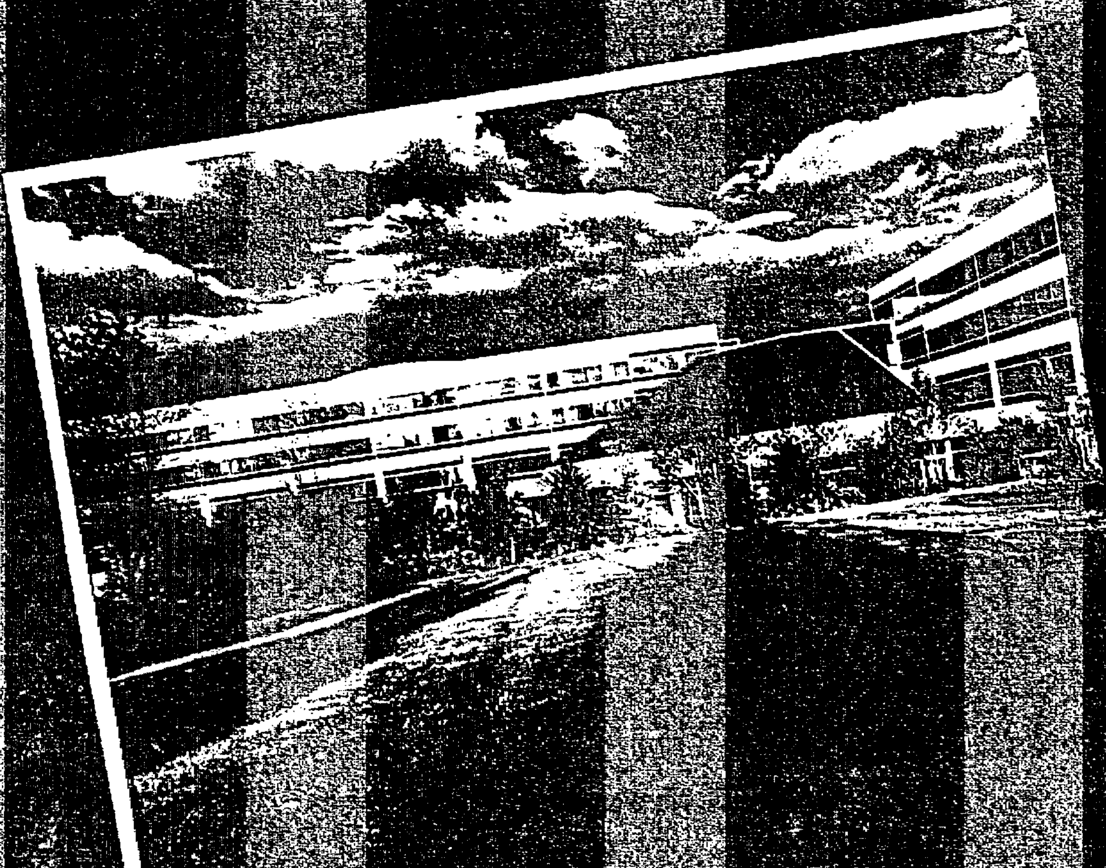

PETE HIGGINS
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BOARD OF DIRECTORS' REPORT

Microsoft Corporation

Q95-1 Board of Directors' Report

To : Q95-1 Board of Directors' Report Recipients

From : John Connors, Corporate Controller

CC: Mike Huber, Bob Lunn, Scott Boggs, Rick Grindley, Craig Bruya, Kevin Dillon, Bill Landefeld, Nell Miller, John Schiemer

Date: October 20, 1994

Subject : Q95-1 Board of Directors' Report

The quarterly Board of Directors' Report has been a Microsoft tradition which is entering it's eighth year. The report was initiated with the objective of communicating financial information about the company to the Board and executives in a consistent format at regular quarterly intervals. I think most recipients and users would agree the objective has been achieved.

In addition to continuing to meet the original objective, my staff and I have concluded that the objective for the Report should be expanded to meet the financial information needs and education of a broader audience, specifically all of executive staff and other key managers worldwide. To achieve this expanded objective, several changes in our approach to producing the report have been introduced with this quarter's publication. The specific changes are as follows:

<u>SEC Plus View</u>: The traditional SEC P&L's summarize both Sales & Marketing and Research & Development. Based on feedback we have received from key executives, we have developed what we call an "SEC Plus" view. The SEC Plus view breaks out separately the marketing spend in both Mike Maples and Nathan Mhyrvold's organization from that spending managed in Steve Ballmer's organization. Additionally, the SEC Plus view identifies separately Mike's R&D spending from Nathan's, both of which are combined in SEC P&L's. The SEC Plus view can be found in the Microsoft Results section on page 1.

<u>Revenue Summary</u>: The Revenue Summary report developed over the last year has become the standard revenue view the Company uses in interpreting our product sales worldwide. As our product line expands and our geographic reach extends, it is critical that channel, product and operations management use a common revenue data set to interpret and discuss the company's results. The Board Report incorporates the Revenue Summary view for Q95-1. In addition to the Revenue Summary, the Controller's organization is also working to standardize management reporting for all other financial information we produce. The Revenue Summary can be found in the Microsoft Results section on page 4 and in the Sales, Marketing & PSS section on pages C2 and C3. In addition to the Revenue Summary, we have included a brief description and reconciliation which will help facilitate your understanding of the Revenue Summary and the means by which we reconcile this report to product division revenue. This reconciliation can be found in the Supplemental Information section on page S1.

<u>Operations</u>: Worldwide Operations has taken on an expanded role since the company reorganized last spring. Operations is charged with managing a budget in excess of $900 million for FY95, the overwhelming majority of which is included in cost of revenue. We have devoted a specific section to Operations, reflecting it's significance to the business. The section will be expanded throughout the year as we improve our analysis of cost of revenue on a worldwide basis, and as Operations formalizes critical non-financial metrics they will be using to measure their progress. The Operations section can be found behind the Worldwide Operations tab.

<u>Cost Centers</u>: Cost Centers is an organization formed in the Controller's group in Q94-4. The group is responsible for measuring and supporting ITG, Facilities, Finance, HR , Legal and PSS. In addition, the group is responsible for ensuring we achieve standardization in headcount taxonomies worldwide, and that we report such information on a regular systematic basis. Cost Centers have also been devoted a specific section. Throughout the year we will report information for these areas that will help broaden your understanding of the Company's support organizations. The Cost Centers section can be found behind the Cost Centers tab.

<u>Feature Feature</u>: Mike Brown suggested we select a particular topic or group each quarter, and provide a brief but in depth feature section. The feature section this quarter is an overview of the Business Systems Division. The section can be found in the Product Division section on page P8. I welcome your input for feature sections in the future.

<u>Management Reporting</u>: The Management Reporting team in our Corporate Accounting group has developed an extensive set of management reports. The creation of this data is only the first step in our management reporting process. The next steps are to ensure we have executed an efficient distribution process and an effective education campaign. Toward an effective distribution process we have devoted a server which will allow on-line distribution of management information. This information is described in the Microsoft's Management Accounting Principles and Management Reporting article found in the Supplemental Information section on page S2 and S3. Over the next quarter each Controller will be responsible for ensuring an effective education campaign has been achieved for their area of responsibility.

Please feel free to contact me with any comments, questions or criticisms you have with the Board Report.

Q95-1 Board of Directors' Report

Contents

This report was prepared with Word for Windows 6.0. All tables were created in Excel 5.0 and either embedded in the document or linked to master spreadsheets. Additionally, most of the channel and product group tables were generated via automation from the general ledger. Each of these automated tables is made accurate in its calculations by using data at a lower level than the rounded amounts shown in this report. These lower level amounts are used to calculate variances and are then rounded and displayed in this report. Therefore, individual amounts are rounded perfectly but totals and variances may not foot precisely. All other tables have individual numbers that may be rounded. While these individual numbers may not tie precisely to supporting schedules, they will foot exactly as shown in this report.

NOTE: Revenue is "net" unless otherwise stated. Gross revenue is net of returns.

Finance

Microsoft Results

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Microsoft Results

Income Statement & Key Ratios
(IN MILLIONS, EXCEPT NET INCOME PER SHARE)

	Q95-1					
	Actual		Plan		Variance	
Net revenue	$1,246.7	100.0%	$1,125.5	100.0%	$121.2	10.8%
Cost of revenue	186.3	14.9	181.9	16.2	4.4	2.4%
Gross profit	1,060.4	85.1	943.7	83.8	116.8	12.4%
Operating expenses						
Research & development						
Worldwide Product Groups:						
Product R&D	149.7	12.0	189.8	16.9	40.1	21.1%
Product marketing, internal	16.3	1.3	17.4	1.5	1.1	6.3%
Product marketing, external	19.4	1.6	31.9	2.8	12.6	39.3%
Total WW Product Groups	185.3	14.9	239.1	21.2	53.8	22.5%
Worldwide Advanced Technology:						
AT R&D	28.5	2.3	31.2	2.8	2.8	8.8%
Product marketing, internal	1.3	0.1	1.9	0.2	0.6	30.3%
Product marketing, external	0.4	0.0	3.0	0.3	2.6	85.8%
Total WW Advanced Technology	30.2	2.4	36.1	3.2	5.9	16.4%
Total	215.5	17.3	275.2	24.5	59.7	21.7%
Sales & marketing						
Sales	181.2	14.5	192.2	17.1	11.1	5.8%
Channel marketing	104.4	8.4	88.1	7.8	(16.3)	(18.5%)
Broad reach	3.6	0.3	37.5	3.3	33.9	90.4%
Support	67.7	5.4	76.6	6.8	8.8	11.5%
Total	357.0	28.6	394.4	35.0	37.5	9.5%
General and administrative	51.1	4.1	80.4	7.1	29.3	36.4%
Total operating expenses	623.6	50.0	750.0	66.6	126.4	16.9%
Operating income	436.8	35.0	193.6	17.2	243.2	125.6%
Other income	34.2	2.7	27.6	2.5	6.6	24.0%
Income before income taxes	471.0	37.8	221.2	19.7	249.8	112.9%
Income taxes	155.4	12.5	75.3	6.7	80.1	106.4%
Net income	$315.6	25.3%	$145.9	13.0%	$169.6	116.2%
Net income per share	$0.51		$0.39		$0.12	30.8%
Avg shares outstanding	622,204		605,824		16,380	2.7%

Metrics Summary (annualized in thousands, except headcount)

	Q93-1	Q93-2	Q93-3	Q93-4	Q94-1	Q94-2	Q94-3	Q94-4	Q95-1
Net revenue per employee	$275	$299	$287	$294	$271	$308	$337	$347	$326
People expense per employee	69	68	66	71	73	74	73	87	85
Infrastructure expense per employee	23	23	23	26	21	23	31	35	29
Marketing expense % net revenue	10%	12%	10%	7%	9%	9%	8%	9%	10%
R&D expense % net revenue	13%	12%	12%	13%	14%	13%	12%	13%	14%
PSS expense % net revenue	5%	4%	4%	5%	5%	5%	5%	6%	5%
Headcount	12,220	12,888	13,802	14,430	14,609	14,737	14,773	15,017	15,605

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MICROSOFT & COMPETITOR HIGHLIGHTS

Microsoft

- Q95-1 revenue increased 27% over the comparable quarter one year ago. EPS increased 30%.
- Announced Microsoft Windows 95 as the official name for the next major release of Windows.
- Unveiled Microsoft BackOffice, the integrated information system for businesses which includes NT Server 3.5, SQL Server, SNA Server, Systems Management Server, and Mail Server.
- Announced intent to acquire Intuit in a $1.5 billion stock exchange. The transaction has been approved by both Boards of Directors and is expected to close in six to nine months.
- U.S. Ninth Circuit Court of Appeals ruled in favor of Microsoft and Hewlett-Packard in Apple's copyright infringement lawsuit.
- Appointment and promotion: Dick Hackborn to Board of Directors and Mike Brown to CFO.
- Quarter-end headcount of 15,605 was 7% above one year ago and 11% below plan.

Novell

- Anticipated release dates: NetWare 4.1 in December 1994 and UnixWare 2.0 in January 1995.
- Announced liaison with Sybase to provide a bundle of five Sybase products with NetWare or UnixWare (SybaseWare) and an associated business model including distribution, training, and support.
- Release of Perfect Office 3.0 will slip to November.
- Announced that TCP/IP will be a core protocol within NetWare in 1995.
- Novell will layoff 1,650 employees: 1,100 in the October quarter and the remainder early in fiscal 1995.

Lotus

- Announced that Sun will bundle Notes with every Sun SPARC server system shipped during 1995.
- Began shipping Lotus Notes Server for NT, Notes Express, 1-2-3 Release 5, SmartSuite 3.0, and Approach 3.0.
- September quarter revenue fell 2% from the prior year due to weak Europe sales and "slower-than-expected conversion of customers' non-binding purchase commitments into actual sales under the volume sales program."
- Analysts estimate that Notes and communications business will account for 50% of Lotus revenue by the end of 1995.
- Analysts believe that weak desktop applications business coupled with management's commitment of 15% operating margins will lead to layoffs.

Oracle

- Oracle stock price has risen from $4 in 1991 to $44 in 1994.
- Announced Oracle Media Server, which will allow digitally compressed text, video, and audio data to be stored and transmitted throughout an enterprise.
- Announced an agreement with Lotus to provide interoperability of Lotus Notes and the new Oracle Media Server.
- Announced a new version of Oracle tools called CDE2, which supports Windows and OLE 2.0.
- Announced Oracle Documents, a suite of application services that includes workflow automation similar to Lotus Notes.

Authors: Jerry Masters & Linda Morgenstern

Comparative Cash Flow & Balance Sheet

Cash Flow Summary (in millions)

	Q94-4	Q95-1	Change
Cash and short-term investments, beginning of quarter	$3,143	$3,614	$471
Cash flow:			
Net income	362	316	(46)
Depreciation and other non-cash items	168	74	(94)
Cash from operations	530	390	(140)
Common stock issued	87	81	(6)
Common stock repurchased	(37)	(242)	(205)
Stock option income tax benefits	42	39	(3)
Cash generated from financing	92	(122)	(214)
Additions to property, plant, and equipment	(112)	(67)	45
Other	(32)	(35)	(3)
Cash used for investments	(144)	(102)	42
Effect of exchange rates on cash	(7)	(4)	3
Net change in cash & short-term investments	471	162	(309)
Cash and short-term investments, end of quarter	$3,614	$3,776	$162

Balance Sheet (in millions)

	Jun. 30, 1994		Sep. 30, 1994		Change	
Assets						
Current assets:						
Cash and short-term investments	$3,614	67%	$3,776	67%	$162	4%
Accounts receivable - net	475	9	527	9	52	11
Inventories:						
Raw materials	45	1	52	1	7	16
Finished goods	57	1	56	1	(1)	(2)
Total inventories	102	2	108	2	6	6
Other	121	3	143	2	22	18
Total current assets	4,312	81	4,554	80	242	6
Property, plant, and equipment - net:						
Land	161	3	163	3	2	1
Buildings	386	7	390	7	4	1
Leasehold improvements	80	1	77	1	(3)	(4)
Furniture & equipment	105	2	106	2	1	1
Computer equipment	198	4	200	4	2	1
Total property, plant, and equipment - net	930	17	936	17	6	1
Other assets	121	2	147	3	26	21
Total assets	$5,363	100%	$5,637	100%	$274	5
Liabilities and Stockholders' Equity						
Current liabilities:						
Accounts payable	$ 324	6%	$ 354	6%	$ 30	9
Accrued compensation	96	2	81	1	(15)	(16)
Income taxes payable	305	4	369	6	64	21
Other	188	4	200	4	12	6
Total current liabilities	913	16	1,004	17	91	10
Put Warrants	0	0	203	4	203	NM
Stockholders' equity:						
Common stock and paid-in capital	1,500	29	1,606	29	106	7
Retained earnings	2,950	55	2,824	50	(126)	(4)
Total stockholders' equity	4,450	84	4,430	79	(20)	0
Total liabilities and stockholders' equity	$5,363	100%	$5,637	100%	$274	5

- In Q95-1 MS sold 4 million put warrants on MS stock, with strike prices ranging from $48.46 to $52.93 and maturities of 3-18 months. Approximately 1.6 million of these puts expire in Q95-2. MS received a $10 million premium on the sale of these puts. A liability of $203 million was recorded as an offset to retained earnings to recognize the amount that would be required to purchase all 4 million shares at their respective strike prices.

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Q95-1 REVENUE SUMMARY
(REVENUE IN MILLIONS, LICENSES IN THOUSANDS)

	Gross Revenue		Licenses	
	Actual	% of Plan	Actual	% of Plan
Finished Goods				
Office	$261.3	134 %	1,040	159 %
Office Professional	90.1	151	344	228
Excel	52.9	79	291	72
Word	72.1	98	508	104
Graphics	11.4	123	96	168
Access	31.6	133	211	154
Project	28.3	111	89	112
Desktop Apps New Users	**547.7**	**121**	**2,579**	**131**
Office	41.2	161	300	214
Office Professional	8.9	100	59	181
Excel	8.6	51	145	79
Word	17.3	99	249	129
Graphics	1.0	50	35	173
Access	7.2	159	105	227
Project	5.9	139	53	133
Desktop Apps Existing Users	**90.1**	**114**	**945**	**144**
Windows	58.7	168	1,151	205
MS-DOS	22.1	208	625	236
Win95 (Chicago)	.0	NM	0	NM
Win95 Add-Ons (Frosting)	.0	NM	0	NM
Personal Operating Systems	**80.8**	**176**	**1,776**	**214**
Family Reference	8.8	36	148	41
Input Device	29.8	101	615	99
Kids/Games	18.0	108	599	113
Lifestyles	5.8	105	149	98
Personal Tools	9.0	88	190	101
Transactions	1.1	39	89	96
Works	21.2	86	392	97
Consumer	**93.6**	**82**	**2,183**	**93**
Windows NT	4.9	57	28	59
Mail - Servers	5.2	104	16	108
Mail - Users	2.8	43	101	44
Other Network	5.5	227	22	361
SMS, SNA Server	1.1	53	1	3
Windows NT Advanced Server-Servers	10.9	100	17	90
Windows NT Advanced Server-Users	.7	11	32	13
SQL Server - Servers	10.7	83	5	88
SQL Server - Users	.1	3	0	0
Mail - AddOns, Upgrades	4.6	116	99	128
Business Systems	**46.5**	**75**	**320**	**45**
Developer Kits	8.1	NM	53	NM
Fox	13.4	128	122	145
Languages	15.2	93	76	87
Visual Basic	17.5	152	107	142
MSIN	4.7	68	13	54
Developer	**59.0**	**129**	**371**	**135**
At Work	.5	70	10	73
MS Education Services	.3	NM	1	NM
Other	13.2	NM	131	24
Total FG	**931.5**	**115**	**8,315**	**113**
AT	**7.1**	**110**	**7**	**NM**
Press	**9.6**	**134**	**0**	**NM**
OEM				
Windows	$144.7	115	7,257	111
MS-DOS	132.9	109	7,569	106
Mouse	18.5	150	1,613	142
Works	5.7	67	761	61
LAN Manager	5.8	NM	195	NM
Other	.9	97	NM	NM
Total OEM	**308.5**	**94**	**24,116**	**136**
Gross revenue	**1,256.7**	**109**	**32,438**	**129**
Revenue adjustments	(10.0)			
Net revenue	**$1,246.7**			

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KEY PRODUCTS RELEASE SCHEDULE

Business Unit / Product:	RTM Date Act/Fcst	RTM Date Plan
Desktop Applications:		
Mac Word 6.0 (Mac Office 4.2)	Aug-94	Aug-94
Mac Excel 5.0	Aug-94	Aug-94
Mac PowerPoint	Aug-94	Aug-94
Mac Project	Oct-94	Oct-94
Win Office 95	Mar-95	Mar-95
Business Systems:		
Windows NT Workstation 3.5	Sep-94	Sep-94
Windows NT Server 3.5	Sep-94	Sep-94
MS SNA Server 2.1	Sep-94	Oct-94
MS SQL Server 4.21a	Sep-94	Sep-94
Systems Management Server	Nov-94	Oct-94
MS Exchange Server 1.0	Jun-95	Jun-95
Personal Operating Systems:		
Windows 95 Preview Program	Dec-94	Dec-94
Windows 95	Feb-95	Feb-95
Developer:		
Visual C++ 2.0	Sep-94	Sep-94
Visual Basic 4.0	Jan-95	Oct-94
FoxPro 3.0	Feb-95	Feb-95
Visual C++ 3.0	May-95	May-95
Consumer:		
Home Mouse	Jul-94	Jul-94
Natural Keyboard	Jul-94	Jul-94
Scenes 2.0	Aug-94	Aug-94
Golf 2.0	Aug-94	Aug-94
Space Simulator	Sep-94	Sep-94
Magic School Bus	Sep-94	Sep-94
Encarta 95	Sep-94	Aug-94
Cinemania 95	Sep-94	Sep-94
Creative Writer & Fine Artist 1.1	Oct-94	Oct-94
Haunted House	Oct-94	Oct-94
Complete Basketball	Oct-94	Oct-94
Ultimate Frank Lloyd Wright	Oct-94	Oct-94
Works 4.0 PPC	Oct-94	Oct-94
Explorapedia	Nov-94	Nov-94
Utopia	Dec-94	Dec-94
Rabbit Ears	Dec-94	Dec-94
Martian Chronicles	Dec-94	Dec-94
Bookshelf 95	Feb-95	Feb-95
Baseball The Game	Feb-95	Feb-95
Wine Guide	Feb-95	Feb-95
Julia Child Cooking	Mar-95	Mar-95
500 Nations	Mar-95	Mar-95
Exploration Series	Q95-3	Q95-3
Publisher 3.0	Q95-4	Q95-4
Works 95	Q95-4	Q95-4
Advanced Technology Divisions		
Timex Data Link Watch	Sep-94	Sep-94
Marvel 1.0	Feb-95	Feb-95
Softimage Digital Studio	Q95-3	Q95-3

Finance

Sales, Marketing & Product Support

Sales, Mktg & PSS

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Summary

Results of Operations
(IN MILLIONS)

Q95-1

	Net Revenue		Gross Profit		Responsibility Margin		Contribution Margin	
	Actual	% of Plan	Actual	% of Plan	Actual	% of Plan	Actual	% of Plan
North America FG	$445.9	116 %	$360.1	122 %	$209.2	193 %	$137.5	497 %
Europe FG	253.9	94	215.2	96	122.4	108	64.1	155
ICON FG	89.5	117	73.8	127	45.5	177	30.4	455
Far East FG	96.7	165	75.8	174	50.6	403	37.1	NM
WW OEM	348.4	106	333.1	105	315.4	106	231.2	122
Other AT	7.9	104	5.6	109	(.5)	NM	(2.6)	NM
Other	4.4	NM	(3.1)	NM	(57.3)	NM	(60.9)	NM
Worldwide	$1,246.7	111	$1,060.4	112	$685.2	135	$436.8	226

	Net Revenue Mix		Gross Profit % Net Revenue		Responsibility Margin		Contribution Margin	
	Actual	Plan	Actual	Plan	Actual	Plan	Actual	Plan
North America FG	36 %	34 %	81 %	77 %	47 %	28 %	31 %	7 %
Europe FG	20	24	85	83	48	42	25	15
ICON FG	7	7	82	76	51	34	34	9
Far East FG	8	5	78	74	52	21	38	(7)
WW OEM	28	29	96	97	91	90	66	58
Other AT	1	1	71	68	(6)	(46)	(33)	(90)
Other	0	0	(70)	NM	NM	NM	NM	NM
Worldwide	100 %	100 %	85	84	55	45	35	17

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FINISHED GOODS REVENUE SUMMARY

GROSS REVENUE (IN MILLIONS)

Q95-1

	North America		Europe		ICON		Far East		Worldwide	
	Actual	% of Plan	Actual	% of Plan	Actual	% of Plan	Actual	% of Plan	Actual	% of Plan
Finished Goods:										
Office	$121.3	141 %	$65.4	93 %	$32.5	151 %	$42.1	249 %	$261.3	134 %
Office Professional	46.0	241	31.6	93	11.5	192	.9	141	90.1	151
Excel	21.7	70	15.4	64	2.8	68	12.9	170	52.9	79
Word	37.1	121	24.8	78	5.3	92	4.9	95	72.1	98
Graphics	7.6	115	1.9	136	.7	168	1.2	144	11.4	123
Access	15.8	157	7.8	88	2.7	170	5.2	165	31.6	133
Project	18.2	113	7.0	103	2.7	115	.4	144	28.3	111
Desktop Apps New Users	**267.7**	**134**	**153.9**	**87**	**58.3**	**139**	**67.7**	**195**	**547.7**	**121**
Office	27.1	308	9.9	99	3.8	119	.4	10	41.2	161
Office Professional	3.7	407	4.3	62	.9	94	.0	24	8.9	100
Excel	3.6	38	5.4	87	1.2	134	(1.6)	NM	8.6	51
Word	7.3	83	6.9	100	1.1	79	2.1	607	17.3	99
Graphics	.3	22	.5	166	.2	130	.0	46	1.0	50
Access	1.8	77	4.8	294	.5	95	.1	241	7.2	159
Project	3.7	111	1.7	313	.5	126	.0	200	5.9	139
Desktop Apps Existing Users	**47.5**	**135**	**33.4**	**103**	**8.2**	**109**	**.9**	**23**	**90.1**	**114**
Windows	31.8	198	14.2	155	8.6	131	4.1	127	58.7	168
MS-DOS	13.4	273	5.8	194	2.4	113	.6	92	22.1	208
Win95 (Chicago)	.0	NM	.0	NM	.0	N/A	.0	N/A	.0	N/A
Win95 Add-Ons (Frosting)	.0	NM	.0	NM	.0	NM	.0	NM	.0	NM
Personal Operating Systems	**45.2**	**216**	**20.0**	**165**	**11.0**	**125**	**4.7**	**114**	**80.8**	**176**
Family Reference	6.4	30	1.3	81	1.0	77	.1	36	8.8	36
Input Device	22.8	120	4.4	64	1.6	66	1.0	81	29.8	101
Kids/Games	14.1	155	2.3	47	.7	52	.9	66	18.0	108
Lifestyles	3.7	181	1.4	77	.5	56	.3	34	5.8	105
Personal Tools	7.3	98	1.0	58	.6	68	.0	50	9.0	88
Transactions	.5	33	.5	49	.1	43	.0	19	1.1	39
Works	11.0	88	7.6	90	1.8	87	.8	47	21.2	86
Consumer	**65.8**	**90**	**18.4**	**70**	**6.2**	**69**	**3.1**	**57**	**93.6**	**82**
Windows NT	3.8	95	.7	22	.2	20	.2	30	4.9	57
Mail - Servers	2.8	133	1.7	103	.4	59	.2	51	5.2	104
Mail - Users	1.6	43	.7	40	.2	28	.3	86	2.8	43
Other Network	2.6	189	1.9	237	.4	246	.7	592	5.5	227
SMS, SNA Server	.6	58	.3	47	.1	44	.1	59	1.1	53
Windows NT Advanced Server-Servers	6.6	118	1.7	49	.9	77	1.8	212	10.9	100
Windows NT Advanced Server-Users	.7	24	.0	N/A	.0	N/A	.0	N/A	.7	11
SQL Server - Servers	5.1	51	2.5	181	1.0	150	2.0	312	10.7	83
SQL Server - Users	.0	N/A	.0	N/A	.0	N/A	.1	20	.1	3
Mail - AddOns, Upgrades	3.4	115	.8	114	.3	122	.1	360	4.6	116
Business Systems	**27.3**	**79**	**10.2**	**61**	**3.6**	**51**	**5.5**	**129**	**46.5**	**75**
Developer Kits	3.9	NM	2.4	NM	.6	NM	1.2	NM	8.1	NM
Fox	5.7	123	2.9	84	3.0	172	1.8	297	13.4	128
Languages	4.6	61	2.5	62	.7	75	7.4	195	15.2	93
Visual Basic	7.8	193	4.1	89	1.3	101	4.4	258	17.5	152
MSIN	3.7	69	.9	126	.0	1	.0	N/A	4.7	68
Developer	**25.7**	**118**	**12.8**	**98**	**5.7**	**131**	**14.9**	**225**	**59.0**	**129**
At Work	.3	57	.1	76	.0	NM	.0	NM	.5	70
MS Education Services	.3	NM	.0	NM	.0	NM	.0	NM	.3	NM
Other	4.6	NM	8.6	NM	(.9)	NM	.8	NM	13.2	NM
Total FG	**$484.4**	**123**	**$257.4**	**92**	**$92.0**	**117**	**$97.7**	**164**	**$931.5**	**115**

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FINISHED GOODS PRICING SUMMARY
(U.S.$ PER LICENSE)

Q95-1

	North America		Europe		ICON		Far East		Worldwide	
	Actual	Plan	Actual	Plan	Actual	Plan	Actual	Plan	Actual	Plan
Finished Goods:										
Office	$235	$296	$314	$321	$219	$265	$253	$265	$251	$297
Office Professional	235	369	320	429	250	329	311	307	262	395
Excel	167	150	192	197	123	134	226	178	182	166
Word	129	130	163	181	123	133	184	147	142	150
Graphics	165	161	54	208	123	140	143	139	120	163
Access	137	154	172	214	118	143	189	167	149	173
Project	324	326	335	328	249	267	339	312	318	320
Desktop Apps New Users	**199**	**212**	**240**	**267**	**194**	**212**	**233**	**204**	**212**	**230**
Office	137	193	152	219	109	137	157	138	137	182
Office Professional	129	183	197	318	123	185	32	316	152	275
Excel	81	86	64	105	43	71	123	89	60	91
Word	76	87	67	104	41	68	87	68	70	90
Graphics	21	94	32	111	50	78	6	70	28	95
Access	34	100	110	105	75	79	72	55	69	98
Project	106	110	127	140	104	65	87	99	111	107
Desktop Apps Existing Users	**101**	**106**	**97**	**152**	**73**	**99**	**57**	**125**	**95**	**121**
Windows	50	67	56	59	43	55	69	70	51	62
MS-DOS	37	46	34	38	33	33	34	36	35	40
Win95 (Chicago)	NM	NM	NM	NM	NM	55	NM	63	NM	61
Win95 Add-Ons (Frosting)	NM	NM	NM	NM	NM	NM	12	NM	12	NM
Personal Operating Systems	**45**	**61**	**47**	**52**	**40**	**47**	**61**	**61**	**45**	**55**
Family Reference	64	72	66	46	37	53	74	73	59	68
Input Device	49	54	50	40	41	36	49	41	48	47
Kids/Games	30	30	27	33	22	30	49	40	30	31
Lifestyles	42	36	35	38	31	32	47	43	39	37
Personal Tools	45	54	67	60	46	50	51	29	47	54
Transactions	8	27	31	34	18	26	10	46	12	29
Works	48	57	64	69	43	46	191	108	54	61
Consumer	**42**	**51**	**49**	**45**	**37**	**39**	**59**	**51**	**43**	**48**
Windows NT	165	175	202	182	145	160	307	192	173	177
Mail - Servers	294	268	365	438	301	303	437	500	320	331
Mail - Users	24	26	33	36	35	29	42	30	28	29
Other Network	355	598	273	489	76	183	281	92	256	408
SMS, SNA Server	2,120	97	1,214	111	1,249	112	1,410	239	1,625	106
Windows NT Advanced Server-Servers	546	782	587	501	773	360	1,745	456	641	578
Windows NT Advanced Server-Users	23	25	NM	29	NM	33	NM	25	23	27
SQL Server - Servers	2,059	2,924	1,857	1,167	1,683	974	2,410	1,022	2,019	2,145
SQL Server - Users	NM	24	NM	113	NM	104	1,506	79	1,506	74
Mail - AddOns, Upgrades	46	51	56	58	41	46	40	47	47	51
Business Systems	**120**	**87**	**191**	**95**	**145**	**76**	**386**	**100**	**145**	**88**
Developer Kits	129	55	179	192	113	236	295	NM	153	137
Fox	87	107	128	145	120	138	210	147	110	125
Languages	149	214	153	176	109	167	324	155	199	185
Visual Basic	152	143	157	150	137	143	218	220	165	154
MSIN	345	350	416	158	369	173	NM	188	357	285
Developer	**136**	**176**	**159**	**157**	**121**	**148**	**266**	**169**	**159**	**166**
At Work	**60**	**43**	**25**	**83**	**56**	**NM**	**77**	**NM**	**46**	**48**
MS Education Services	**312**	**NM**	**NM**	**NM**	**NM**	**NM**	**NM**	**NM**	**312**	**NM**
Average FG Revenue per License	**$100**	**$96**	**$133**	**$142**	**$102**	**$97**	**$193**	**$129**	**$114**	**$110**

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SUBSIDIARY PERFORMANCE

NET REVENUE AND RESPONSIBILITY MARGIN (IN MILLIONS)

Q95-1

	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	$ 419.9	117 %	$ 197.2	198 %	$ 668.2	120 %	$ 421.4	157 %
Canada	26.0	109	12.0	135	26.7	112	12.5	140
	445.9	116	209.2	193	694.9	120	433.9	156
Europe								
Denmark	4.4	89	1.4	99	4.9	86	1.9	83
Finland	3.4	138	1.2	214	6.3	114	4.0	114
Norway	6.1	148	2.8	258	6.9	118	3.4	126
England	65.0	113	38.9	146	70.1	104	43.0	121
Sweden	11.5	93	4.1	104	12.8	92	5.3	100
Hungary	1.9	245	0.9	(563)	2.0	165	1.0	456
Russia	1.7	143	0.6	(945)	1.8	107	0.7	184
Czechoslovakia	3.4	189	2.3	443	3.9	153	2.8	226
Switzerland	13.9	73	6.4	61	14.6	73	7.1	62
Germany	47.5	64	17.3	47	58.7	56	27.3	41
Poland	2.1	171	1.0	1019	2.5	101	1.3	106
Austria	6.2	72	2.8	60	6.6	71	3.1	60
Netherlands	9.8	113	5.3	128	12.3	109	7.7	117
Spain	4.5	168	1.8	(1428)	5.3	138	2.5	284
France	44.8	90	23.7	101	47.8	89	26.2	97
Italy	16.8	134	11.5	217	21.2	109	15.8	131
Belgium	7.4	136	3.6	209	8.6	142	4.6	201
Portugal	3.8	163	2.3	196	3.9	148	2.4	163
Slovenia	-	0	(0.0)	(11)	0.0	5	(0.0)	(0)
EHQ / Other	(0.3)	(173)	(5.7)	82	0.1	NM	(5.5)	78
	253.9	94	122.4	106	290.3	86	154.6	86
ICON								
Caribbean	1.3	125	0.7	282	1.7	142	1.1	267
Ecuador	0.1	46	(0.1)	(249)	0.1	27	(0.1)	(50)
Chile	1.6	108	0.8	138	1.7	103	0.9	121
Colombia	4.0	176	2.5	245	4.0	161	2.6	204
Venezuela	1.2	120	0.6	172	1.2	108	0.6	127
Brazil	10.5	115	4.8	124	12.9	113	7.1	119
Argentina	3.8	116	1.9	162	4.1	114	2.2	154
Mexico	11.6	121	6.7	159	12.7	114	7.7	138
Morocco	0.4	92	0.0	21	0.4	95	0.0	52
Middle East	2.5	109	0.6	210	2.6	113	0.7	309
Turkey	0.3	256	(0.2)	77	0.3	148	(0.2)	100
South Africa	7.5	137	4.6	227	8.4	140	5.4	222
Greece	0.7	107	0.3	192	0.8	98	0.3	133
Israel	1.5	74	0.8	73	1.9	77	1.1	75
India	1.1	113	0.6	141	1.4	115	0.9	133
Thailand	0.8	119	0.5	212	0.9	106	0.5	152
Malaysia	1.7	156	1.0	339	1.7	115	1.0	145
Singapore	3.3	111	2.0	155	14.7	189	11.9	202
New Zealand	5.2	109	2.9	153	5.6	109	3.2	146
Australia	29.6	115	16.7	174	34.2	115	20.8	157
Philippines/Indonesia	0.5	61	0.3	71	0.5	64	0.4	76
Peru	0.5	89	0.2	306	0.5	89	0.2	334
RHQ/Other	(0.0)	NM	(2.8)	84	0.1	12	(2.8)	92
	89.5	117	45.5	177	112.2	121	65.5	161
Far East								
PRC	0.5	33	(0.1)	(49)	0.5	33	(0.1)	(50)
Korea	7.5	131	4.3	177	8.7	72	5.4	63
Taiwan	5.3	125	3.0	595	16.0	127	13.5	161
Japan	78.3	183	41.0	499	105.0	145	66.7	181
Hong Kong	5.1	113	3.0	137	6.8	73	4.3	65
RHQ/Other	0.0	NM	(0.7)	70	0.1	NM	(0.8)	77
	96.7	165	50.6	400	137.1	127	89.0	149
Worldwide								
Other	12.3	163	(57.8)	118	12.3	145	(57.8)	116
Total	$ 898.3	113	$ 369.8	173	$ 1,246.7	111	$ 685.2	135

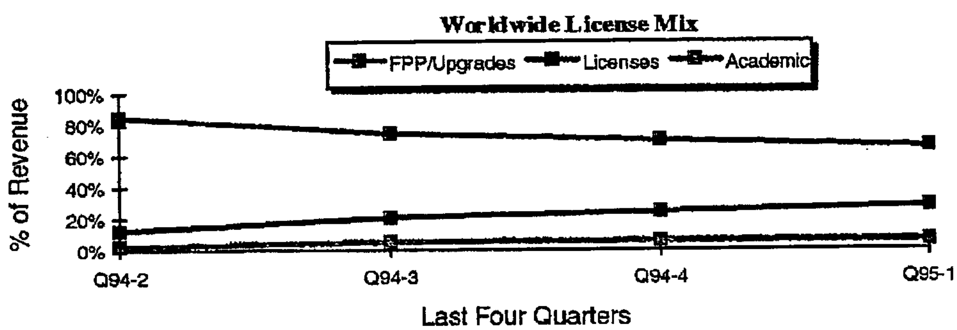
GROSS REVENUE HIGHLIGHTS

Revenue Summary:

- Net revenue across all regions with the exception of Europe exceeded plan. Japan became the second largest subsidiary behind the US during Q95-1.
- Office and Office Professional exceeded expectations following the roll out of localized product in ICON and Far East, as well as the continued success of 'suite' products versus stand-alone applications. Market share for Office products in many countries continues to improve. European sales of Desktop Applications, which represents 60% of the region's revenue, were 10% under plan.
- Personal Operating Systems revenue exceeded plan in all regions. North American volumes followed a trend established in FY94 by exceeding plan. Sales volumes have not declined as anticipated pending the release of Windows 95.
- Consumer revenue was lower than plan in all regions. Sell-in of Win Encarta in North America was particularly disappointing, in part due to a later than planned product release and significant inventory in the channel. The FY95 plan assumes Consumer revenue will double in Q95-2 as compared to Q95-1 related to seasonal sales patterns and new product releases.
- The Business Systems division had weak sales across all regions except the Far East, primarily due to the later than planned release of Win NT 3.5.
- Developer revenue exceeded plan in all regions except Europe. Sales in the Far East across all Developer products were particularly strong, comprising 25% of worldwide Developer revenue and exceeding plan by 225%.

Pricing Summary:

- Office and Office Professional revenue per license across all regions, except the Far East, were lower than plan. This decrease relative to plan is primarily due to an increased trend toward Select and other license programs not assumed in the FY95 plan. Additionally, an increase in academic sales in North America contributed to a lower than planned revenue per license for these products. The table below illustrates the trend towards a greater mix of license programs relative to full package product on a worldwide basis.



- This trend, while not as significant, also negatively impacted revenue per license compared to plan for Personal Operating system sales across all regions expect the Far East.
- Far East revenue per license for major products was generally better than plan due principally to aggressive pricing assumed in the plan that has not materialized, as well as minimal business from license programs in Q95-1.
- Consumer revenue per license approximated plan across all regions with the exception of the Money product, due largely to a reduction in the per unit price for Money in North America from $19 to $9. Ironically, this reduction was intended to help Money compete against Intuit's Quicken.

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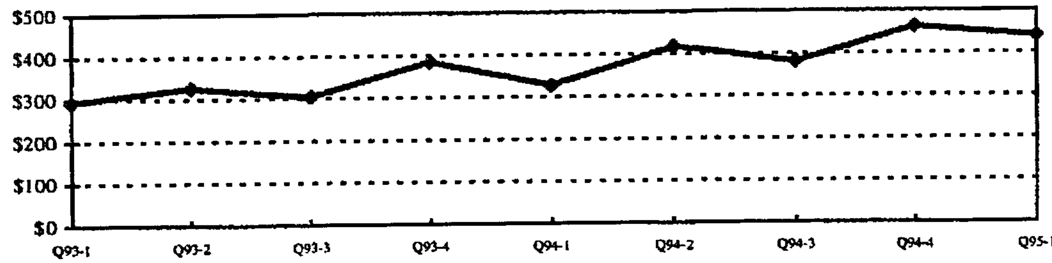
CHANNEL METRICS
(ANNUALIZED IN THOUSANDS)

	Finished Goods					
	No. Amer.	Europe	ICON	Far East	Worldwide	OEM
Net revenue per employee						
Actual Q95-1	$497	$431	$583	$987	$510	$7,129
Plan	419	433	470	539	435	6,274
Q94-4	522	632	541	626	569	7,206
Q94-3	423	655	441	945	533	6,982
Q94-2	464	545	417	590	494	5,657
Q94-1	314	440	480	607	386	5,426
People expense per employee						
Actual Q95-1	$92	$89	$92	$113	$92	$88
Plan	98	91	94	115	96	93
Q94-4	91	86	105	128	93	132
Q94-3	74	75	79	119	77	101
Q94-2	73	77	80	121	77	101
Q94-1	71	76	80	105	76	90
Infrastructure expense per employee						
Actual Q95-1	$32	$28	$36	$50	$32	$20
Plan	36	29	38	46	34	22
Q94-4	35	35	33	35	34	18
Q94-3	28	26	29	33	28	17
Q94-2	23	25	30	34	25	15
Q94-1	21	27	29	34	24	15
Marketing expense % net revenue						
Actual Q95-1	10%	10%	7%	8%	9%	0%
Plan	17%	13%	10%	20%	15%	1%
Q94-4	18%	12%	11%	11%	14%	1%
Q94-3	11%	8%	9%	7%	9%	0%
Q94-2	13%	12%	9%	12%	12%	0%
Q94-1	10%	8%	9%	13%	9%	0%

- North American revenue per employee was higher than plan in Q95-1 due to strong Desktop Applications and Personal Operating System sales, coupled with actual headcount 9% below plan. Lower than planned spending for travel & entertainment, temporary employees and training contributed to the favorable variance in people expense. Infrastructure expense was favorably impacted by lower than planned depreciation. Marketing expenses trailed plan due to a significant lag in actual spending.
- European revenue per employee approximated plan. Below plan net revenue was offset by a favorable headcount variance of 280 people and a weaker than planned dollar. People and infrastructure expenses per employee were slightly below plan, the favorable headcount variance was largely offset by higher U.S.$ expenses due to the weaker than planned dollar.
- In ICON, revenue per employee was significantly greater than plan due to sales above plan for Office and Personal Operating System products throughout the region, combined with slower than planned headcount hiring. People expenses approximated plan, despite a positive headcount variance due to increased outsourcing. Infrastructure expenses in aggregate remained lower than plan, but was largely offset by lower than planned headcount thus inflating the per employee rate.
- Far East FG revenue per employee was nearly $1 million, the result of record revenue realized during the quarter combined with headcount being 18% below plan. People expense per employee approximated plan. Infrastructure expenses per employee exceeded plan principally due to the high fixed cost of infrastructure in Japan combined with lower than planned headcount. Marketing expenses as a percent of revenue were low because of both higher revenue and below plan absolute marketing expenditures.

NORTH AMERICA FINISHED GOODS REVIEW

Net Revenue Stream (in millions)



Key Highlights

- North America FG net revenue during Q95-1 was $445.9 million, 16% above plan. The Desktop Applications and Personal Operating Systems divisions exceeded gross revenue plan by 34% and 116%, respectively.
- Strong demand for Win Office continued during Q95-1, as North America sell-in reached $99.7 million, 37% above plan. Continuing the successful launch of Access 2.0 in Q94-4, sales of Win OfficePro during Q95-1 approached $50 million, or nearly 250% of plan. Offsetting the success of Win Office was lower than planned sales of Win Excel at 38% below plan.
- New versions of Mac Excel, Mac Word, and Mac Office shipped during the quarter. Initial sell-in of Mac Office exceeded plan by 92%. The shift to the Mac suite negatively impacted sell-in of stand-alone Mac Excel and Mac Word, as sell-in for those products trailed plan by 36% and 21%, respectively.
- MS-DOS sell-in was $12.6 million, 158% of plan. Windows 3.X and Windows for Workgroups combined sales exceeded plan by 98%.
- Consumer division revenue in North America fell 10% short of plan, despite numerous new products shipped during Q95-1. Favorable sales variances to plan included Win Golf (592%), Nexus Key Board (262%), Space Simulator (95%), and Home Mouse (34%). Sell-in for Encarta trailed plan by $14.6 million as the initial sell-in of the new version slipped from August to September.
- Business Systems division sales trailed plan by 21%, primarily as a result of lower than planned sell-in of SQL server and PC Mail client.

Operational Issues

- Product returns represented approximately 6% of Q95-1 gross revenue, primarily due to update exchanges and stock balancing. In addition, a $5.7 million returns accrual was made for anticipated returns of consumer products from a new distribution partner, GT Software.
- As of the end of Q95-1, the order backlog for USFG was $56.1 million. Of this amount, $27.2 million was due to stock outs. The key products comprising the stock outs were Serial Mouse 2.0 and the Nexus Keyboard.

Marketing, Advertising and Sales Programs

- The Microsoft Open License Pack (MOLP) was launched in February, 1994, with the purpose of extending many of the Select program benefits to the large and growing medium-sized business segment. MOLP revenue was $10.8 million during Q95-1, 20% above plan.
- $3.6 million was spent during Q95-1 on advertising associated with the corporate Broad Reach campaign. Significant Broad Reach spending is anticipated in Q95-2.

Author: Shawn Rose

Results of Operations ($ in millions)

	Q95-1 Actual	Plan	Variance
Net revenue	$445.9	$383.8	$62.1
Cost of revenue	85.9	89.3	3.4
Gross profit	360.1	294.6	65.5
People	82.5	90.3	7.8
Infrastructure	28.4	32.9	4.5
Marketing	43.7	64.2	20.5
MCS	(.6)	(.2)	.4
Cost recovery programs	(8.1)	(7.2)	.9
Bad debt & taxes	4.5	4.3	(.2)
Other	.4	1.7	1.3
Controllable expenses	150.8	186.0	35.1
Responsibility margin	209.2	108.6	100.6
Shared resources	(8.7)	(10.6)	(1.9)
Shared resource margin	$218.0	$119.2	$98.7
Key ratios			
Annualized per employee (in thousands)			
Net revenue	$497	$419	$79
Salespeople expense	124	134	11
% Net revenue			
Cost of revenue	19 %	23 %	4 %
Marketing expense	10	17	7
Controllable expenses	34	48	15
Shared resource margin	49	31	18

Salespeople expense summarizes people and infrastructure expenses. Ratios reflect period results annualized.

Cost Driver Analysis

Q95-1

- Gross profit margin for the quarter was 81% of net revenue compared to plan of 77%. Higher than planned material costs, due to a significant shift in sales mix toward Academic Win Office with low revenue per license product, were more than offset by lower than planned freight, processing, manufacturing and inventory costs.
- Controllable expenses were 19% under plan for Q95-1. Headcount and resulting people expenses trailed plan by 9%. Marketing expense was 32% under plan.

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Author: Shawn Rose

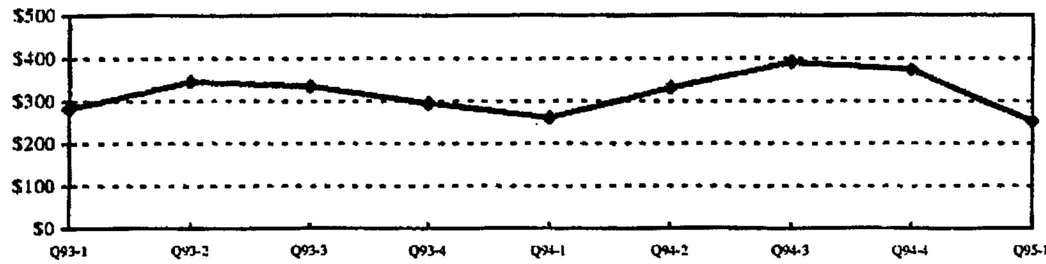
Significant Customers (in millions)

	Q93-1	Q93-2	Q93-3	Q93-4	Q94-1	Q94-2	Q94-3	Q94-4	Q95-1
Ingram Micro	$ 72	$ 61	$ 92	$ 72	$ 89	$ 146	$ 113	$ 140	$ 143
Merisel	51	56	56	51	67	99	95	99	106
Egghead	22	51	46	22	22	49	36	44	45
Software Spectrum	14	11	18	14	10	22	19	20	18
Corporate Software	10	11	17	10	9	22	18	20	24
Intelligent Electronics	5	4	5	2	5	14	9	13	14
Tech Data	—	—	—	—	6	12	9	18	13
800 Software	8	7	8	8	8	11	9	10	8
Softmart	6	6	8	6	6	10	9	15	10
Vanstar	8	8	6	9	6	6	6	8	6
	$ 196	$ 215	$ 256	$ 194	$ 228	$ 391	$ 323	$ 387	$ 387
Percent of gross revenue	73%	75%	77%	73%	74%	81%	81%	81%	80%

- Inventory for certain key products (Win NT, Win Office 4.X, Win Word 6.0 and Win Excel 5.0) in the U.S. distribution channel is tracked. As of the end of Q95-1, there was approximately 30 days of inventory in the channel for Win Office 4.X, Win Word 6.0 and Win Excel 5.0. After initial sell-in of the new version of Win NT there were 9,300 units in channel inventory, approximately 30 days of inventory at expected sales rates.
- During September, Microsoft signed a distribution agreement with Good Time Software, a subsidiary of Good Time Home Video. GT Software, a specialty consumer products distributor, will be stocking "towers" of MS Home products at the ends of aisles at between 1,700 and 2,600 WalMart stores. GT Software has the right to unlimited returns of these products through March, 1995.
- During Q95-1, Corporate Software agreed to purchase 800 Software from Digital Equipment Corporation.

EUROPE FINISHED GOODS REVIEW

Net Revenue Stream (in millions)



Key Highlights

- Net revenue (94% of plan) declined for the second consecutive quarter. While the first quarter is typically a slow period in Europe, year over year Q1 net revenue has shown a slight downward trend over the last two years. Q95-1 revenue was lower than any quarter since Q92-1.
- A shift in mix towards licensing programs (Select and MOLP) and version upgrades led to an overall decline in revenue per license. The number of Win Office and Win Office Pro licenses sold in the quarter exceeded plan by 8%, while revenue per license was $49 below plan ($282 actual versus $331 budget).
- Revenue for Windows and MS-DOS remain strong despite the anticipation of the upcoming release of Windows 95. Personal Operation Systems division gross revenue were 165% of plan.
- Desktop Applications, Business Systems, and Consumer divisions each failed to achieve Q95-1 revenue plan.

Geographic Factors

- Germany experienced a significant shortfall in plan, with net revenue for Q95-1 at 64% of plan. This is due principally to a licensing mix shift that is not being offset with volume increases. Net revenue in Germany has fallen from $84 million in Q94-1 to $48 million in Q95-1.
- Switzerland and Austria net revenue were both at approximately 72% of plan.
- Foreign exchange trends have led to a weaker dollar in comparison to plan, resulting in an 8% favorable impact on European net revenue for the quarter.
- Eastern European subsidiaries net revenue grew 129% from the prior year, and 179% ahead of plan. The Southern Region (Spain, Portugal and Italy) and the UK also had a strong quarter with net revenue at 143% and 113% of plan respectively.

Marketing, Advertising and Sales Programs

- The "Step Up" competitive upgrade campaign in Benelux contributed to stronger revenue, helping the region beat plan.
- There was no European wide campaign in the quarter. A Q95-2 Europe Fall Office campaign is planned.

Author: Kevin Dillon

Results of Operations ($ in millions)

	Q95-1 Actual	Plan	Variance
Net revenue	$253.9	$270.2	($16.3)
Cost of revenue	38.7	45.2	6.5
Gross profit	215.2	225.0	(9.8)
People	52.1	56.5	4.4
Infrastructure	16.7	18.3	1.6
Marketing	25.0	35.7	10.7
MCS	.6	.5	(.1)
Cost recovery programs	(3.4)	(3.4)	.0
Bad debt & taxes	1.2	2.4	1.2
Other	.6	1.7	1.2
Controllable expenses	92.9	111.8	19.0
Responsibility margin	122.4	113.1	9.2
Shared resources	3.0	1.8	(1.3)
Shared resource margin	$119.3	$111.4	$8.0
Key ratios			
Annualized per employee (in thousands)			
Net revenue	$431	$433	(2)
Salespeople expense	117	120	3
% Net revenue			
Cost of revenue	15 %	17 %	1 %
Marketing expense	10 %	13 %	3
Controllable expenses	37 %	41 %	5
Shared resource margin	47 %	41 %	6

Salespeople expense summarizes people and infrastructure expenses. Ratios reflect period results annualized.

Cost Driver Analysis

- Shared resource margin exceeded plan primarily due to lower than plan cost of revenue and marketing expenses. The previously mentioned shift in mix towards licensing programs had a positive impact on cost of revenue (15% of net revenue versus plan of 17%).
- Foreign exchange trends adversely impacted controllable expenses in comparison to plan by $12 million for the quarter, or 11%.
- Marketing expense was behind plan primarily due to the summer lull in the market, but should increase in subsequent quarters. Marketing expenses for the full year are expected to reach plan.

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Significant Customers (in millions)

	Q93-1	Q93-2	Q93-3	Q93-4	Q94-1	Q94-2	Q94-3	Q94-4	Q95-1
C2000	$ 55	$ 75	$ 68	$ 57	$ 51	$ 71	$ 79	$ 72	$ 50
Ingram	14	18	22	23	17	29	46	37	24
Merisel	20	31	33	27	35	33	48	36	22
Olivetti	5	8	11	13	10	14	21	14	15
Datateam	1	3	4	3	4	6	6	8	6
Raab Karcher	—	--	—	—	6	16	13	10	5
Scribona AB	6	9	10	7	4	7	9	14	4
Macrotron	7	10	14	8	13	17	16	14	4
Softmart	6	11	9	5	5	8	7	7	4
Also ABC	4	4	4	4	5	7	11	7	3
	$ 118	$ 169	$ 175	$ 147	$ 150	$ 208	$ 256	$ 219	$ 137
Percent of gross revenue	40%	45%	51%	47%	57%	60%	63%	59%	53%

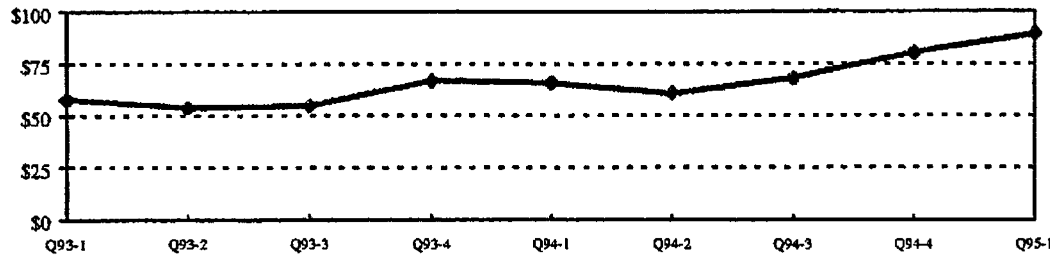
- The top 10 customers accounted for approximately 53% of total Q95-1 European gross revenue, while the top three customers represented 37% for Q95- 1. The decrease in percentage of gross revenue from 59% in Q94-4 is primarily attributable to increasing revenue from licensing programs which do not go through the distribution channel in certain significant markets, such as Germany.
- The European channel decreased the number of direct ship customers significantly at the beginning of Q95-1, in line with the Concorde Project plan. This substantially increased the packaged product market share of the remaining distributors. The significant shift to licensing more than offset this effect, leading to an overall decline in top customer share for the quarter.
- C2000 represented 19% of total gross revenue in Q95-1. This percentage has remained relatively constant since Q93-1.
- Ingram share decreased slightly from 10% of gross revenue in Q94-1 to 9% in Q95-1. Ingram bought Datateam, a major Nordic distributor and as a result have increased market share in the Nordic countries.
- Merisel's market share decreased from 10% in Q94-4 to 8% in Q95-1. Senior management changed (VP Europe and Operations Director) during Q95-1. Profitability is decreasing. The biggest market share decrease was in the UK.

Operational Issues

- President of Europe, Bernard Vergnes, will be on sabbatical during Q95-2. European VPs for customer units, Michel Lacombe (End User) and Rolf Skoglund (Organization), will assume management responsibilities for Europe.
- Italy, Holland, and Russia warehouses were closed in Q95-1. All European warehouses other than the European Operations Center (EOC) in Ireland have now been closed in line with the Concorde Project plan. All European customers are direct shipped from Dublin.
- All European subsidiaries have been converted to commission agents of MS Manufacturing BV (EOC).
- Ingram began ordering directly from EOC in Q95-1. Order entry for all European distributors will be handled by EOC by Q95-4.
- Approximately 100 positions in operations and finance have been eliminated under Project Concorde from FY94 levels. A further 20 will be eliminated during Q95-2.

ICON FINISHED GOODS REVIEW

Net Revenue Stream (in millions)



Key Highlights

- Revenue continued to grow following a pattern begun with Q94-2. Revenue increased 11% over Q94-4 primarily due to Office and Windows.
- Australia, Mexico and Brazil, representing 58% of ICON revenue, exceeded plan by 15%, 21% and 15%, respectively.
- Revenue per license for key products, particularly Office and Office Professional fell significantly below plan across the region due to a pronounced shift in license mix, particularly MOLP.
- Consumer and Business System division revenues fell significantly below plan, 31% and 49%, respectively.

Geographic Factors

- Political uncertainty in several key markets have constrained growth. Economic crises continue in Turkey and Venezuela with distributors in the latter now paying in local currency. Unrest and civil violence in Mexico, together with tight economic policy in Argentina and economic recession in significant Middle Eastern markets have limited opportunities in these geographies.
- Significant revenue growth year over year in South Africa (35%) and Columbia (53%) reflect stronger economies and a loosening of the trade restrictions.
- Distribution channels have been established in Vietnam after the lifting of the U.S. trade embargo in February, 1994. The initial focus for MS will be helping to plan infrastructure projects through MCS.

Operational Issues

- R.R. Donnelley began warehouse and manufacturing operations in Sydney, replacing the MS warehouse closed in the previous quarter. By the end of Q95-2 an estimated one third of packaged product sold in Australia and New Zealand will be built by R.R. Donnelley. This has led to a reduction in cost of revenue, particularly freight expenses.
- R.R. Donnelley began building Office, Word, Excel and Works in Mexico. This is in addition to the MS-DOS assembly begun in FY94. Product lead times have been reduced significantly.
- A new subsidiary in Indonesia is planned in Q95-4.

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Marketing, Advertising and Sales Programs

- License sales in Latin America have increased significantly under the MOLP program. This has contributed to increased penetration in small and medium sized companies, and has been a strong vehicle in the push to reduce pirate software in smaller companies. Approximately 24% of ICON revenue is generated from licenses including MOLP and Select. Although this has a negative impact on revenue per license, it has a positive impact on margins.

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Results of Operations ($ in millions)

	Q95-1 Actual	Plan	Variance
Net revenue	$89.5	$76.6	$12.9
Cost of revenue	15.7	18.4	2.6
Gross profit	73.8	58.2	15.5
People	14.1	15.3	1.2
Infrastructure	5.5	6.1	.6
Marketing	6.6	7.9	1.3
MCS	.4	.5	.1
Cost recovery programs	(.6)	.5	1.1
Bad debt & taxes	1.6	1.4	(.2)
Other	.6	.7	.1
Controllable expenses	28.3	32.4	4.2
Responsibility margin	45.5	25.8	19.7
Shared resources	1.3	1.7	.4
Shared resource margin	$44.1	$24.1	$20.1
Key ratios			
Annualized per employee (in thousands)			
Net revenue	$583	$470	$113
Salespeople expense	128	132	4
% Net revenue			
Cost of revenue	18 %	24 %	6 %
Marketing expense	7	10	3
Controllable expenses	32	42	11
Shared resource margin	49	31	18

Salespeople expense summarizes people and infrastructure expenses. Ratios reflect period results annualized.

Cost Driver Analysis

- Cost of revenue was under plan primarily due to the positive effect of the shift in license mix described above and lower than planned spending.
- Operating expenses were lower than plan, due primarily to headcount hiring slower than planned, combined with a lag in marketing activity in the first quarter of the year relative to plan.

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Author: John MacLellan

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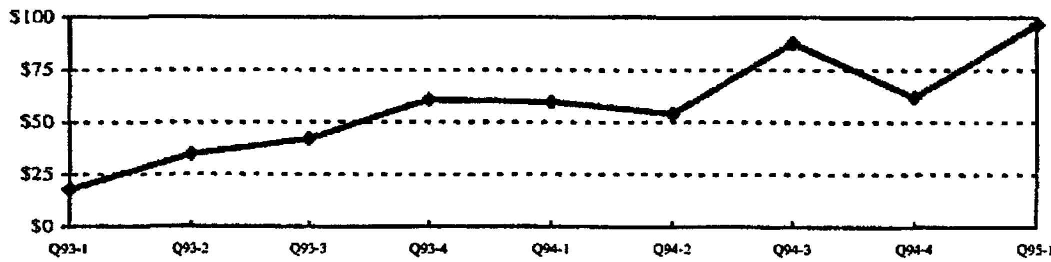
Significant Customers in Major Subsidiaries (in millions)

	Q93-1	Q93-2	Q93-3	Q93-4	Q94-1	Q94-2	Q94-3	Q94-4	Q95-1
Australia & SE Asia									
Tech Pacific	$ 4.2	$ 4.8	$ 4.8	$ 8.1	$ 8.8	$10.1	$ 8.7	$12.5	$ 9.5
Merisel	3.4	3.8	6.1	9.0	5.7	5.2	3.6	6.2	6.2
Datacom	0.0	0.0	0.0	0.0	0.0	1.7	4.8	2.0	7.0
Aus. Govt. Services	-	-	-	-	-	-	-	-	4.7
Mexico									
Ingram-Dicom	2.9	3.9	2.1	4.8	1.4	1.7	3.9	2.1	3.0
Brazil									
Compucenter	1.9	1.8	1.7	2.2	2.3	2.2	2.5	4.1	4.2
South Africa									
Workgroup	3.1	2.6	2.0	3.5	3.0	2.9	2.6	3.0	3.7
	$15.5	$16.9	$16.7	$27.6	$21.2	$23.8	$26.1	$29.9	$38.3
Percent of gross revenue	27%	31%	30%	41%	32%	36%	38%	36%	43%

- Tech Pacific was signed as a distributor in Indonesia and now distributes for MS in all APAC countries.
- Ingram has been added as a distributor in Peru.
- Compucenter of Brazil has gained market share in the last two quarters due to the insolvency of a local competitor, Agoal, at the end of last fiscal year.
- Datacom in Australia and New Zealand is a fulfillment house primarily used to distribute upgrade product. Consequently their product volumes are driven by major software releases.
- Australian Government Services is a government agency buying product from MS under a contract similar to Select. This product is sold through the normal distribution channel but analysis of this figure, by distributor, will not be available until Q95-2.

FAR EAST FINISHED GOODS REVIEW

Net Revenue Stream (in millions)



Key Highlights

- Q95-1 net revenue of $96.7 million was 65% above plan and 60% above Q94-1 revenue. The $38.0 million favorable variance against plan was contributed by the following subsidiaries: Japan provided $35.5 million, Korea $1.6 million and Taiwan $1.1 million. Revenue in China for the quarter was $1.1 million below plan. Significant product introductions and higher than expected PC sales growth in the Far East contributed to the strong quarter.
- Office (new and existing users) comprised $42.4 million, or 44%, of the region's total revenue for the quarter. This was $22.0 million, or 108%, above plan. Japan's Office revenue was $20.7 million over plan due to the exceptionally strong demand for the release of a new version of localized Office.
- Developer Division recorded revenue of $14.9 million in Q95-1, which was $8.3 million (125%) over plan. Languages were $3.6 million (95%) above plan due to strong C++ sales in Japan. Visual Basic revenue for the period was $2.7 million (158%) over plan and the Fox product unit was $1.2 million (197%) over plan.
- Business Systems Division finished the quarter with revenue of $5.5 million compared with a plan of $4.3 million. The favorable variance was due to strong sales of SQL server in Japan; Windows NT sales for the region were under plan.
- Consumer Division sales were $2.4 million under plan at $3.1 million. Korea and Taiwan were the only locations with above-budget revenues for Consumer, while Japan was $2.4 million under plan. No significant new Consumer products are expected to be released until after the Christmas holiday season.

Geographic Factors

- Foreign exchange rate variances contributed approximately $4.4 million (11%) of the favorable variance in Q95-1. Virtually all of this favorable exchange rate variance relative to plan, was from Japan.

Operational Issues

- Cost or revenue was 4% below plan for Q95-1. This variance was due to favorable pricing (total revenue per license for the quarter was 49% over plan) and continuing efforts to reduce product costs which were initiated in FY94.

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Marketing, Advertising and Sales Programs:

- The main event in the Far East was the launch of new versions of Office in Japan and Korea.
- Increased emphasis is being placed on the sales of Select and MOLP in the Far East with the goal of boosting sales efficiencies and gross margins.

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Author: Bill Landefeld

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Results of Operations ($ in millions)

	Q95-1 Actual	Plan	Variance
Net revenue	$96.7	$58.7	$38.0
Cost of revenue	20.9	15.2	(5.7)
Gross profit	75.8	43.5	32.3
People	11.1	12.5	1.4
Infrastructure	4.9	5.0	.1
Marketing	7.7	11.8	4.1
MCS	.0	.1	.1
Cost recovery programs	.2	.1	(.1)
Bad debt & taxes	.7	.6	(.1)
Other	.5	.8	.2
Controllable expenses	25.2	30.9	5.7
Responsibility margin	50.6	12.5	38.0
Shared resources	(.2)	(.4)	(.2)
Shared resource margin	$50.7	$12.9	$37.8
Key ratios			
Annualized per employee (in thousands)			
Net revenue	$987	$539	$448
Salespeople expense	163	161	(2)
% Net revenue			
Cost of revenue	22 %	26 %	4 %
Marketing expense	8 %	20 %	12
Controllable expenses	26 %	53 %	27
Shared resource margin	52 %	22 %	30

Salespeople expense summarizes people and infrastructure expenses. Ratios reflect period results annualized.

Cost Driver Analysis

- Controllable expenses were $5.7 million (18%) below plan for the quarter; Japan contributed $2.7 million of this variance, Taiwan $1.5 million and Korea $0.8 million. This $5.7 million variance included an unfavorable foreign exchange variance of $1.1 million, without which controllable expenses would have been $6.8 million (22%) under plan.
- People expenses were $1.4 million (11%) below plan as headcount hiring was slower than planned. All subsidiaries in the region were below plan in people expenses for the period.
- Marketing expenses of $7.7 million were 35% below plan. Marketing expenses in Hong Kong and China were at plan, while Japan, Taiwan and Korea had favorable variances of $2.3 million, $1.1 million and $0.6 million, respectively. It is expected that Q95-2 and FY95 marketing expenses will be close to plan.

Significant Customers in Major Subsidiaries (in millions)

	Q93-1	Q93-2	Q93-3	Q93-4	Q94-1	Q94-2	Q94-3	Q94-4	Q95-1
Japan									
Softbank	$1.1	$7.2	$7.1	$11.6	$9.4	$11.8	$25.4	$9.0	$22.9
Software Japan	1.4	3.3	3.5	5.1	6.2	6.4	7.4	6.0	9.5
Soft Wing	0.9	3.5	3.1	4.5	4.0	4.1	6.7	3.7	7.3
Fujitsu	1.0	0.9	1.9	1.4	1.9	2.2	3.7	2.8	6.2
Otsuka Shokai	0.2	0.3	0.6	0.7	0.9	1.1	2.2	2.2	2.7
Canon Sales	2.1	1.2	2.3	1.7	2.0	1.0	2.6	1.9	2.3
NEC	1.2	1.0	1.2	2.4	2.3	1.4	1.4	1.1	1.3
Taiwan									
Acer Sertek	0.8	0.8	0.6	1.3	2.3	0.5	1.9	2.1	2.1
Eten	0.8	0.5	0.9	1.9	2.4	0.6	1.5	1.8	1.4
Korea									
Infotech	0.6	0.4	0.5	1.7	3.0	1.9	1.3	0.8	2.0
	$10.2	$19.0	$21.7	$32.3	$34.3	$30.9	$54.1	$31.4	$57.7
Percent of gross revenue	57%	54%	52%	53%	57%	55%	60%	51%	59%

- The ten customers above comprised 59% of the region's revenue in Q95-1. This is essentially the same share as in the previous record sales quarter for the region, Q94-3. This implies that certain customers, such as Softbank Corp. in Japan are more dominant in sales of desktop applications as Excel and Office in Japan accounted for the sharp increases in sales in these two quarters.
- Softbank accounted for 29% of MS Japan's sales in Q95-1, compared with 26% in FY94. The combination of Softbank, Software Japan and Soft Wing comprised 50% of the subsidiary's Q95-1 sales; the comparable figure for FY94 was 37%.
- Infotech's share of MS Korea's sales was 27% in Q95-1, compared with 36% in Q94-4 and 53% for all of FY94. This trend is a result of MS Korea's efforts to reduce dependence on Infotech by increasing sales through three additional distributors, Sunkyung, Softline and Samtech. These three distributors represented 44% of MS Korea's Q95-1 sales.
- Inventory in Japan, Korea and Taiwan increased 7% from the end of Q94-4 to the end of Q95-1. MS Japan's inventory increased 20%, but was offset by reductions of inventory in Korea and Taiwan. This increase of inventory in Japan was less than the increase in product costs during Q95-1, and days of inventory on-hand decreased from 150 days to 94 days in sequential quarters.
- The Far East region does not have good visibility into inventory in the sales channel currently. In an effort to improve this visibility, FastTrack is being rolled out in the region, and MS Hong Kong started to collecting sell-out information from key distributors there in Q95-1.

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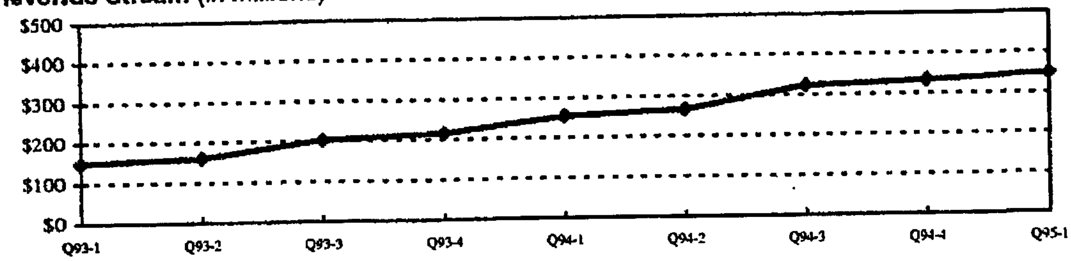
OEM REVIEW

Net Revenue Stream (in millions)



Key Highlights

- OEM Q95-1 net revenue of $348 million was 28% of MS consolidated net revenue. OEM Q95-1 contribution margin of $227 million was 46% of consolidated contribution margin. Revenue was not materially affected by billing changes that occurred as a result of the Department of Justice ruling.
- All OEMs with Per System agreements were notified of the Department of Justice ruling and their resultant right to exclude specific models from their contracts. Virtually no OEMs took advantage of this option during the quarter. Licenses are being amended to remove Personal Operating System minimum commitments, resulting in lower minimum commitment billings and higher product-specific billings. Contracts for Windows 95 will require monthly reporting and billing, leading to a more timely view of the OEM business and better cash flow.
- Most of the top 20 OEMs are committed to Windows 95. OEM Sales is working with major OEMs to develop and certify "plug and play" PCs and to develop joint marketing strategies.
- Over 250 of Microsoft's larger OEMs attended the OEM Briefing in September. Smaller OEMs will attend regional briefings throughout the country during the remainder of the year.

Geographic Factors

- Billing changes relating to the Department of Justice ruling impacted the international channels with a timing difference that was adjusted at a consolidated but not at a subsidiary level. Consequently, Europe and the Far East were below plan by approximately the amount of their unbilled minimum commitments.
- ICON business improved due to strengthening economies, increased marketing, anti-piracy actions, and more stable distribution channels.
- Europe and the Far East also reported increased shipment numbers. Europe anticipates a strong Christmas quarter buoyed by sales of Consumer products. IBM aggressively marketed OS/2 for Windows in Europe, giving away over 500,000 CDs through computer magazines. Discussions are being held with IBM regarding royalty payments on these units, and an audit is planned.

Operational Issues

- OEM licensed four new replicators in Australia, South Africa, Latin America, and North America.
- The OEM operations group is considering process improvements for international hardware distribution.

Marketing, Advertising and Sales Programs

- The marketing group focused on Windows 95, putting together tools and programs to help Account Managers and Systems Engineers work with their OEMs to license, sell, and support the product. They are working to coordinate their efforts with MS channel marketing activities where OEMs are present.
- The group developed generic marketing kits in preparation for a worldwide Delivery Service Partner (DSP) marketing campaign.

Author: Neil Miller

Top Products (units in thousands, revenue in millions)

Q95-1

	Q95-1			Q95-1 Plan			Variance		
	Units	Revs	$/Unit	Units	Revs	$/Unit	Units	Revs	$/Unit
Windows	7,257	$ 144	$ 20	6,512	$ 125	$ 19	745	$ 19	$ 1
MS-DOS	7,569	132	17	7,158	121	17	411	11	--
Mouse	1,613	18	11	1,133	12	11	480	6	--
Works	761	6	8	1,239	9	7	(478)	(3)	1
Lan Manager	195	6	31	--	--	N/A	195	6	N/A
Other		2	N/A	--	62	N/A	--	(60)	N/A
		308			329			(21)	
Revenue adjustments		40			--			40	
Net Revenue		$ 348			$ 329			$ 19	

- Virtually all mouse sales were the low-end "Defender" mouse at a gross margin of approximately 50%. Mouse sales continued to grow as more OEMs bundled mice with their Windows machines.
- The negative Works variance stemmed from an aggressive budget, late royalty reports, and low IBM shipments.
- Unbilled minimum commitments as a result of the Department of Justice ruling created most of the "Other" variance. This shortfall was partially offset by higher product-specific billings.
- Revenue adjustments of $40 million related to a revenue accrual for product shipped but not yet reported by OEMs.

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Author: Nell Miller

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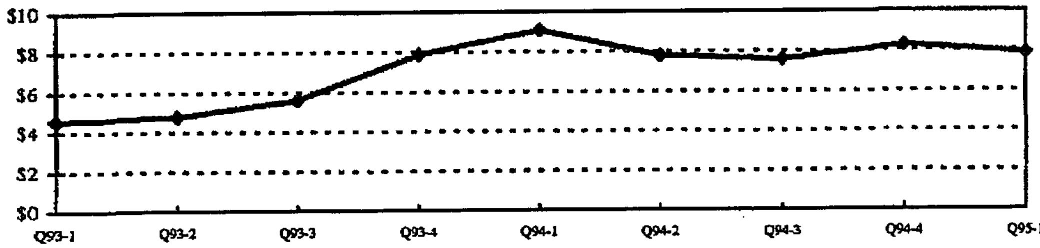
Significant Customers (in millions)

	Q95-1 Actual	Plan	Variance
Large Accounts			
Compaq	$ 33.7	$ 36.5	$ (2.8)
Gateway 2000	29.4	18.9	10.5
IBM	22.8	28.0	(5.2)
Dell	11.0	10.6	0.4
AST	10.2	12.0	(1.8)
Packard Bell	10.1	9.5	0.6
Solution Providers			
Hewlett Packard	15.2	6.2	9.0
DEC	11.0	7.6	3.4
AT&T GIS	5.3	6.0	(0.7)
Unisys	2.3	3.2	(0.9)
Other	3.2	6.6	(3.4)
Named Accounts	24.0	20.7	3.3
New Business Accounts	29.2	27.8	1.4
International Accounts			
Toshiba	12.2	6.0	6.2
NEC	5.2	5.2	--
Acer	4.7	2.9	1.8
Epson	3.4	6.2	(2.8)
Olivetti	3.1	5.3	(2.2)
Sanyo	2.5	2.5	--
Other	70.0	106.9	(36.9)
Gross revenue	308.5	328.6	(20.1)
Revenue adjustments	39.9	--	39.9
Net revenue	$ 348.4	$ 328.6	$ 19.8

- Driven by Compaq, Gateway, and Packard Bell, the "Big 6" continued to grow, accounting for $117 million and 38% of Q95-1 gross revenue. IBM, AST, and Dell experienced slower unit growth.
- Price cuts by Compaq of up to 22% on its Deskpro and ProLinea lines were quickly followed by up to 27% price cuts by IBM on its business PCs.
- Hewlett Packard and Digital Equipment continued to outperform plan due to aggressive pricing and successful product strategies.
- Channel consolidation continued in Europe: Amstrad acquired Viglen; SNI acquired a 10% stake in Escom, and Elonex is for sale.

OTHER ADVANCED TECHNOLOGY CHANNEL REVIEW

Net Revenue Stream (in millions)



Note: The net revenue graph represents Softimage. Inclusion in MS results began Q95-1

Key Highlights

- Other Advanced Technology is a new sales channel in FY95. The channel consists of the Softimage sales group and the Advanced Consumer Technology (ACT) sales group which was formed in Q94-4. Both groups report to Richard Fade, VP AT Sales.
- The Softimage sales group managed by David Macrae is based in Redmond and includes offices in the U.S., a Latin America office in Florida, a branch office in Singapore, and current subsidiary operations in the U.K., France and Italy. Softimage Japan is being established in MSKK and plans are being considered for establishing operations in Germany.
- The ACT Sales Group managed by Steve Wells is based in Redmond and includes resources devoted to public network operators, OEM device manufacturers focused on ITV and Pulsar, and an incubating effort to address various private network opportunities.

<u>Softimage:</u>

- Other AT Channel Revenue relates entirely to Softimage. To date, MS has not realized any revenue from ACT sales activities. For the quarter, Softimage net revenue was $7.9 million versus a plan of $7.6 million.
- Softimage product revenue was particularly strong for Creative Environment, Hardware, and Options/tools.
- Key account wins for the quarter included Disney Advanced Research, Hanna-Barbera 3D, Sports channel, and many TV stations.
- Alias Research, a competitor, recently formed a strong joint marketing agreement with Nintendo and has introduced a low priced software package for $5K.

<u>ACT Sales:</u>

- MS reached an agreement with Southwest Bell to provide the end-to-end software solution including video on demand, navigator, electronic program guide and network operator software for Southwest Bell's interactive video trial in Richardson, Texas. The project is scheduled to begin customer testing in Q95-4.
- The ACT sales platform team focused on finalizing the license and development agreement and RTM with Timex for the Data Link Schedule+ watch.
- Significant progress was made in Q95-1 in the selection of, and agreements with Platinum level system integrators. Selected investigators are currently Lockheed, Andersen Consulting, Alcatel, Olivetti, and NTT Data.

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Author: Brian Aron

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Operational Issues

Softimage

- Priorities for sales operations include pre-planning for the Digital Studio roll-out in Q95-3, instituting a formal field communications process, executing a customer survey on product features, distributor programs, and actively reducing third party component of sales from 20% to 0%.
- The integration of Softimage into MS continues from an operations and finance standpoint. Implementation of the subsidiary 'Platinum' accounting and order management system in Montreal in still underway. Prior to the acquisition, monthly financial closing took 2-3 months. For September, Softimage complied with MS's five-day close process. Additional focus is required to complete the integration with Softimage operations with MS.

ACT Sales

- Final pricing strategy and product RTM schedules relative to the numerous agreements executed by the ACT sales force are currently being determined.
- Private network operator resource(s) must be staffed as soon as possible.
- Infrastructure and appropriate levels of system engineers or other technical support must be obtained to adequately support upcoming trials.
- A contract license management and administration plan needs to be worked out with the OEM Operations ("Pipe") group.

Marketing, Advertising and Sales Programs

Softimage

- Two key events in Q95-1 for Softimage were Siggraph and the IBC in Europe. The IBC show booked approximately $1 million in revenue.
- A large accounts program for ITV and Games began which will provide worldwide focus to key accounts such as Sega, Sony, AT&T, Viacom, Time Warner and Rocket Science.
- Development of a Digital Studio roll-out training plan for direct accounts and dealers is in progress and methods for improving formal distribution of marketing materials and success stories are also under development.
- Development of an advertising campaign for new platform and branding strategy to address segmentation of Digital Studio from Creative Environment is under development.

ACT Sales

- Preparations are underway for the ACT Industry Summit event November 1 and 2.
- The Public Network Operator team is focused on closing marketing program agreements with 18 Alpha and TestView partners.

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Results of Operations ($ in millions)

	Q95-1 Actual	Q95-1 Plan	Q95-1 Variance
Net revenue	$7.9	$7.6	$.3
Cost of revenue	2.3	2.5	.2
Gross profit	5.6	5.1	.5
People	3.3	4.3	1.0
Infrastructure	.7	.7	.0
Marketing	1.7	3.1	1.4
MCS	.0	.0	.0
Cost recovery programs	.0	.0	.0
Bad debt & taxes	.1	.3	.2
Other	.3	.3	(.0)
Controllable expenses	6.1	8.7	2.5
Responsibility margin	(.5)	(3.5)	3.0
Shared resources	(.5)	.0	.5
Shared resource margin	($.0)	($3.5)	$3.5
Key ratios			
Annualized per employee (in thousands)			
Net revenue	$224	$186	$38
Salespeople expense	114	122	9
% Net revenue			
Cost of revenue	29 %	32 %	4 %
Marketing expense	22	41	19
Controllable expenses	78	114	36
Shared resource margin	(0)	(46)	46

Salespeople expense summarizes people and infrastructure expenses. Ratios reflect period results annualized.

Cost Driver Analysis

Q95-1

- People expenses were under plan in Q95-1 due to a lower than planned hire rate in Softimage Sales, ACT Sales and Softimage Product Support. This was coupled with a lower than planned spending rate per head.
- Cost of revenue was favorable to plan resulting in gross profit for Q95-1 at 29% of net revenue versus a plan of 32%. This was a result of continued movement away from SGI hardware resales and a mix shift away from royalty bearing products.
- Marketing expenses include both Other AT Channel specific marketing and AT Product Marketing from the ACT, BMA, and APD divisions. Marketing expense was below plan due to various events, collateral, and market research planned for Q95-1 which has been delayed to future quarters. Additionally, certain expenses for key events such as Siggraph and the IBC have not yet been fully realized.

Author: Brian Aron

WORLDWIDE PSS

Highlights

- PSS continued implementation of Office Conversion support in Q95-1 by offering a dedicated phone number targeted at customers who need assistance in converting to MS Office from competitive products. The conversion line is currently receiving approximately 1,000 calls per week and is staffed with engineers skilled in helping customers making the transition from WordPerfect, Lotus 1-2-3, QuattroPro, dBASE and Harvard Graphics. In addition, organizations converting 2,000 or more desktops to MS Office, Word or Excel, can request an Office Conversion Manager who will work with the organization's designated contact for 90 days, via telephone, to assist in the planning and smooth implementation of the conversion effort. The program will be available to customers between November, 1994 and June, 1995.
- In September, PSS completed a thorough analysis of its fixed and marginal costs to determine its cost recovery by support cluster (customer segment). This analysis, which was presented to the BOOP, endorsed PSS's strategy to invest in the Desktop cluster (DAD and Consumer) by continuing to offer unlimited no charge support, and decrease investment in Developer and Business Systems by improving cost recovery with revised pricing and a range of support offerings.
- PSS continued Windows 95 support planning. Five third party organizations will partner with PSS to provide support during the Windows 95 launch. Contract negotiations are in process and expected to close early in Q95-2. The primary objective of the partner program is to meet peak support demand and spur development of a third party support channel to minimize future support costs.
- During Q95-1, PSS formed the Catalyst Group, a group specifically tasked with extending MS's ability to support enterprise customers using our business systems products. The catalyst group works with MCS, Solution Provider's, and Authorized Support Center's to provide coordinated on-site support, mission critical/hot-site support, as well as proactive support such as configuration, architectural reviews, and consulting from a support perspective.

Worldwide Cost Distribution by Channel (in millions)

	Q95-1			
	Actual	% Net Rev	Plan	% Net Rev
North America	$42.8	6.2 %	$45.9	7.9 %
Europe	16.1	5.6	20.6	6.1
ICON	2.9	2.5	3.7	4.0
Far East	6.4	4.7	6.8	6.3
Worldwide PSS	$68.2	5.5	$77.0	6.8

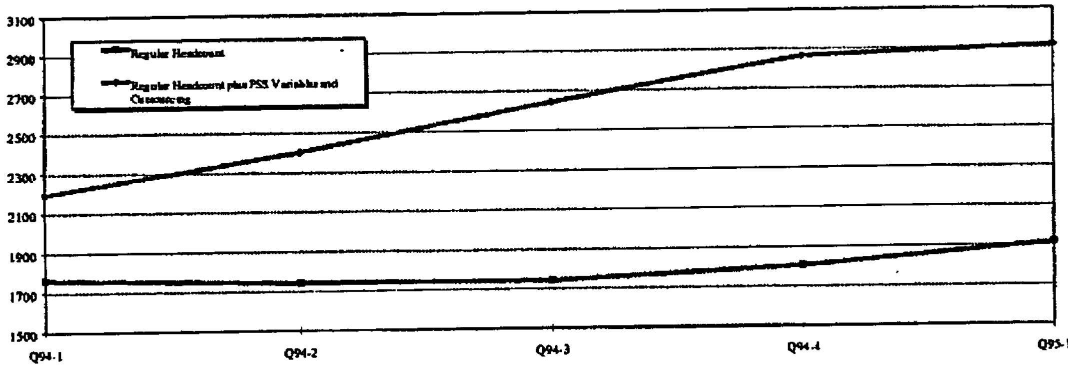
- Worldwide PSS costs as a percent of net revenue were lower than plan primarily due to strong product sales revenue and slower than planned hiring in Europe.

Worldwide Cost Distribution by Support Cluster (in millions)

	Q95-1 Actual			Q95-1 Plan		
	PSS Cost	Mix	% Net Rev	PSS Cost	Mix	% Net Rev
Desktop	$26.3	38.5 %	4.3 %	$28.2	36.7 %	5.3 %
Consumer	3.4	5.1	5.1	4.6	6.0	4.8
Personal Operating Systems	15.4	22.6	3.9	18.1	23.4	5.5
Business Systems	10.5	15.3	14.1	11.7	15.3	12.4
Developer	12.6	18.5	26.0	14.4	18.6	31.9
Total	$68.2	100.0 %	5.5	$77.0	100.0 %	6.8

- For Q95-1, PSS spending is under plan in all support clusters (customer segments).
- For the Business Systems and Consumer clusters, cost as a percent of net revenue ended slightly higher than plan. This is primarily due to lower than planned revenue in those clusters.

PSS Headcount - Domestic



- PSS continues to meet support demand by leveraging less expensive variable and outsourced staffing.

Q95-1 Average Daily Call Volume - Domestic

Product	Average Duration (in min)	Daily # of Calls Offered	Daily # of Calls Handled	Handled Ratio	Service Level
Word for Windows	13	4,290	4,231	99 %	67 %
Excel for Windows	13	3,213	3,022	94	59
Access	13	3,183	3,168	100	76
Windows	17	1,769	1,768	100	84
Windows for Workgroups	21	1,341	1,338	100	91
MS-DOS	17	972	971	100	78
Word for Mac	10	712	673	95	73
Fox Pro for Windows	15	697	687	99	83
Windows NT	18	240	237	99	70
PSS Weighted Average	14	22,737	22,085	97	69

- The handled ratio is a measure of the percentage of customer calls that reach a support engineer; the remainder of the customers abandon the call prior to reaching an engineer. Service level is a measure of the percentage of customers who reach a support engineer in less than 60 seconds.
- MS Access daily call volumes have increased 23% to 3,183 in Q95-1 due to a new product release. Service levels for MS Access remained relatively high in spite of higher than planed sales.
- MS Windows call volumes have decreased 26% since Q94-4. PSS is beginning to feel the effects of limiting the standard no charge support offering to 90 days and referring OEM customers to the manufacturer for support.

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Finance

Product Division

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Product Divisions

SUMMARY

Results of Operations
(IN MILLIONS)

Q95-1

	Net Revenue		Gross Profit		Operating Margin		Burdened Operating Income	
	Actual	% of Plan	Actual	% of Plan	Actual	% of Plan	Actual	% of Plan
Desktop Apps	$612.6	116 %	$525.2	116 %	$404.2	128 %	$321.3	144 %
Consumer	111.7	82	72.4	78	22.9	82	3.4	74
Personal Op Sys	366.4	120	351.8	121	299.3	136	275.1	150
Business Systems	66.9	88	56.7	98	(7.1)	NM	(38.9)	NM
Developer	57.1	123	42.1	135	3.0	NM	(21.1)	NM
Advanced Technology	7.9	103	4.6	136	(24.4)	NM	(37.3)	NM
Other Product Groups	15.0	74	2.8	20	(59.8)	NM	(62.7)	NM
Press & Other	9.2	130	4.8	135	(3.0)	NM	(3.0)	NM
Total	$1,246.7	111	$1,060.4	112	$635.2	147	$436.8	226

	Net Revenue Mix		Gross Profit % Net Revenue		Oper. Margin % Net Revenue		B.O.I. % Net Revenue	
	Actual	Plan	Actual	Plan	Actual	Plan	Actual	Plan
Desktop Apps	49 %	47 %	86 %	86 %	66 %	60 %	52 %	42 %
Consumer	9	12	65	68	21	21	3	3
Personal Op Sys	29	27	96	95	82	72	75	60
Business Systems	5	7	85	76	(11)	(36)	(58)	(85)
Developer	5	4	74	67	5	(45)	(37)	(105)
Advanced Technology	1	1	58	44	NM	NM	NM	NM
Other Product Groups	1	2	18	68	NM	(31)	NM	(51)
Press & Other	1	1	53	51	NM	NM	(32)	(672)
Total	100 %	100 %	85	84	51	39	35	17

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WORLDWIDE PRODUCT GROUPS & ADVANCED TECHNOLOGY METRICS
(ANNUALIZED IN THOUSANDS)

	Desktop	Developer	Consumer	At Work	POS	BSD	WPG	AT	Total
Net revenue per employee									
Q95-1 Actual	$2,443	$ 303	$ 755	$ 48	$3,180	$ 273	$1,137	$ 52	$1,005
Q95-1 Plan	2,075	231	772	14	2,406	280	943	39	814
People expense per employee									
Q95-1 Actual	$ 87	$ 97	$ 99	$ 108	$ 95	$ 99	$ 96	$ 120	$ 99
Q95-1 Plan	86	93	100	108	92	98	94	113	97
Infrastructure expense per employee									
Q95-1 Actual	$ 25	$ 26	$ 23	$ 31	$ 19	$ 33	$ 26	$ 26	$ 26
Q95-1 Plan	28	27	22	33	20	31	27	24	27
Product development expense % of people expense									
Q95-1 Actual	14%	16%	68%	30%	22%	30%	29%	9%	26%
Q95-1 Plan	34%	29%	102%	57%	66%	49%	53%	28%	49%
Marketing expense % of net revenue									
Q95-1 Actual	8%	9%	12%	6%	2%	16%	10%	22%	10%
Q95-1 Plan	10%	24%	11%	38%	5%	28%	11%	41%	11%

- Net revenue per employee exceeded plan by 23% due to a positive revenue variance of 11% combined with business unit headcount ending the quarter at 90% of plan. Desktop Applications and Personal Operating Systems net revenue per employee continues to fund significant long term investment in other product divisions.
- People expense per employee for AT includes expenses during Q95-1 that are not expected to continue through the remainder of the year. AT is forecasted to be at or below plan for people expense per employee for the year.
- Product development expense, which includes purchased code, contractors, beta program expense and third party localization, was $34 million under plan for Q95-1 across all divisions resulting in a favorable variance as a percentage of people expense. Division management anticipates this variance will be absorbed throughout the remainder of FY95.
- Actual marketing spend at the division level was 70% of plan, representing $35 million under planned spending. However, total WPG marketing includes an additional $41 million accrual of marketing expense related to marketing projects that were committed and in progress, but not invoiced. These expenditures will be recorded in the appropriate product divisions as invoices are rendered.

DESKTOP APPLICATIONS

Results of Operations ($ in millions)

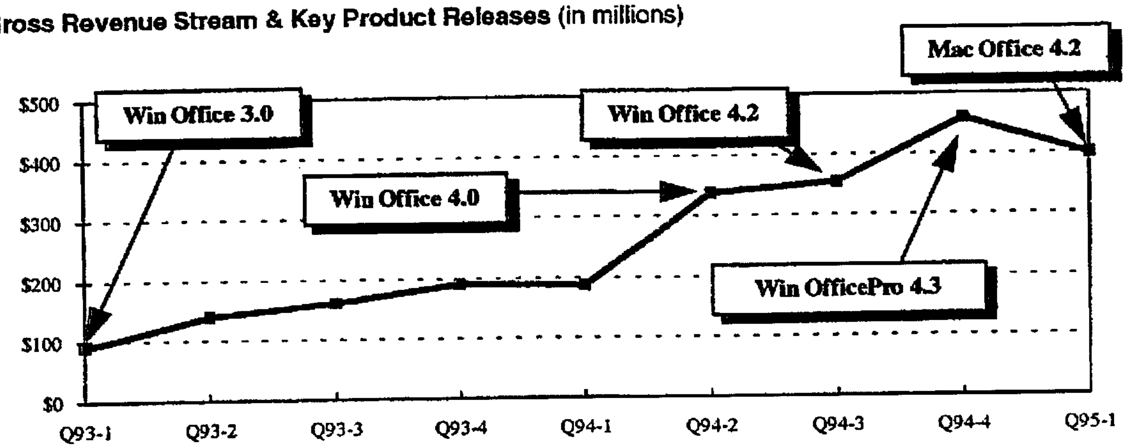
	Q95-1 Actual	Plan	Variance
Net revenue	$612.6	$528.0	$84.6
Cost of revenue	87.3	76.2	(11.1)
Gross profit	525.2	451.8	73.5
People	21.8	21.9	.1
Infrastructure	6.4	7.1	.7
Marketing	46.1	51.9	5.7
Bad debt & taxes	6.2	6.1	(.1)
Product development	3.1	7.6	4.4
Other	.1	.1	.0
Shared resources	11.2	12.6	1.4
Product support services	26.2	28.2	2.0
Operating expenses	121.1	135.4	14.3
Operating margin	$404.2	$316.3	$87.8
% Net revenue			
Cost of revenue	14 %	14 %	0 %
Operating margin	66	60	6
Operating expense mix			
All product development	26 %	27 %	
Marketing	38	38	
PSS	22	21	
Other expenses	14	14	
Total costs	100 %	100 %	

Cost Driver Analysis

- Net revenue for the Desktop Applications division was $85 million above plan at $613 million in Q95-1. This is almost identical to the previous quarter's revenue, but this quarter includes $60 million of Access Product Unit revenue which is now included in the Desktop Applications division P&L.
- Desktop Applications sales through the North American FG channel were particularly strong this quarter in both absolute terms ($315 million gross revenue), and as a percent of plan (34% above plan). The Far East FG channel also had a very successful quarter, exceeding plan by 77%. New versions of Macintosh applications (Office, Word, Excel and PowerPoint) shipped in Q95-1, bringing total Desktop Macintosh application revenue to $87 million, $12 million above plan. This was 55% higher than last quarter's $56 million, and 53% above Q94-1's $57 million.
- Total cost of revenue as a percent of net revenue was virtually at plan for the division in Q95-1. Gross margin was 86%, which is one percentage point higher than one year ago. The favorable increase is due to lower bill of materials costs on new versions of Desktop Applications products as well as a mix favoring licensed product. For example, the mix of Win Office licenses sold as non-packaged product was 33% in Q94-1 versus 41% this quarter.
- Operating expenses were below plan, primarily due to underspending in marketing and third party product development. It is expected that this trend will reverse in future quarters as development and marketing efforts ramp up to ship Office 95 near the end of the fiscal year. PSS costs were also below plan, and lower than last year as a percent of revenue. Desktop division average headcount was below plan, and as a result, people and infrastructure costs were slightly below plan.

OFFICE

Gross Revenue Stream & Key Product Releases (in millions)



Office revenue is stated in terms of gross revenue, prior to being allocating to Word, Excel, Graphics Access and Workgroup Product Units.

Highlights

- Market share for MS's Windows applications as of June, 1994 was as follows*:

	Domestic	International
- Office	88%	85%
- Word	71%	74%
- Excel	77%	72%
- PowerPoint	70%	77%

  *Unit share of the Windows categories, for the three months ending June, 1994; the most recent period for which SPA market category information is available.

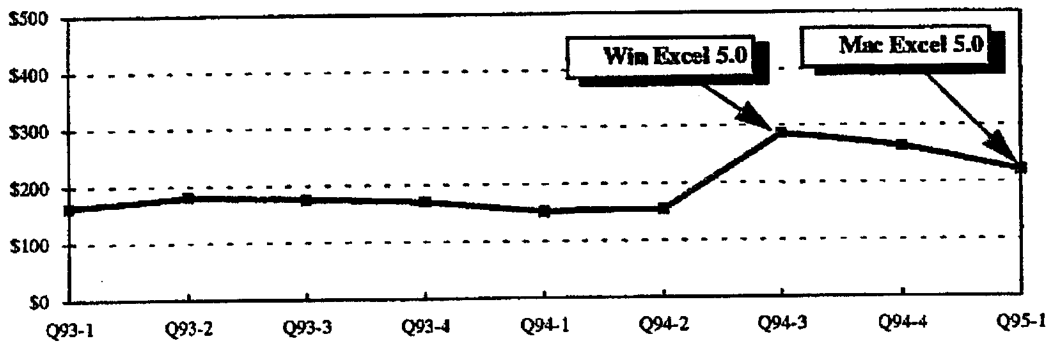
- In August 1994, MS released to manufacturing Office version 4.2 for the Macintosh. It contains Excel 5.0, Word 6.0, PowerPoint 4.0 and Mail 3.2. The U.S. ERP for full packaged product is $499, with an upgrade price of $259 after redeeming a $40 coupon in the upgrade package (expires 12/31/94). All of these new Macintosh applications will include disks for Power Macintosh optimization beginning October 1994. MS Office for the Macintosh will also be available on CD-ROM.
- MS's Akio Fujii was promoted to Director of Far East Development, reporting to Pete Higgins, Senior Vice President of the Desktop Applications Division. Mr. Fujii will oversee development efforts in Korea, Taiwan and Peoples' Republic of China, as well as applications development in Japan.

Competition

- In August 1994, Lotus began manufacturing Lotus 1-2-3 Release 5 for Windows, Approach 3.0 for Windows, Lotus Ami Pro Release 3.1 for Windows, Freelance Graphics Release 2.1 for Windows, Lotus Ami Pro Release 3.0b for OS/2 and 1-2-3 Release 4 for DOS. They were available in retail stores in mid-August. SmartSuite 3.0 for Windows shipped in late August.
- Lotus is predicting 15% to 20% revenue growth in calendar year 1994, and states that desktop application revenue will grow at a modest 10%, while most growth will come from workgroup applications like Notes. Analysts are less optimistic about Lotus' desktop applications business, and news of recent organizational turmoil has also hurt the credibility of Lotus' desktop applications business.
- Novell announced CD-ROM PerfectOffice Select, a 'roll-your-own' suite, in which users can discover, evaluate, and purchase individual applications from a list of eight major applications, plus roughly twenty additional programs from third party developers, all on one CD. Availability is expected late this year, or early 1995. Pricing has not yet been announced.

EXCEL

Net Revenue Stream & Key Product Releases (in millions)



Highlights

- Excel 5.0 for the Macintosh released to manufacturing in August 1994. This version of Excel incorporates IntelliSense technology, and new analysis tools such as MS Query and PivotTable features. The U.S. ERP is $339. Excel upgrades are $99 after redeeming a $30 rebate coupon included in the upgrade package. MS Excel for the Macintosh is scheduled to be available in more than 14 languages, among them, French, German, Japanese and Spanish.
- In September 1994, MS announced Excel 5.0 for Windows NT Workstation operating system version 3.5. The NT version will cost approximately $339, upgrades for current Excel users in the U.S. will be approximately $129. The Intel and Alpha AXP versions are expected to ship 30 days after the Windows NT Workstation. The MIPS and Power PC versions are expected to ship in the fourth quarter of 1994. Set-ups for all hardware platforms will be included in the same SKU.

Competition

- Lotus shipped 1-2-3, Release 5 for Windows this quarter. Lotus claims the new version broadens workgroup capabilities, improves ease of use, and expands database handling with tighter integration with Lotus' Approach 3.0. Some features found in Excel and Quattro Pro, such as data pivoting and reports will only be available in 1-2-3 if the user also purchases Approach. A new dimension available with this release is maps. (The next version of MS Excel will also include graphical mapping.)
- Lotus shipped an update to 1-2-3 for DOS called Release 4. Product enhancements are focused in four areas: ease of use, a highly graphical user interface, a powerful version manager and integrated mail enabling.
- Novell began shipping Quattro Pro version 6.0 in October. Key improvements include better integration and compatibility with other Novell applications, such as WordPerfect. Version 6.0 also supports OLE 2.0. Retail pricing is $395 (US); version upgrades are $49, and competitive upgrades are $99.

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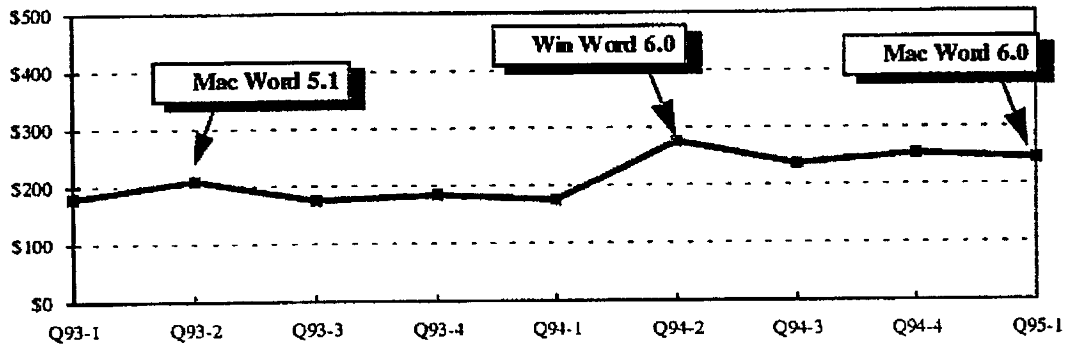
WORD

Net Revenue Stream & Key Product Releases (in millions)



Highlights

- The Word business unit wrapped up its Novell/WordPerfect response strategy which included a $99 competitive upgrade promotion on August 31, 1994. The broad marketing theme was "There's never been a better time to switch from WordPerfect to Word". Incremental marketing funds of $3 million were allocated to execute the plan.
- MS Word 6.0 for the Macintosh released to manufacturing in August 1994.
- In September 1994, MS announced Word 6.0 for Windows NT Workstation operating system version 3.5. The NT version will cost approximately $339, upgrades for current Word users in the U.S. will be approximately $129. The Intel and Alpha AXP versions are expected to ship 30 days after the Windows NT Workstation. The MIPS and Power PC versions are expected to ship in the fourth quarter of 1994.
- In September 1994, MS announced the updated version of the MS Word and Bookshelf bundle on CD-ROM. The new version combines MS Word 6.0 for Windows with the MS Bookshelf CD-ROM reference library '94. The announcement was made in the Seattle Public Library. Seattle Mayor Norm Rice, on behalf of libraries across the country, accepted a donation of 500 copies of the Word/Bookshelf bundle and 500 copies of MS Encarta at the event.

Competition

- The Novell Applications Group demonstrated WordPerfect 3.1 for the Power Macintosh at MacWorld Expo in Boston. It supports Apple's System 7.5 and includes features such as QuickCorrect, Quickdraw GX printing, and an improved drag-and-drop feature. The suggested retail price will be $495, upgrade will be $89, and competitive upgrades will be $99. The expected ship date is 30 days after Apple releases System 7.5.
- Novell announced WordPerfect version 6.1, to be available in early November. The focus of new feature development was in making the application easier to install and optimize for networks. It also will include more sophisticated grammar checking and linguistic technology.
- Lotus shipped AmiPro 3.1 for Windows, which adds mail integration and document management features. Lotus is positioning this update as highly compatible with Lotus Notes and as a customizable and flexible combination for document sharing and creation.

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BUSINESS SYSTEMS DIVISION

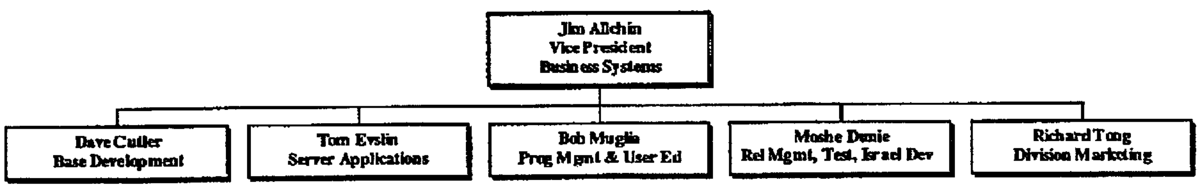
OVERVIEW

Mission

The mission of the MS Business Systems Division (BSD) is to provide the *total* computing solution for solving the organizational computing problems which end-users, administrators, and developer/solution providers experience today. The BSD mission is about access to, and management of information. BSD will release major revisions to its entire product line over the course of FY95, and will introduce two key new products, MS Exchange and the Systems Management Server. The updated product line will also be packaged together to create MS BackOffice, the world's best-integrated suite of server operating system and server application software designed to deliver enterprise-wide, client-server computing.

Organization

BSD is managed by vice president Jim Allchin, who joined Microsoft in 1990. Dave Cutler is responsibile for Windows NT and Windows NT Server development, while Tom Evslin is responsible for SNA Server, Systems Management Server, Mail, and Exchange development. SQL Server, also a BackOffice component, is engineered in Microsoft's Developer Division under the direction of Roger Heinen. Richard Tong manages BSD Division Marketing, which includes all BackOffice product marketing.



Products

- Windows NT Server version 3.5 released to manufacturing in mid-September. The updated Server product delivers a highly available, scalable, and portable client-server operating system designed to run on the industry's most popular computer systems, including systems built with Intel, MIPs, Alpha, and PowerPC microprocessors. The Server product functions equally well as an applications server, aimed at competing with Unix-based systems, and as a File and Print Server, directed at competing with Novell's NetWare and other local area network operating systems. Application servers are robust systems that support mission critical client-server applications, while file/print servers are designed for efficient sharing of disk storage and printing resources.
- SQL Server version 4.21a released to manufacturing in September. The latest release of Microsoft's client-server database for PC networks combines improved performance and scalability with broader network and ODBC support.
- SNA Server version 2.1 released to manufacturing in September. SNA Server is a server-based gateway to IBM mainframe and AS/400 systems. The latest release of SNA Server will deliver improved performance, increased capacity, and improved network support.
- Systems Management Server (SMS) version 1.0 will release to manufacturing by November. SMS is a network management product which will introduce ease-of-use and cost effective systems management to client-server computing. SMS supports software distribution and installation, performance monitoring and analysis, remote system troubleshooting, and hardware and software inventories.
- Microsoft Mail is a current-shipping product which delivers Microsoft's complete electronic mail messaging solution. By the end of FY95, Microsoft will deliver its client-server messaging solution Exchange. The concept of Exchange is to provide a product that integrates e-mail, scheduling, electronic forms, document sharing, and applications such as customer tracking to make it easier to turn information into a business advantage.

- Windows NT Workstation also released to manufacturing in September. The latest release dramatically increases desktop performance, and offers size improvements, better application support, and improved productivity features.

Business Metrics

	FY94 Actual	FY95 Budget
Gross Revenue ($ in millions)	$265	$442
Headcount	987	1,125
Operating Expenses ($ in millions) (People, Infrastructure, Prod Dev)	$136	$179
Windows NT Workstation (units in thousands)	145	403
Windows NT Server Shipments (units in thousands)	48	134

Key FY95 Business Initiatives

Microsoft BackOffice

BackOffice is an integrated information system which makes it easier for companies to improve decision making and streamline business processes while reducing business costs. BackOffice packages Windows NT Server, SQL Server, SNA Server, Systems Management Server, and Mail Server together as a single solution, providing a robust platform for customers' mission critical applications. With BackOffice, client-server solutions can be built on less expensive and equally reliable microprocessor hardware, enabling companies to interoperate with, and eventually downsize from, minicomputer or mainframe systems, while increasing business efficiency. BackOffice is priced aggressively and is orderable today through the Microsoft Select program; the product will be available in retail outlets in Q95-3.

New Licensing Model

A new BSD licensing model is being introduced with the updated release of the Server products. The new model will introduce a consistent licensing scheme across the entire line of Server products, is scalable for customers of all sizes, and introduces licensing flexibility and ease of administration. Under the new model, servers and clients will be licensed independently, with licensed clients granted the right to access any number of servers for a low cost fixed fee, regardless of user capacity and without charge for the class of machine. Pricing has been modified to reflect the updated licensing, resulting in lower pricing for smaller organizations (high volume market segment) and a moderate price increase for large organizations. Migration paths to the new licensing model exist for current users of Windows NT 3.1 and Advanced Server 3.1, LanMan, SNA Server 2.0, and SQL Server 4.21. A Windows NT Server competitive upgrade is also available to NetWare customers through March 31 for a reduced price.

Solutions Provider

Over the past year, Microsoft has built an extensive worldwide Solutions Provider network to meet the unique needs of organizations who use technology in, or apply it to, businesses. Microsoft's 7,000 Solution Providers are independent organizations which have teamed with us to apply technology to address company's business needs. They offer a complete range of services to create business solutions using Microsoft products so their customers achieve the full potential of current and emerging technologies. Solution Providers enable Microsoft to reach more small/medium organization and further penetrate large accounts. Microsoft is aggressively recruiting Novell, Sun, IBM, and HP channel partners into our Solution Providers program in an attempt to sell more networking, workstation, and server products.

Results of Operations ($ in millions)

	Q95-1 Actual	Plan	Variance
Net revenue	$66.9	$75.8	($8.9)
Cost of revenue	10.2	17.9	7.8
Gross profit	56.7	57.9	(1.2)
People	24.3	26.4	2.1
Infrastructure	8.0	8.4	.4
Marketing	10.9	21.1	10.3
Bad debt & taxes	.8	1.0	.2
Product development	7.3	13.0	5.6
Other	.1	.1	.0
Shared resources	3.5	5.1	1.6
Product support services	9.0	10.1	1.1
Operating expenses	63.8	85.1	21.3
Operating margin	($7.1)	($27.3)	$20.2
% Net revenue			
Cost of revenue	15 %	24 %	8 %
Operating margin	(11)	(36)	25
Operating expense mix			
All product development	62 %	56 %	
Marketing	17	25	
PSS	14	12	
Other expenses	7	7	
Total costs	100 %	100 %	

Cost Driver Analysis

- Although OEM sales were strong during the quarter, gross revenue for finished goods was 25% below plan, primarily as a result of a weak software market in Europe and a sales slowdown prior to new product releases. In particular, finished goods revenue for Windows NT Workstation and SQL Server were 57% and 66% of plan, respectively. Windows NT Workstation and Server 3.5 began shipping only a few days prior to the end of the quarter, so the majority of the new release sell-in is expected in Q95-2.
- Cost of revenue was 15% of net revenue for Q95-1 compared to plan of 23%. This variance was a result of higher than planned OEM license business, lower than planned material costs in Europe, and below plan manufacturing expenses. In addition, royalty payments to Sybase were $1.1 million less than plan as a result of lower than expected unit sales of SQL Server.
- Marketing expense for Q95-1 was only 52% of plan, principally the result of product launch expenses shifting into Q95-2. Spending was below plan across all marketing segments, including product marketing, channel marketing, and subsidiary marketing.
- Underspending of $2.8 million in product localization was the primary driver for the 43% variance in product development expense. Additionally acquisition of intellectual property rights planned for Q95-1 were delayed.

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Author: Norm Tonina

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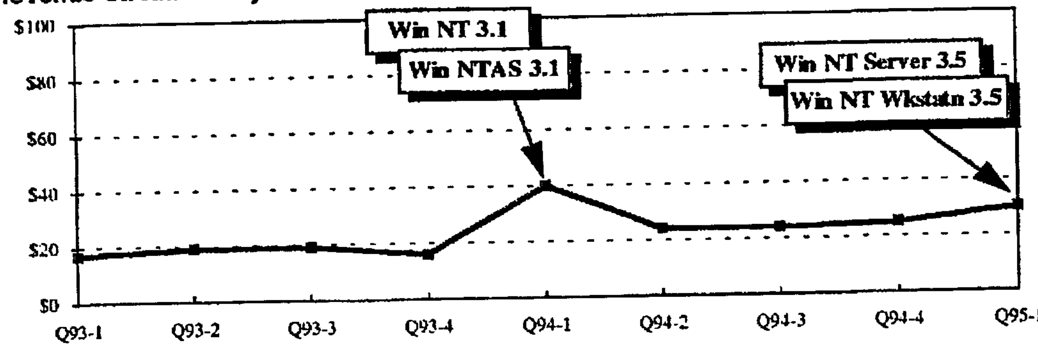
BUSINESS SYSTEMS OPERATING SYSTEMS

Net Revenue Stream & Key Product Releases (in millions)



Highlights

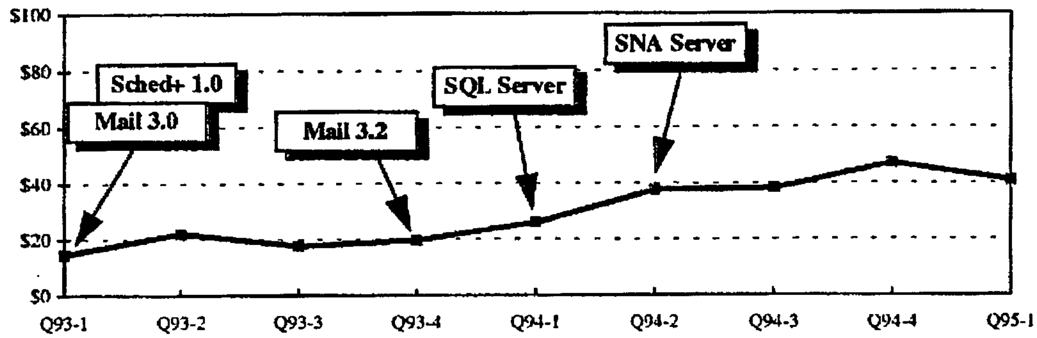
- Windows NT Workstation 3.5 and Windows NT Server 3.5 were released to manufacturing in September and began shipping shortly before the end of Q95-1. Significant enhancements include improved performance and crash protection, greater support for interaction of 16 and 32-bit OLE objects, and better networking support with regard to TCP/IP, NetWare services, and remote access.
- MS and Btrieve Technologies agreed to deliver and jointly market the Btrieve database engine, a leading NetWare database product, for Windows NT Server. As part of this agreement, MS will include a coupon in Windows NT Server redeemable for a 10-user version of the Btrieve database engine for $99. After one year, Btrieve plans to offer a Windows NT/Btrieve bundle through its distributors.
- The Microsoft BackOffice product was announced at Windows World Dallas in September. The BackOffice bundle will include:
  - Windows NT Server 3.5
  - SQL Server 4.21a
  - NA Server 2.1
  - Systems Management Server 1.0
  - Mail Server 3.2 (Upgrade to Microsoft Exchange Server in 1995)
- A broad license and price restructuring for server operating systems and applications was announced in September and becomes effective with the latest releases of the Business Systems products. Under the new model, servers and clients are licensed separately, providing customers with greater flexibility in obtaining and managing their network licenses, and allowing a more competitive entry price for low-end customers requiring a small number of clients.
- Unisys and AT&T GIS announced intentions to pre-install MS BackOffice on some server products, and Dell and HP announced their support of the suite. In addition, Compaq indicated that they will distribute BackOffice beginning in early 1995 via Smartstart, their encrypted CD distribution system.

Competition

- Novell identified plans to develop a new network operating system, SuperNOS, by 1996. The system is expected to combine elements of Novell NetWare and Unix, while maintaining compatibility with both. The operating system will be based on an object-oriented programming framework.
- In August, Novell implemented a price reduction of approximately 15 percent on its competitive upgrade for NetWare 3 and Netware 4, and expanded its upgrade program by adding peer-to-peer upgrades and server consolidation options. As part of the promotion, customers who purchase a minimum 10-user upgrade to NetWare 3 or 4 before the end of October are provided a copy of GroupWise 4.1, Novell's mail, scheduling, and task management application.

SERVER APPLICATIONS

Net Revenue Stream & Key Product Releases (in millions)



Highlights

- MS SQL Server 4.21a released to manufacturing in September and will begin shipping in October. SQL Server is an improved version of the Microsoft client-server database which combines better performance and scalability with broader network and ODBC support.
- MS SNA Server 2.1 also released to manufacturing in September and will begin shipping in October. SNA Server is a major upgrade of the network-to-IBM connectivity product and includes enhancements for better performance, increased capacity, and greater network support.
- MS Systems Management Server 1.0 was announced in September and is scheduled to release to manufacturing before November. SMS is Microsoft's new network management product which supports hardware and software inventories, software distribution and installation, performance monitoring and analysis, and remote system troubleshooting.
- MS Mail 3.2 has continued to garner industry awards including:
  - GroupWare '94 Best of Show Award for E-mail and messaging.
  - NetWare Users' International Readers' Choice Award.
  - Number one E-mail package selected by Communications Week and Network Computing magazines.

Competition

- In September, Lotus announced Notes Express, a Notes client available for less than $100 per copy. Although priced significantly less than a standard Notes client ($329 ERP), Notes Express excludes all the design features of the standard client, and limits users to only five basic communication and collaboration templates.
- Lotus began shipping its Notes Server for Windows NT in late September. At the same time, they began shipments of the Notes Server for NetWare and announced availability of the Notes Server for Unix in October.
- Oracle and Lotus entered into a joint marketing and development agreement regarding the interoperability of Lotus Notes and Oracle Media Server. Together the products will allow customers to combine Lotus' workgroup capabilities with Oracle's recently announced multimedia management system.
- WordPerfect released Novell GroupWise 4.1 in early September. GroupWise combines electronic mail, personal calendaring, group scheduling, task management, rules-based message management and workflow routing in a single application, supporting a broad array of client and server platforms.
- Oracle agreed to buy Digital Equipment's database software operations for $108 million.

Author: Bill Benack

PERSONAL OPERATING SYSTEMS

Results of Operations ($ in millions)

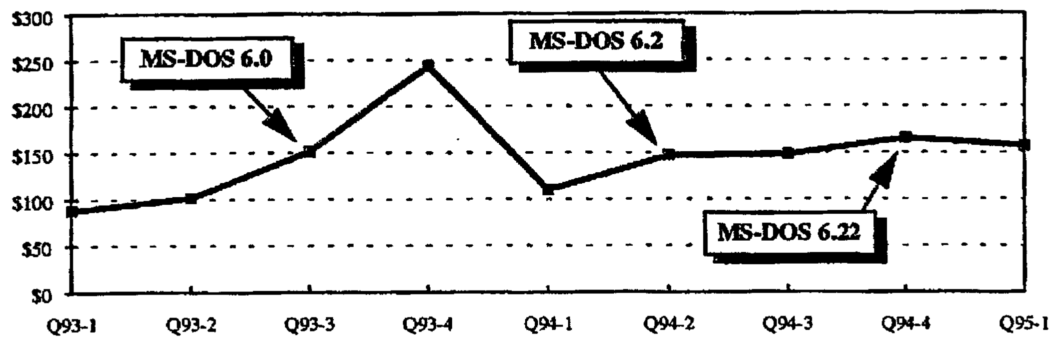
	Q95-1 Actual	Q95-1 Plan	Q95-1 Variance
Net revenue	$366.4	$304.9	$61.6
Cost of revenue	14.6	15.1	.5
Gross profit	351.8	289.8	62.0
People	11.0	10.9	(.1)
Infrastructure	2.2	2.3	.1
Marketing	7.4	15.0	7.6
Bad debt & taxes	11.6	11.9	.3
Product development	2.4	7.2	4.8
Other	.0	(.1)	(.1)
Shared resources	2.9	4.7	1.8
Product support services	15.0	17.7	2.6
Operating expenses	52.5	69.5	16.9
Operating margin	$299.3	$220.3	$79.0
% Net revenue			
Cost of revenue	4 %	5 %	1 %
Operating margin	82	72	9
Operating expense mix			
All product development	30 %	29 %	
Marketing	14	22	
PSS	29	25	
Other expenses	28	24	
Total costs	100 %	100 %	

Cost Driver Analysis

- OEM and FG gross revenue exceeded Q95-1 plan by $32 million (13%) and $35 million (76%). respectively. North America FG exceeded its MS-DOS gross revenue plan by $8 million (173%) and its Windows gross revenue plan by $16 million (98%). Retail demand for MS-DOS and Windows continues to be strong, even as a first half 1995 Windows 95 launch approaches. Division revenue also includes $17 million in OEM Unspecified Product Billing revenue.
- The Q95-1 marketing variance was due principally to below plan spending by channel marketing.
- The $2.6 million positive PSS variance was driven by below plan headcount and shorter than expected call lengths in international subsidiaries.
- The $4.8 million positive variance in product development resulted from below plan spending for temporaries and contractors, beta program expenses and purchased code.

MS-DOS

Net Revenue Stream & Key Product Releases (in millions)



Highlights

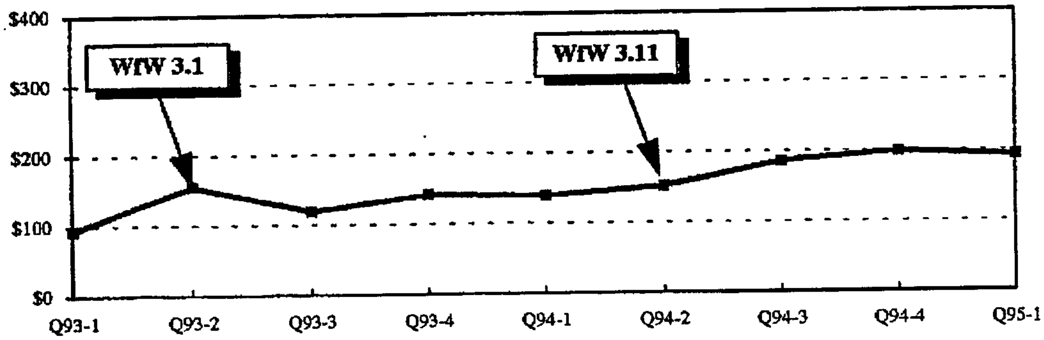
- MS-DOS for Dummies 6.22 Upgrade released at the end of July.

Competition

- Novell announced that it will discontinue development of Novell DOS 7.0 and will phase out the product line. Novell will continue to support Novell DOS 7.0 customers and is considering selling the product to a third party.
- IBM has indicated PC DOS 7.0 will include multitasking capabilities.
- PC Exchange version 2.0, Apple's file format conversion software for the Macintosh, recognizes diskettes formatted with various operating systems, including DOS, OS/2 and Apple II ProDOS. PC Exchange is included in Apple's System 7.5 upgrade and is currently offered as a stand-alone product for $79.
- Apple held a DOS Compatibility card technology demonstration for the Power Macintosh. The compatibility card allows Mac Users to run DOS & Windows applications on an Intel processor. This card uses a 50MHZ 486DX2 microprocessor and offers improved networking support over the discontinued 25MHZ 486SX-based DOS Compatibility card for Centris and Quadra 610 Macintoshes.
- Insignia Solutions Inc. released SoftWindows 1.0, a PC-emulation software product for the Power Macintosh. Apple and Insignia intend to offer an 80486 version of SoftWindows by the end of 1994 which will allow Windows applications to run in enhanced mode. SoftWindows 1.0 is available at a list price of $499 but is currently bundled with some Power Macintosh models.

WINDOWS

Net Revenue Stream & Key Product Releases (in millions)



Highlights

- Windows or Windows for Workgroups is projected to ship on 89% of MS-DOS-based OEM systems in FY95, up from 74% in FY94.
- The Ninth Circuit Court of Appeals affirmed a lower court's dismissal of Apple Computer's copyright infringement claims against Microsoft Windows operating system versions 2.03 and 3.0, as well as Hewlett-Packard's NewWave.
- Windows 95 was announced as the new name for the next generation 32-bit Windows operating system. The change in naming conventions is designed to help customers make it easier to identify products that will work with the technology.
- The Windows 95 M6.3 beta shipped in early September to approximately 200 end-user and ISV beta testers. The Windows 95 Preview Program, the final beta version of the new operating system, is scheduled to be sent over 350,000 participants worldwide this January.

Competition

- IBM announced the newest version of its 32-bit PC operating system, OS/2 Warp, on October 11. Warp offers improvements over earlier OS/2 versions including support for PCMCIA peripherals, smaller memory and hard disk requirements, improved multi-tasking, and bundled applications, such as Kodak CD, and access to the Internet and CompuServe on-line information services. Street pricing is estimated at approximately $80 for DOS and Windows users and $130 for new users. The next version of OS/2, for use on local area networks, will begin beta testing next month.
- Independent research conducted by PC Watch indicates OS/2 is currently installed and used on 1-2% of PC's in the US.
- Dell will make OS/2 Warp available preloaded on its computer systems upon request. Dell and IBM will also conduct joint marketing activities. In total, IBM will spend $50 million in advertising over the next 12 weeks to promote the new OS/2 Warp. Lee Reiswig, president of the IBM personal software product division, said publicly that IBM would spend as much as $500 million to market and advertise the new operating system.
- Apple Computer plans to license the Macintosh operating system to other personal computer vendors. Initially, Apple plans to license its core Mac OS (System 7.5) and elements of its PowerPC RISC-based hardware architecture to companies with strengths which are complimentary to Apple's; over time, Apple plans to more broadly license to a wider range of vendors.
- Apple, IBM and Motorola continue defining a PowerPC-based reference hardware platform. The reference platform is expected to be consistent with the current Power Macintosh family, OS/2 and NT operating systems.

CONSUMER

Results of Operations ($ in millions)

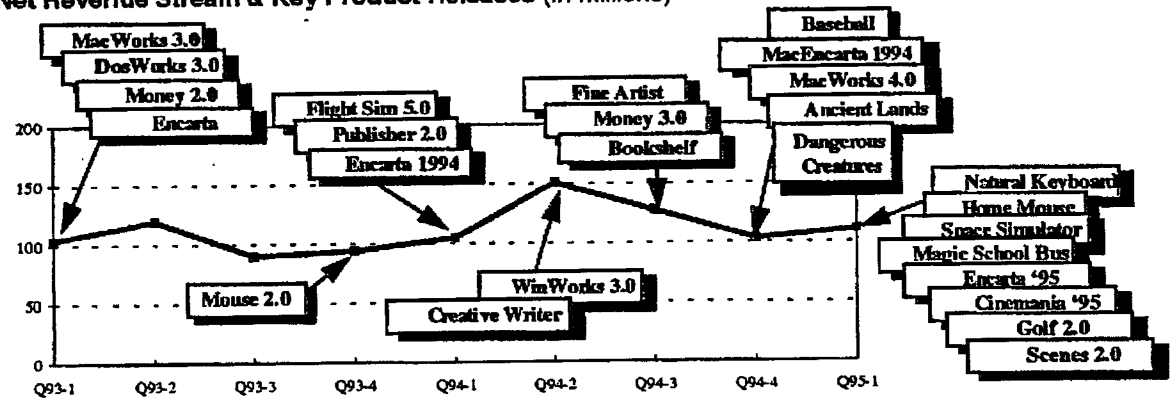
	Q95-1 Actual	Plan	Variance
Net revenue	$111.7	$135.4	($23.8)
Cost of revenue	39.3	43.0	3.7
Gross profit	72.4	92.4	(20.0)
People	14.7	17.5	2.8
Infrastructure	3.4	3.9	.5
Marketing	13.5	15.0	1.5
Bad debt & taxes	1.8	2.1	.3
Product development	9.9	17.8	7.9
Other	.1	.0	(.0)
Shared resources	2.3	3.2	.9
Product support services	3.8	4.9	1.2
Operating expenses	49.5	64.4	15.0
Operating margin	$22.9	$28.0	($5.1)
% Net revenue			
Cost of revenue	35 %	32 %	(3) %
Operating margin	21	21	(0)
Operating expense mix			
All product development	56 %	61 %	
Marketing	27	23	
PSS	8	8	
Other expenses	8	8	
Total costs	100 %	100 %	

Cost Driver Analysis

- Net revenue for the Consumer division was $24 million below plan, principally due to delays in shipping Encarta '95, and a shortfall in sales of Works.
- Cost of revenue was 35% of net revenue compared to plan of 31%. This higher cost of revenue is due to a higher mix of Mouse products than planned, which represented 39% of gross revenue versus plan of 29%.
- Operating expenses were lower than plan due to a 18% positive variance in headcount, and delays in third party development spending.
- Marketing expense in aggregate was 10% below plan, but as a percentage of net revenue was 12% compared to plan of 11%.

 Author: Kim Janzik

Net Revenue Stream & Key Product Releases (in millions)



Highlights

- Fifty-nine titles (which includes different languages and operating environments) shipped during Q95-1. An additional thirty-nine titles are expected to be released in Q95-2.
- The MS Home Mouse was shipped in mid-July. MS Home Mouse has an ERP of $39.95, offering high-quality components at a price to suit the home budget. It includes IntelliPoint Home software, which provides entertaining special effects and practical features to make "mousing" more enjoyable.
- The MS Natural Keyboard was released to manufacturing in July and has been well received by the market. The result of more than 18 months of ergonomic testing and market and usability research, the Keyboard incorporates hardware features t hat permit users to maintain a more relaxed, natural position while typing. For Q95-1, 40,000 units were sold, compared to a plan of 10,000 units. Additionally, 40,000 units were on backorder at the end of Q95-1.
- MS announced an agreement with Children's Television Workshop (CTW) to make creative software for children. CTW and MS will combine characters and stories from CTW's Ghostwriter TV Series.
- MS announced a development and publishing agreement with The Reader's Digest Association. The relationship will produce original multimedia software for home computer users based on content from Reader's Digest best-selling books.

Competition

- Random House and Knowledge Adventure announced a co-publishing arrangement in which they will jointly create, produce and market multimedia titles, beginning in November.
- Broderbund Software signed Quadrangle Software as a new affiliate. They will jointly produce sports screen savers. Broderbund released 15 new products during Q95-1, of which two-thirds were on CD-ROM.
- Electronic Arts announced it would shift its focus from video cartridge games to game titles for CD-ROM. It plans to produce roughly 50 new titles on CD-ROM by next March.
- Compaq announced it was investing in Books That Work Software, a home-improvement/how-to publisher. The agreement marked Compaq's second equity investment in a consumer software firm. As part of the partnership, Compaq is bundling titles from Books That Work's home improvement software with its Presario line.

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DEVELOPER

Results of Operations ($ in millions)

	Q95-1 Actual	Plan	Variance
Net revenue	$57.1	$46.5	$10.6
Cost of revenue	15.0	15.3	.3
Gross profit	42.1	31.2	10.9
People	18.8	18.7	(.1)
Infrastructure	4.9	5.5	.5
Marketing	5.4	11.3	5.9
Bad debt & taxes	.3	.6	.3
Product development	2.5	5.4	3.0
Other	(.8)	(.1)	.7
Shared resources	(4.7)	(3.6)	1.1
Product support services	12.6	14.4	1.7
Operating expenses	39.1	52.1	13.0
Operating margin	$3.0	($21.0)	$23.9
% Net revenue			
Cost of revenue	26 %	33 %	7 %
Operating margin	5	(45)	50
Operating expense mix			
All product development	67 %	57 %	
Marketing	14	22	
PSS	32	28	
Other expenses	(13)	(6)	
Total costs	100 %	100 %	

Cost Driver Analysis

- Total cost of revenue as a percent of net revenue was well below plan at 26%. This was due largely to a variance in sales mix which resulted in more than planned "kits" (sdk's, various toolkits) being sold relative to other products. These kits, including the Access Developers Toolkit, had a significantly lower cost of revenue than plan at 14%.
- Operating expenses for the quarter were 25% below plan. Marketing spend was under plan by $5.9 million, primarily due to delays in spend relative to plan. Marketing expenditures are likely to exceed plan in each of the next two quarters when new versions of Visual Basic, FoxPro and Visual C++ are scheduled to ship. Product development was also below plan by $3 million due to underspend third party contractor expenses.
- Product Support costs for developer tools were high, 22% of net revenue. Analysis is under way to determine means of reducing these costs. One alternative is to reduce the current free support model for developer tools from 90 to 30 days.

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Author: Cal Dauncey

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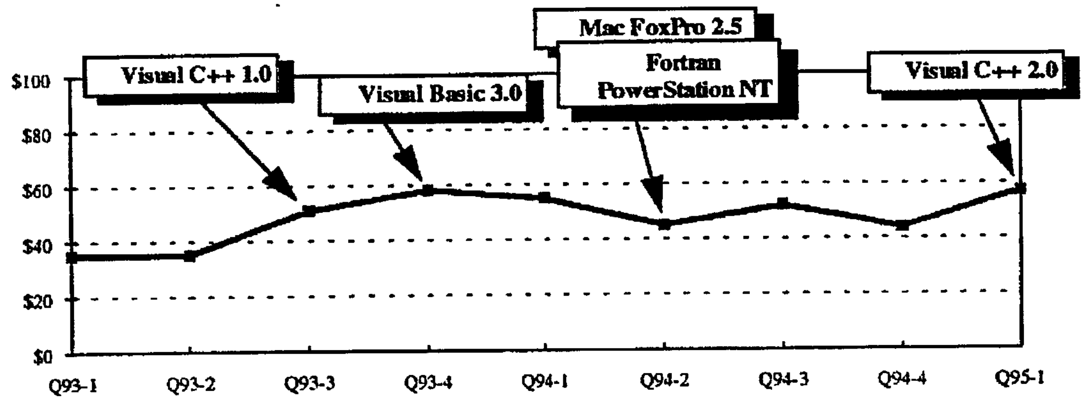
Net Revenue Stream & Key Product Releases (in millions)



Highlights

- Overall, divisional net revenue was 23% above plan at $57 million. Most of the revenue variance occurred in the Far East where sales of Japanese versions of Visual C++ and Visual Basic continue to be strong.
- Visual C++ 2.0 Development System and Tools released to manufacturing late in Q95-1. The product offers both 16 bit and 32 bit tools enabling developers to build high performance applications on both current and future versions of Windows. In the US the product will be offered both as a single issue at $399, as well as a quarterly subscription product for $499 .
- Visual Basic 4.0, originally scheduled for release to manufacturing during Q95-2 has been delayed to Q95-3.
- The division is in the final stages of acquiring One Tree Software, the developer of SourceSafe. SourceSafe has received positive reviews in the press for its easy-to-use and fast Windows oriented Source Code Control (SCC) system. Integrated SCC is the number one feature requested by our Visual C++, Visual Basic and FoxPro users. Plans are to integrate SourceSafe into the division's language offerings during calendar '95. SourceSafe's version control and configuration management infrastructure will be evolved into the MS Repository. The MS Repository is being jointly designed with Texas Instruments and will enhance team development through improvement in the re-use of components and integration between MS and third party tools. To date, three key members of the development team have accepted employment with MS as part of the deal, which is expected to close early in Q95-2.

Competition

- Borland released dBase for Windows and Paradox 5.0 during the quarter. Reports from the field indicate that sales of dBase are very slow.
- Powersoft Corporation announced that PowerBuilder 3.0a has been named the Best New Development Product, the Best Front-End Development Tool and the Best Application Development Tool by Data Based Advisor in its 1994 Readers Choice Awards. PowerBuilder is Visual Basic's primary competitor.

ADVANCED TECHNOLOGY

Results of Operations ($ in millions)

	Q95-1 Actual	Plan	Variance
Net revenue	$7.9	$7.6	$.3
Cost of revenue	3.3	4.3	1.0
Gross profit	4.6	3.3	1.2
People	18.1	22.1	4.0
Infrastructure	3.9	4.7	.8
Marketing	1.7	3.1	1.4
Bad debt & taxes	(.0)	.0	.0
Product development	1.6	6.1	4.5
Other	6.5	.1	(6.3)
Shared resources	(2.8)	(3.4)	(.6)
Product support services	.0	.0	.0
Operating expenses	28.9	32.7	3.8
Operating margin	($24.4)	($29.4)	$5.0
% Net revenue			
Cost of revenue	42 %	56 %	14 %
Operating margin	(310)	(385)	76
Operating expense mix			
All product development	81 %	101 %	
Marketing	6	9	
PSS	0	0	
Other expenses	13	(10)	
Total costs	100 %	100 %	

Cost Driver Analysis

- People expense was under plan due to a hiring rate much slower than planned. The Advanced Consumer Technology group (ACT) ended the quarter 68 people below its hiring plan, MS On-line Services (MOS) 61 people and Broadband Media Applications (BMA) 24 people below plan.
- The favorable infrastructure expense variance was the result of lower than plan headcount coupled with lower than plan building and grounds distributions.
- ACT marketing spend was $1.7 million versus a budget of $2.3 million, while MOS, BMA and Advanced Product Development (APD) have not yet incurred any material marketing expenses. The overall marketing spend is forecasted at budgeted levels for the year.
- Product development was below plan in all areas of AT, principally due to underspending for third party contractors.
- The $6.5 million variance in other expenses was due to the unplanned expense for the acquisition of Altamira.

Highlights

- MS will provide the end-to-end software solution including video on demand, navigator, electronic program guide and network operator software for Southwestern Bell's interactive video trial in Richardson, Texas. The project is set to begin testing with customers during Q95-4.
- MS completed a merger with Altamira Software Corp. near the end of Q95-1. Altamira is a computer graphics software company focusing on innovative desktop color-imaging technology and applications. Altamira founder Dr. Alvy Ray Smith will join MS as graphics fellow, and Nicholas Clay, former Altamira VP of technology will become a director of architecture development in ACT.
- In Japan, NEC demonstrated Tiger video server technology. NEC plans to market Tiger on its proprietary PCs and servers.
- The Data Link watch jointly developed with Timex is scheduled to ship in Q95-2 and will retail for $99 to $129. The product allows users to download from their computers to the wristwatch personal information management entries such as appointments and telephone numbers.

Competition/Industry Highlights

Wireless

- A federal judge approved AT&T's $12.6 billion purchase of McCaw Cellular.
- Sony announced a new $1000 hand-held communicator, Magic Link, that has the ability to filter e-mail or find information on an on-line service network while the device is disconnected using electronic agents
- Oracle began selling Oracle in Motion, a software product that will allow users with a laptop computer and special wireless modem to query their companies' databases via an electronic agent.

ITV

- In early July the FCC approved an application by Bell Atlantic to offer interactive television service in New Jersey. This was the first time the FCC cleared the way for a telephone company to offer commercial cable television.
- Disney, Ameritech Corp., BellSouth and Southwestern Bell plan to form a joint venture to develop, market and deliver traditional and interactive video programming to consumers.
- Oracle introduced Oracle MediaServer which allows companies to manage, share and access all types of information including structured operational data, unstructured document data and stream audio and video data.
- US West signed up seven Hollywood studios and Visa as partners in their new entertainment information service, GOtv.
- Prodigy developed a prototype for a cable-delivered version of itself called Prodigy TV.

Online

- During Q95-1 America Online announced it surpassed the one million subscriber mark. America Online reported that their FY94 revenue increased 161% over FY93 while their fully taxed net income increased 102%. Their number of subscribers at the end of FY94 was 199% of the number at the end of FY93.
- CompuServe did final testing on Usenet, its Internet access services.
- Lotus Notes Information Services was announced by CompuServe. For $22.80 per hour of connect time users of Lotus Notes groupware can connect to CompuServe's online databases and services.
- Apple launched eWorld for Macintosh in Canada and offered both new and existing users a 10-hour free trial. They plan to launch eWorld in the UK in October, and to follow soon afterwards with launches in Australia and New Zealand.
- IBM is testing a service whereby computer users could order software electronically and have it delivered to their machines via IBM's international network.

Finance

Worldwide Operations

Worldwide Operations

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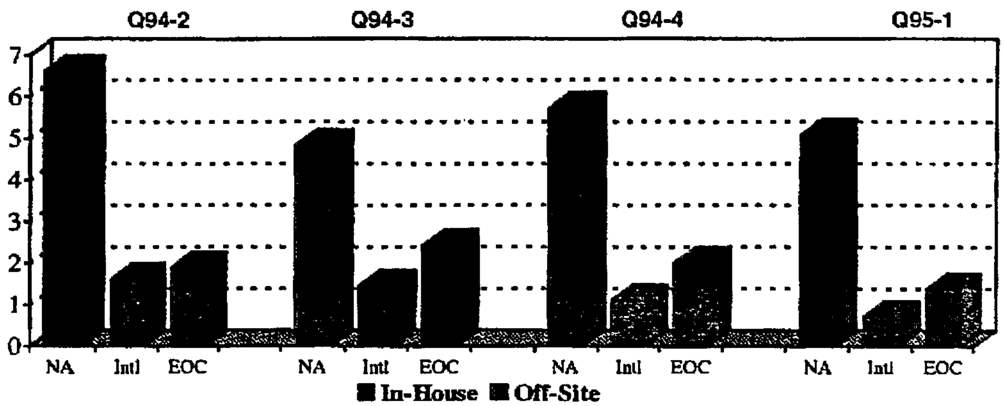
WORLDWIDE OPERATIONS

Highlights

- The company wide reorganization which took place in Q94-4 expanded the role of Worldwide Operations. The Operations organization is responsible for the entire order management cycle at MS. This includes integration of product introduction, sales planning, order processing, manufacturing, distribution, fulfillment logistics, billing and collections for all regions of the world.
- Operations has developed shared performance metrics with Sales and Marketing. These metrics include:
  - Revenue generation: Fulfilling created demand compared to budget.
  - Cost of revenue management: Total supply chain costs managed to cost of revenue budget.
  - Dependable service: Delivery cycle time by product and / or service.
  - Customer service: Done by customer survey or informally.
- MS warehouses in Italy, Benelux, and Russia were closed during Q95-1. This completes warehouse closures in the European region related to the Concorde project, with all remaining warehousing and distribution performed at the European Operations Center (EOC) in Ireland. Total MS warehousing space in Europe has been reduced from 150,000 to 40,000 square feet over the last year.
- Benelux, France and Italy order processing were successfully converted to the EOC as planned at the end of Q95-1. Central and Eastern Europe will convert during Q95-2. These last conversions will complete the migration of all full packaged product, Select, and MOLP European revenue streams to the EOC.
- All European subsidiaries are now commission agents of MS Manufacturing B.V. (EOC).
- Ingram began placing European orders centrally to EOC via EDI in Q95-1 for all countries except Italy, which will be added in Q95-2. Merisel Germany was fully tested on EDI in Q95-1 and is ready for implementation pending user training at Merisel.
- Canyon Park was audited and recommended for ISO registration during Q95-1.
- North America has implemented a transaction fee based system for direct end user fulfillment with third party fulfillment houses, Upgrade Corporation of America and Matrix Inc.
- North America has implemented distributed manufacturing at KAO, Plymouth Massachusetts to supply consumer products to the east coast during the upcoming holiday sales season.
- North America has completed a conference room pilot of an Account Forecasting System that will be the foundation for the emerging supply chain management, forecasting and distribution strategy.
- An initial plan for developing a Far East regional processing center was completed. Project recommendations will be delivered before the end of Q95-2.

Production Comparison (units in millions)



North America

- North America produced 5.1 million units during Q95-1, which includes North America and domestic OEM finished goods and license products. The largest volume products were Office (675,000 units), MS-DOS (535,000 units), and Word (522,000 units).
- North America outsourced 41% of its production against a budget of 55% resulting in lower than planned outsourcing costs for Q95-1.

International

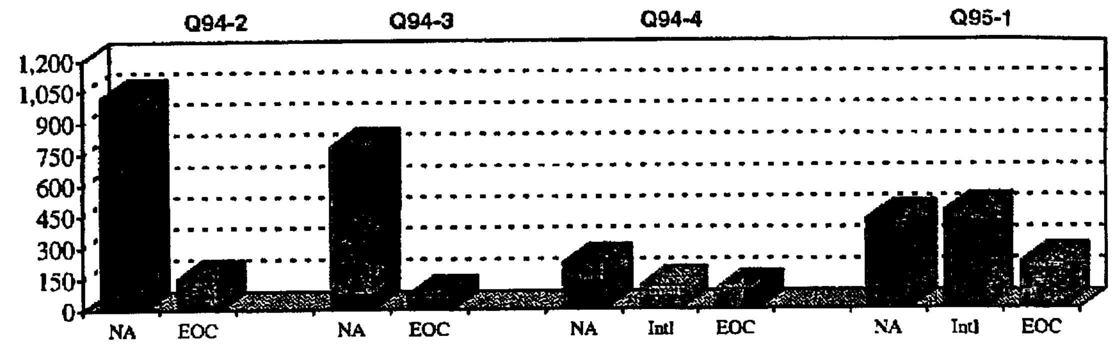
- The International factory at Canyon Park produced 0.7 million units during Q95-1 consisting primarily of Windows 3.11 (96,000 units), Office (81,000 units), MS-DOS (73,000 units), Works (38,000 units) and Access (35,000 units).
- During Q95-1 the International factory outsourced 16% of its production.

European Operations Center (EOC)

- The European Operations Center produced 1.4 million units during Q95-1. EOC production decreased by 32% from Q94-4 levels resulting from lower sales activity during the summer months.
- EOC outsourced 10% of its production units compared to 14% in Q94-4.

Author: Bob Lunn

Backlog Comparison (units in thousands)



Buildable backlog represents released products. Non-buildable backlog occurs when orders are placed for unreleased products.

North America

- Q95-1 backlog of 429,000 units was an increase of 94% from the Q94-4 level.
- Q95-1 buildable backlog of 374,000 units consisted primarily of Space Simulator 1.00 (80,000 units), MS-DOS 6.22 upgrade (45,600 units), and Mac Excel 5.0, Mac Word 6.0 and Mac Office 4.2 (108,900 units combined). Space Simulator, Mac Excel, Word and Office represented new product releases. The MS-DOS 6.22 upgrade units were unforecasted orders. The 374,000 buildable backlog represents 7.4 day's production.
- The non-buildable backlog of 55,000 units consisted primarily of various Mouse products (49,000 units) which accounted for 89% of the non-buildable backlog. These products were non-buildable pending release of related software. MS Keyboard 1.0 Retail had a backlog of 5,100 units due to demand in excess of the third party vendor's production capacity (KeyTronics).

International

- Q95-1 backlog totaled 466,000 units of which 89% (414,000 units) were buildable and 11% (52,000 units) were non-buildable.
- Q95-1 buildable backlog totaled 414,000 units consisting primarily of Mouse 2.0a (87,900 units), Win Encarta 1995 CD-ROM (13,500 units), Mouse Home 1.0 (12,000 units), Clamshell Mouse 2.0 (10,000 units).
- Current daily capacity is estimated at 20,000 units per day at 2 shifts/day, 5 days/week.

European Operations Center

- EOC's total Q95-1 backlog of 221,000 units represents an increase of 140% over the Q94-4 backlog.
- Buildable backlog totaled 184,000 units of which only 27,000 (15%) had a ship date due prior to September 30. The 27,000 buildable backlog represents 1.2 day's production.
- Non-buildable backlog totaled 37,000 units.

Cost Of Revenue Summary

Q95-1 total cost of revenue for worldwide finished goods was 18% of net revenue compared to plan of 21%, and was lower than plan across all regions.

- North America was favorably impacted by revenue in excess of plan, combined with lower than plan spending in aggregate.
- Europe, while below plan in revenue, benefited from a dramatic shift in sales to licensed product compared to plan.
- ICON cost of revenue was significantly below plan due to lower than plan spending in all categories, except freight, and a shift in license mix.
- Far East benefited from an exceptionally strong revenue quarter, combined with the favorable effects of shifts in license mix and a continuing decrease in product costs. This decrease in product cost continues a concerted effort to reduce cost of revenue begun in FY94, particularly in Japan.

Product Costs

- Product costs consist of all costs incurred to manufacture and assemble finished goods.
- Total product costs exceeded budget by $4.9 million, but as a percentage of net revenue were 1% below plan. This was principally due to below plan spending for manufacturing and materials, particularly reflecting reduced cost of manuals in North America and lower than planned manufacturing spend in Europe. Additionally, product costs were favorably impacted by lower than planned spending for hardware tooling in North America.

Processing Costs

- Processing consist of costs related to program management, planning and order transaction processing. These costs are incurred by the Operations management & planning groups in Redmond, OSC's, and in subsidiaries.
- Processing costs were 1.4% of net revenue compared to plan of 2.1%. Spending for processing was less than planned across all regions due principally to below plan headcount and slower than planned spending for outsourcing related to a broad range of sales programs.

Inventory Adjustments

- Inventory adjustments include the costs of rework, scrap, obsolete inventory, product recost and cycle count adjustments.
- Inventory adjustments totaled $9.1 million, or 1% of net revenue, compared to plan of $16.5 million. This favorable variance was primarily the result of a positive annual inventory recost, and lower than plan inventory adjustments related to subsidiary warehouse closures.

Freight and Distribution

- Freight and distribution includes the cost of freight-out, warehousing, duties and customs and shipping supplies including pallets, shrink wrap, labels, packing slips and other materials.
- Freight and distribution costs were below plan across all regions except ICON. A negative variance in ICON was primarily due to air freight costs from the R.R. Donnelley distributed manufacturing facility in Singapore to Australia.

Author: Bob Lunn

COST OF REVENUE SUMMARY
($ IN MILLIONS, LICENSES IN THOUSANDS)

	North America				Europe				ICON				Far East				Total FG			
	Actual		Plan		Actual		Plan		Actual		Plan		Actual		Plan		Actual		Plan	
Net revenue	$ 445.9	100.0%	$ 384.0	100.0%	$ 253.9	100.0%	$ 270.2	100.0%	$ 89.5	100.0%	$ 76.5	100.0%	$ 96.7	100.0%	$ 58.7	100.0%	$ 886.0	100.0%	$ 789.4	100.0%
Cost of revenue																				
Product cost	54.5	12.2%	52.0	13.5%	26.0	10.2%	28.6	10.6%	13.1	14.7%	12.9	16.8%	15.6	16.1%	10.7	18.3%	109.2	12.3%	104.3	13.2%
Processing	6.8	1.5%	7.8	2.0%	4.2	1.7%	6.3	2.3%	0.5	0.5%	0.7	0.9%	1.1	1.2%	1.5	2.5%	12.6	1.4%	16.2	2.1%
Inventory adjustments	8.4	1.9%	11.3	3.0%	1.9	0.8%	2.5	0.9%	(1.5)	(1.6%)	2.2	2.9%	0.3	0.3%	0.4	0.7%	9.2	1.0%	16.5	2.1%
Freight & distribution	4.4	1.0%	6.3	1.6%	3.4	1.4%	4.1	1.5%	2.4	2.7%	1.6	2.1%	2.2	2.3%	1.8	3.1%	12.5	1.4%	13.8	1.8%
Royalties	7.9	1.8%	7.4	1.9%	2.5	1.0%	3.0	1.1%	1.1	1.2%	1.0	1.3%	1.6	1.6%	0.8	1.3%	13.1	1.5%	12.1	1.5%
Miscellaneous costs	3.8	0.9%	4.1	1.1%	0.7	0.3%	0.8	0.3%	0.1	0.1%	(0.1)	(0.1%)	0.1	0.1%	-	0.0%	4.6	0.5%	4.9	0.6%
Total cost of revenue	85.8	19.2%	89.0	23.2%	38.7	15.2%	45.3	16.8%	15.7	17.5%	18.3	23.9%	20.9	21.6%	15.2	25.8%	161.1	18.2%	167.8	21.3%
Gross margin	$ 360.1	80.8%	$ 295.0	76.8%	$ 215.2	84.8%	$ 224.9	83.2%	$ 73.8	82.5%	$ 58.2	76.1%	$ 75.8	78.4%	$ 43.5	74.2%	$ 724.9	81.8%	$ 621.6	78.7%
Revenue Mix																				
FPP	$ 337.8	75.8%	$ 288.9	75.2%	$ 131.8	51.9%	$ 188.0	69.6%	$ 56.5	63.2%	$ 57.4	75.0%	$ 83.5	86.3%	$ 51.1	87.1%	$ 609.6	68.8%	$ 585.4	74.2%
Select	34.7	7.8%	34.2	8.9%	46.0	18.1%	28.8	10.7%	6.2	6.9%	4.2	5.6%	1.8	1.8%	1.7	2.8%	88.6	10.0%	68.9	8.7%
License	58.2	13.0%	40.7	10.6%	53.0	20.9%	48.6	18.0%	21.5	24.1%	13.8	18.0%	10.1	10.4%	5.4	9.2%	142.8	16.1%	108.4	13.7%
Maintenance	20.2	4.5%	7.2	1.9%	8.3	3.3%	6.3	2.3%	2.6	2.9%	0.8	1.1%	0.3	0.3%	-	0.0%	31.4	3.5%	14.3	1.8%
Hardware	22.9	5.1%	19.0	4.9%	4.6	1.8%	6.9	2.6%	1.6	1.8%	2.4	3.1%	1.0	1.1%	1.2	2.1%	30.0	3.4%	29.5	3.7%
Revenue adj & other	(27.8)	(6.2%)	(6.0)	(1.6%)	10.3	4.0%	(8.4)	(3.1%)	1.1	1.2%	(2.1)	(2.7%)	0.0	0.0%	(0.7)	(1.2%)	(16.4)	(1.9%)	(17.2)	(2.2%)
Total net revenue	$ 445.9	100.0%	$ 384.0	100.0%	$ 253.9	100.0%	$ 270.2	100.0%	$ 89.5	100.0%	$ 76.5	100.0%	$ 96.7	100.0%	$ 58.7	100.0%	$ 886.0	100.0%	$ 789.4	100.0%
License Mix																				
FPP	2,830	57.5%	2,278	55.6%	902	46.4%	1,371	69.8%	474	50.6%	622	76.4%	389	76.7%	383	83.3%	4,595	55.3%	4,654	63.4%
Select	308	6.3%	285	7.0%	319	16.4%	144	7.3%	53	5.7%	23	2.8%	13	2.6%	13	2.8%	693	8.3%	465	6.3%
License	741	15.0%	542	13.2%	394	20.3%	216	11.0%	227	24.2%	82	10.1%	70	13.8%	34	7.4%	1,432	17.2%	874	11.9%
Maintenance	487	9.9%	144	3.5%	206	10.6%	60	3.1%	119	12.7%	20	2.5%	14	2.8%	-	0.0%	826	9.9%	224	3.1%
Hardware	467	9.5%	353	8.6%	88	4.5%	174	8.9%	38	4.1%	67	8.2%	21	4.1%	30	6.5%	614	7.4%	624	8.5%
Other	91	1.8%	494	12.1%	36	1.9%	-	0.0%	26	2.8%	-	0.0%	-	0.0%	-	0.0%	153	1.8%	494	6.7%
	4,924	100.0%	4,096	100.0%	1,945	100.0%	1,965	100.0%	937	100.0%	814	100.0%	507	100.0%	460	100.0%	8,313	100.0%	7,335	100.0%

Author: Bob Lunn

Royalties

- Royalty costs include payments to third parties for the use of their intellectual property. MS currently has approximately 170 software royalty agreements. Nearly all agreements require royalties be paid on a fixed per unit basis or a fixed percentage of revenue.
- As a percent of net revenues, royalties equaled plan.

Inventories by Location (in millions)

	Q94-2	Q94-3	Q94-4	Q95-1
Canyon Park	$78	$71	$72	$73
Ireland	14	16	14	19
Puerto Rico	1	1	1	1
Subsidiary warehouses				
Japan	9	8	7	7
France	7	4	2	1
Australia	6	6	0	0
Sweden	2	2	0	0
Germany	2	14	1	1
Others	11	9	5	6
	$130	$131	$102	$108

- Consolidated inventories increased 6% for the quarter.
- The increase in Ireland's inventory was primarily due to the transfer of inventory from the French warehouse to Ireland ($2 million) and the buildup of inventory from slow sales activity during the summer months.
- The remaining inventory balances in Germany and France are primarily related to Press and inventory returns.

Finance

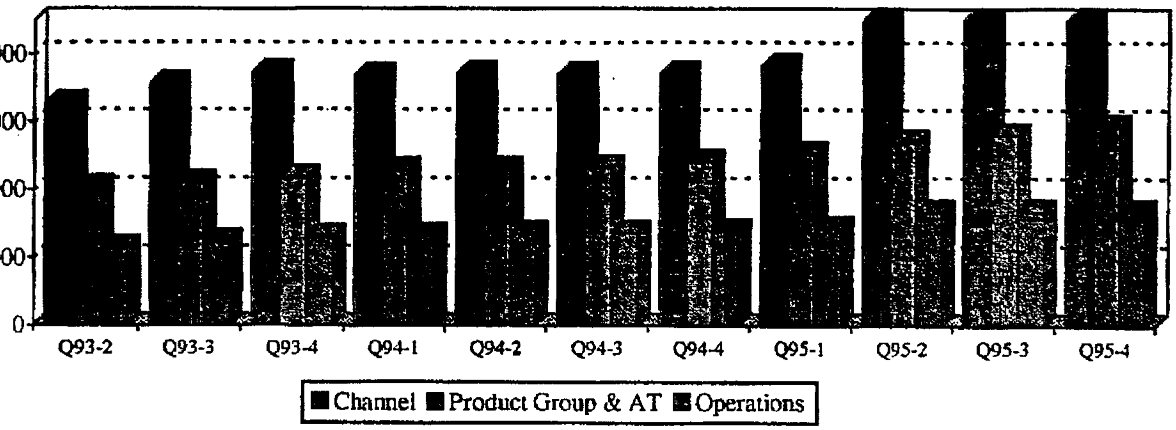
Cost Centers

Cost Centers

HEADCOUNT

	Q95-1 Actual	Q95-1 Plan	Q95-1 Variance	FY95 Plan
USFG End User	590	624	34	625
USFG Org	754	849	95	858
USFG - Other	129	152	23	179
Canada	263	273	10	280
Total North America FG	1,736	1,898	162	1,942
US PSS	1,899	1,897	(2)	2,082
MCS	304	317	13	393
Europe FG	2,345	2,625	280	2,736
ICON FG	634	708	74	742
Far East FG	388	476	88	594
OEM	205	233	28	237
Other AT	143	173	30	210
Other Channel	3	6	3	6
CHANNELS	**7,657**	**8,333**	**676**	**8,942**
At Work	289	299	10	411
Business Systems	970	1,091	121	1,181
Consumer	601	736	135	803
Desktop Applications	1,018	1,007	(11)	1,106
Developer	775	826	51	893
Personal Operating Systems	458	477	19	514
International/Other WPG	330	442	112	550
Total WPG	**4,441**	**4,878**	**437**	**5,458**
Advanced Consumer Tech	360	428	68	574
Advanced Technology - Other	154	203	49	230
Microsoft On-Line	114	175	61	233
Total AT	**628**	**806**	**178**	**1,037**
TOTAL PRODUCT GROUPS & AT	**5,069**	**5,684**	**615**	**6,495**
Campus North	1,012	1,142	130	1,148
Ireland	380	432	52	446
Puerto Rico	175	180	5	180
OPERATIONS	**1,567**	**1,754**	**187**	**1,774**
ITG	379	474	95	486
Law & Corporate Affairs	162	185	23	199
Finance	217	263	46	267
Human Resources	228	239	11	249
Corporate Services	321	355	34	355
Executive Staff	5	5	0	5
CORPORATE	**1,312**	**1,521**	**209**	**1,561**
MICROSOFT	**15,605**	**17,292**	**1,687**	**18,772**

Headcount Trend



The above graph uses actual headcount from Q93-2 through Q95-1 and budgeted headcount for Q95-2 through Q95-4.

Worldwide Headcount by Location

- The following chart shows the distribution of total Microsoft employees by location. Approximately 57% of total employees are employed in the Puget Sound Area.

	Q95-1	
Corporate campus	43	%
Subsidiaries	30	
Field locations	13	
Other Puget Sound	9	
Canyon Park	5	
Total	100	%

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Profile of Employees

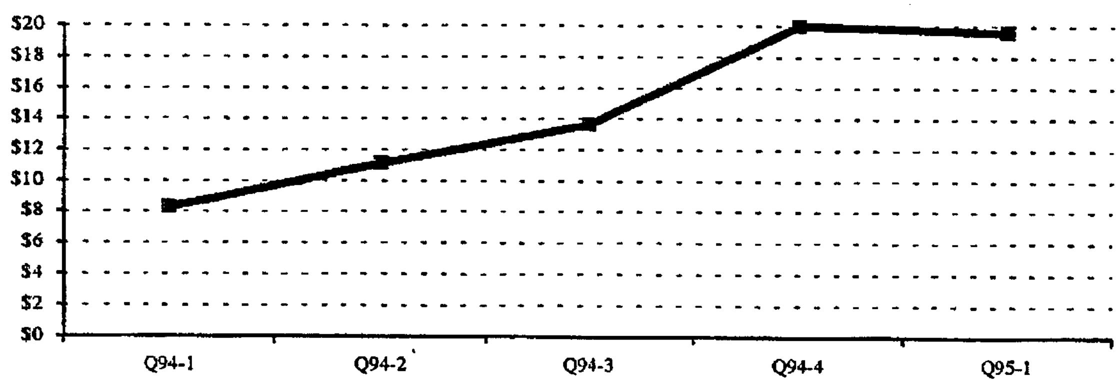
U.S. Employee Statistics

Description	No. of Employees	Mix
Sex:		
Female	3,663	34%
Male	7,170	66%
Ethnicity:		
White	8,997	83%
Asian Pacific/Islander	965	9%
African American	295	3%
Hispanic	247	2%
American Indian/Alaska Native	55	< 1%
Other	274	2%
Age:		
Under 20	27	< 1%
20 - 29	3,468	32%
30 - 39	5,257	49%
40 and Over	2,081	19%
Average Age:	33.9 years	

Worldwide Employee Statistics

Description	Average Tenure
Domestic	3.2 years
Subsidiaries	2.9 years
Worldwide average	3.1 years

Domestic Temporary Employee Expense (in millions)



- The use of temporary employees has more than doubled since Q94-1. The total domestic spend for Q95-1 was $19.6 million. The Product Groups accounted for $11.7 million of the total, Operations $4.1 million and the Channel $3.8 million.

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INFORMATION TECHNOLOGY
(IN MILLIONS)

	Q95-1 Actual	Plan	Variance
People	$13.8	$22.1	$8.3
Infrastructure	2.4	3.1	0.7
Other expenses	(0.2)	(0.5)	(0.3)
Controllable expense	$16.0	$24.7	$8.7

- Q95-1 people expenses were significantly below plan mainly due to the delay in approval of IT's FY95 business plan. The ITG budget was given formal approval in late September. In the interim, IT focused on producing products on the critical path and postponed the hiring of employees and contractors. Significant favorable variances include $2.2 million in temporary help, $1.4 million in payroll, $0.8 million in recruiting, and $0.8 million in T&E. Additionally, outsourcing was $2.2 million under budget as the outsource operations of MS's VAX and AS/400 systems ramped up slower than anticipated.
- First quarter infrastructure expense was below plan due to the delay in hiring. Favorable variances include buildings and grounds, $0.4 million, and depreciation and amortization, $0.3 million.
- Other expenses primarily reflects the charge-back of MOS activity to the Advanced Technology group. Since the release of Marvel is linked to the Windows 95 release, both expenses and charge-backs have been behind plan.

Q95-1 Product Costs (major applications)
(IN THOUSANDS)

	Actual	Plan	Variance	Comp. Date
Mariposa (Domestic PSS Phone System)	$702	$593	(109)	Nov-94
MS Manager (Customer Management)	526	2,400	1,874	Mar-95
MS Product (Pricing & SKU Mgmt.)	481	2,700	2,219	Jun-95
Fast Track v1.0 (Market Share)	362	204	(158)	Nov-94
People (Headcount Tracking)	344	457	113	Mar-95
Manugistics (Supply Chain Mgmt.)	281	2,700	2,419	May-95
MS Sales v1.0 (Worldwide Revenue)	275	280	5	Nov-94
PSS Activity Based Costing	101	139	38	Nov-94

- The Mariposa budget variance was caused by extending the test period to minimize PSS's risk at cutover which uncovered a number of critical integration problems that have required extra development.
- Fast Track variance is expected to reach $200,000 by completion. Variance was caused by unanticipated project rework.
- It is anticipated that all other projects will be delivered within budget.

Top Products Released

- Mariposa installed in all domestic PSS sites and in the process of being tested. Anticipate complete roll over to this new system on October 21.
- Worldwide Pricing Tool (centralization of MS pricing information).
- Marketing Spend Tracking System.
- Fast Track v1.0 to beta.
- CMS 1.0a (Channel revenue measurement) installed in 15 sites in ICON and Far East regions.

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Author: Vaughan Briggs

FACILITIES

Worldwide Facility Distribution

	September 30, 1994		June 30, 1994	
	Square Feet	% of Total	Square Feet	% of Total
Location				
Corporate Campus	2,318,000	39%	2,120,000	38%
Other Domestic	1,597,000	27%	1,491,000	27%
International	2,000,000	34%	1,900,000	35%
	5,915,000	100%	5,511,000	100%

- In terms of square footage, the size of the worldwide portfolio increased 7% over Q94-4.
- Facilities capital spending for all campus and other domestic locations totaled $16.8 million in Q95-1, 48% or $15.5 million below the plan of $32.3 million. Redmond West ($9.9 million) and Building 26 ($2.4 million) accounted for most of the variance.

Domestic Facilities

- Despite starting one month later than in the capital plan, the Redmond West project reached several milestones in Q95-1. Land is fully acquired, excavation will be completed in October, and building permits are almost complete. Construction is slated to begin in Q95-2 with a scheduled completion of the first two buildings planned for August 1995. The next three buildings will be completed in three phases of 1-2 months thereafter. The project, which has a total budgeted cost including land, permits and design of approximately $140 million, will add 700,000 square feet of office space (enough for more than 2,500 employees) to the campus.
- Growth on the main campus continues as well. Construction of Building 26, which will add approximately 225,000 square feet to the portfolio, is in full swing and is projected to be completed at the beginning of Q95-4. The total budgeted cost of this project is $40 million.
- We expect to begin construction of Building 27 in early Q95-4, with completion expected in December 1995. Building 27 design will resemble building 26, but will have slightly more office space and will be located directly south of Building 26. The total cost is estimated at $40 million, with the majority of the capital spending occurring in FY96.
- New leased office space added this quarter included 103,000 square feet (ITG) at Sammamish Place and 95,000 square feet at Canyon Park Commons (WOG).

International Facilities

- We are experiencing an oversupply of space in France. The subsidiary currently holds approximately 53,000 square feet of vacant space in a building with a total of about 165,000 square feet. Efforts to sub-lease this space are underway, however the French office market is currently depressed.
- Approximately 88,000 square feet of office space is being constructed in Ireland on behalf of WPG to accommodate localization of products. Approval for land acquisition and construction was obtained in Q95-1. Total cost of the building will be approximately $19 million. The facility is projected to be completed in December 1995.
- The Far East region is set to experience a significant amount of growth in office space. In Tokyo, approximately $20 million expansion/relocation will add 100,000 square feet to the portfolio before the end of the fiscal year. Smaller expansions and relocations are planned for Seoul, Beijing, Hong Kong and Bangkok.
- Latin American facility needs are also growing, with a new subsidiary in Lima, Peru and other relocations in Mexico City and Bogota. Additionally, the Sao Paulo, Brazil location is also adding 25,000 square feet to its holdings.

Finance

Treasury

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Treasury

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CASH & SHORT-TERM SECURITIES

Cash and Investment Portfolio Balances (in millions)

	June 30, 1994		Sep. 30, 1994	
U.S. $ investment portfolio	$ 3,384	94%	$ 3,593	95%
Foreign currency investments	142	4	81	2
Operating bank accounts	88	2	102	3
Worldwide cash and investments	$ 3,614	100%	$ 3,776	100%

U.S. $ Investment Portfolio by Security Type (in millions)

	June 30, 1994			Sep. 30, 1994		
Security type	Cost	%	Pre-Tax Yield	Cost	%	Pre-Tax Yield
Municipal bonds	$ 1,245	37%	5.5%	$ 1,496	42%	5.8%
Commercial paper	656	19	4.4	537	15	5.0
Treasury securities	453	13	4.2	434	12	4.7
Floating rate notes	307	10	5.2	356	10	5.5
Money market preferred	171	5	4.8	259	7	5.1
Certificate and time deposits	215	6	4.8	213	6	5.7
Corporate bonds	131	4	4.8	198	5	5.7
Other	206	6	4.6	100	3	5.5
U.S. $ investment portfolio	$ 3,384	100%	4.9	$ 3,593	100%	5.4
Yield Comparison:						
90 day T-Bill			4.3			4.9

- The U.S.$ Portfolio is fully invested in investment grade securities with an average AA credit quality.

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ACCOUNTS RECEIVABLE

Gross Accounts Receivable of the Ten Largest Customers Worldwide ($ in millions)

	Total	Percent	Aging Summary Current	1-30	31-60	Over 60
Ingram	$99	15 %	$89	$7	$1	$2
Merisel	85	13	68	12	1	4
C2000	30	5	15	10	2	3
Gateway 2000	20	3	20	0	0	0
Olivetti	20	3	8	8	2	2
Egghead	18	3	13	2	1	2
Good Times Software	12	2	12	0	0	0
Tech Pacific	11	2	10	0	0	1
Packard Bell	10	2	0	10	0	0
Software Japan	7	1	7	0	0	0
Total ten largest	312	47	242	49	7	14
Other	348	53	249	54	13	32
Total Q95-1	$660	100	$491	$103	$20	$46
Total Q94-4	$643	100	$480	$91	$22	$50
Total Q94-3	$675		$486	$98	$38	$53
Aging mix of top ten	100%		78	16	2	4

- The top 3 customers represent 33% at the end of Q95-1, versus 28% at the end of Q94-4
- The top 10 customers represent 47% at the end of Q95-1, versus 41% at the end of Q94-4

Worldwide Accounts Receivable (in millions)

	DSO Q94-2	DSO Q94-3	DSO Q94-4	DSO Q95-1	Total A/R Q94-2	Total A/R Q94-3	Total A/R Q94-4	Total A/R Q95-1	Aging Summary Current	1-30	31-60	60+
Retail												
USFG	43	44	31	37	$233	$197	$185	$200	$171	$19	$6	$4
International	58	53	59	72	299	333	343	358	270	56	13	19
					532	530	528	558	441	75	19	23
OEM	24	33	30	24	68	127	98	81	39	21	1	20
Other	81	84	NM	NM	20	18	17	21	11	7	0	3
Total accts receivable	45	46	42	47	620	675	643	660	$491	$103	$20	$46
Aging percentages									74%	16%	3%	7%
GAAP adjustments					114	115	146	201				
Sales returns reserve					(91)	(99)	(143)	(172)				
Customer deposits/deferred revenue					(44)	(43)	(43)	(35)				
Reseller rebates					(42)	(19)	(36)	(24)				
Allowance for doubtful accounts					(97)	(107)	(92)	(104)				
Accounts receivable-net					$460	$522	$475	$527				

Allowance for doubtful accounts represent about 16% of total accounts receivables

- International DSO climbed to 72 days in Q95-1 in part due to the increased mix of ICON and Far East sales (which have longer trade terms than Europe) and in part due to short-term collection delays related to the EOC conversion and Select billings.

OTHER ASSETS
(IN MILLIONS)

	Cost			Market Value (if public)		
	Jun. 30, 1994	Sep. 30, 1994	Change	Jun. 30, 1994	Sep. 30, 1994	Change
Financial assets						
Stac Electronics	$ 40	$ 40	$ --	$ --	$ --	$ --
Mtel/ Destineer	--	30	30	--	--	--
Santa Cruz Operation	20	20	--	26	37	11
Dorling Kindersley	19	19	--	60	59	(1)
MicroUnity	15	15	--	--	--	--
Metricom	6	6	--	4	3	(1)
Academic Systems	--	4	4	--	--	--
Monotype	4	3	(1)	--	--	--
Natural Language Inc.	3	3	--	--	--	--
Citrix Systems	2	2	--	--	--	--
ASCII NT	1	1	--	--	--	--
	110	143	33	$ 90	99	$ 9
Valuation allowance	(62)	(65)	(3)			
	48	78	30			
Intellectual property rights						
Consumer Software, Inc.	13	13	--			
Other	54	55	1			
	67	68	1			
Accumulated amortization	(43)	(46)	(3)			
	24	22	(2)			
Miscellaneous	49	47	(2)			
	$ 121	$ 147	$ 26			

- Financial assets include equity and equity-related investments. MS maintains a valuation allowance to cover operating losses at investee companies and potential losses on disposition. The provision is charged to non-operating income in the financial statements. There were two new investments during this first FY95 quarter : Mtel/Destineer and Academic Systems.
- Intellectual property rights represent purchased code or other intellectual property and rights. Their cost is amortized over periods of up to five years. Amortization is generally charged to research and development expense.
- Miscellaneous assets include other long-term assets, primarily lease and other deposits and patent rights.

Stac Electronics, Inc.

	Nine Months Ended Jun. 30, 1993	Nine Months Ended Jun. 30, 1994	Change $	Change %
Net revenue	$ 29.2	$ 23.7	$ (5.5)	(19) %
Cost of revenue	5.6	4.2	(1.4)	(25)
Gross profit	23.6	19.5	(4.1)	(17)
Controllable expenses	22.8	21.1	(1.7)	(7)
Net income	$ 0.8	$ (1.6)	$ (2.4)	(300)

- On June 21, 1994, MS and Stac Electronics signed cross-license and investment agreements to end their disk compression patent dispute MS agreed to pay Stac license royalties of $1 million per month for 43 months. In addition, Microsoft purchased $39.9 million of 4.0% convertible preferred stock. The preferred stock is convertible into a total of 4.44 million common shares, which represent approximately 15% of Stac's shares.
- The new relationship between the two companies continues to progress. Stac has met with a number of MS personnel, including representatives from the Windows 95, Windows NT RAS and Advanced Technology teams. The two companies are exploring potential areas of cooperation.
- Net revenue has been negatively impacted by the introduction of MS-DOS 6.x which includes data compression features. In addition, earnings were significantly impacted by increases in controllable expenses related to cost of litigation with MS.
- Stac's common stock currently trades at $5.75, about the same level as of one quarter ago. The preferred stock is convertible at $9.00 per share.

Santa Cruz Operation, Inc.

	Fiscal Year Ended Sep. 30, 1993	Fiscal Year Ended Sep. 30, 1994	Change $	Change %
Net revenue	$ 178	$ 186	$ 8	4 %
Cost of revenue	59	51	(8)	(14)
Gross profit	119	135	16	13
Controllable expenses	105	121	16	15
Net income	$ 14	$ 14	$ 0	0

- SCO completed FY94 with revenue slightly above FY93 (+4%), but 12% below plan, and experienced its first $50 million quarter in Q4 ($52.2M). From FY93 to FY94, EMEA sales (Europe, Middle East and Africa) grew by 17%, while the Americas declined by 4%; average price per license increased by 15% (from $475 to $545). Services sales are still very low, and at a surprisingly low margin for this type of business.
- EPS was $ 0.44 for FY94, down 3 cents compared to FY93. For Q4, EPS was $ 0.17, in the high range of the analysts' expectations. SCO stock, currently at about $ 9, is trading at a 12 month high.
- FY95 budget shows a revenue increase of between 15% and 21% (2 scenarii), and a EPS of $0.70 (year-to-year growth of 59%). Headcount would be almost flat, at 1,178 in September 95 (compared to 1,170 in September 94 and 1,242 in June 93). FY95 focus and positioning will be in the "Business Critical Server" segment.
- Jean-Francois Heitz, representing MS, joined the SCO Board of Directors at the September 1 Board meeting.

Author: Jean-Francois Heitz

Destineer Corporation (formerly Nationwide Wireless Network)

- In September, Mtel, the 80% owner of Destineer, agreed to purchase the 10% of the Skytel paging system it does not own for $60 million in Mtel stock. In September, Mtel also announced an agreement to purchase the U.S. Paging Network, an integrated reseller of messaging services to corporate customers, for approximately $35 million in Mtel stock.
- MS is assisting in the development of an optimized network for the Pulsar client and will receive: (i) royalty-free access to the Destineer Network Operations Center (NOC) to ensure compatibility with the Pulsar NOC; (ii) a 2% royalty on all revenues generated by Pulsar clients on Destineer; and (iii) marketing "ownership" of Pulsar's Destineer customers. Destineer's network is expected to be operational by July 1995.

Dorling Kindersley PLC

	Fiscal Year Ended Jun. 30, 1993	Fiscal Year Ended Jun. 30, 1994	Change £	Change %
Net revenue	£ 87	£ 107	£ 20	23 %
Cost of revenue	59	73	14	24
Gross profit	28	34	6	21
Controllable expenses	22	28	6	27
Net income	£ 6	£ 6	£ 0	0

- In fiscal 1994, DK's revenue grew 12% in the United Kingdom, 19% in the U.S. and 32% in the rest of the world, reflecting the greater saturation of demand for DK's products in its original home market. Revenue from the U.S. under the DK imprint is now £24.5 million.
- Growth in revenues and gross profit was paced by the company's two principal businesses, DK Adult and DK Children's, which increased revenues 23% and 19%, respectively.
- Overall, DK's flat profits were due to increased spending in the Multimedia division, continued distribution problems related to the termination of Tiptree (the distributor of DK's Family Library series) and weakness in the newer Education and DK Direct divisions.
- Particularly successful titles in fiscal 1994 included *Ultimate Sex Guide*, *The RHS/AHS Encyclopedia of Gardening*, *The Classic Pasta Book*, and *The Dorling Kindersley Science Encyclopedia*.
- In the next few weeks, DK Multimedia will introduce its first CD-ROM titles - *The Ultimate Human Body*, *Incredible Cross-Sections - Stowaway!*, *The Way Things Work*, *Eyewitness Encyclopedia of Science*, and *My First Incredible, Amazing Dictionary*.
- With the release of DK's fiscal 1994 financial statements on September 27th, MS is free to sell its shares in the company.

MicroUnity Systems Engineering, Inc.

- MicroUnity remains in the development phase. The ACT group is working closely with MU to insure compatibility with MS's broadband efforts.
- In August 1994, Motorola invested $15 million in an MU Series E convertible preferred at a valuation of $3.70 per common share, 50% higher than the Series D round in September 1993.
- Assuming conversion and/or exercise of all preferred stock, warrants and options, MS owns approximately 6% of the fully-diluted common stock. If the performance of MicroUnity's chips exceeds certain performance benchmarks, MS's position could be diluted. Concurrent with its investment, MS signed agreements with MicroUnity and the other Series D Preferred investors which grant MS access to certain technical specifications for the cable chip and other future developments.

Metricom, Incorporated

	Quarter Ended Jun. 30, 1993	Quarter Ended Jun. 30, 1994	Change $	Change %
Net revenue	$ 1.6	$ 6.8	$ 5.2	325 %
Cost of revenue	1.5	4.8	3.3	220
Gross profit	0.1	2.0	1.9	1900
Controllable expenses	1.8	4.1	2.3	128
Net income	$ (1.7)	$ (2.1)	$ (0.4)	(24)

- In March 1994, MS purchased 200,000 shares of Metricom common stock and 75,000 warrants. Fully-diluted, MS owns approximately 2% of Metricom.
- Metricom's "Ricochet" Microcellular Data Network commenced service in Cupertino in early to mid 1994 and has now extended to several campus networks in the Bay area. Metricom's deployment plan continues to target coverage in 30 Metropolitan Statistical Areas by 1996. The company's strategy is to partner with domestic utilities to assist this timetable. The losses sustained were primarily attributable to the continued development and deployment costs of Ricochet. These losses translated to $0.20 per share and $0.16 per share in 1993 and 1994, respectively.
- MS and Metricom are working on a technology and marketing contract, similar to that signed with Destineer, that will complement MS's Pulsar and local wireless data strategy.

Academic Systems Corporation

	Year Ended Jun. 30, 1993	Year Ended Jun. 30, 1994	Change $	Change %
Net revenue	$ 0.0	$ 0.2	$ 0.2	N/A %
Cost of revenue	0.0	1.8	1.8	N/A
Gross profit	0.0	(1.7)	(1.7)	N/A
Controllable expenses	1.3	1.4	0.1	4
Net income	$ (1.3)	$ (3.0)	$ (1.7)	(130)

- In August 1994, MS invested $4 million in Academic Systems, along with Telecommunications Inc., Kleiner Perkins and other prominent investors. Pursuant to this transaction, MS acquired 1,468,093 shares of Series D Preferred stock at $2.725 per share. This represents approximately a 9% stake in the company.
- Academic System's mission is to become a major player in the field of technology mediated learning systems targeting the higher education market. The company intends to leverage partnerships with universities and community colleges to offer interactive multimedia courses over a network.
- The current round of financing raised $12 million for Academic to support its development and marketing needs. Further, the company is installing the full Introductory Algebra course on six college campuses this Fall.

Monotype Typography Limited

	Quarter Ended Jun. 30, 1994	Quarter Ended Sep. 30, 1994	Change $	Change %
Net revenue	$ 2.0	$ 2.0	$ 0.0	0 %
Cost of revenue	0.6	0.6	0.0	0
Gross profit	1.4	1.4	0.0	0
Controllable expenses	1.2	1.2	0.0	0
Net income	$ 0.2	$ 0.2	$ 0.0	0

- Revenue and costs were essentially flat this quarter versus the prior quarter, with a 10% profit margin. The revenue mix this quarter essentially remained unchanged versus the previous quarter. While overseas operations accounted for approximately 60% of revenue, US operations accounted for 40%. The Company's continuing profitability is largely attributable to cost and headcount reduction measures adopted in September 1993. This has resulted in twelve consecutive profitable quarters.
- Revenue for the twelve months ended September 30, 1994 was $7.6 million, with approximately 55% or $4.2 million generated by overseas operations. During this period, the company generated a $0.9 million profit versus a $0.8 million loss in the corresponding twelve months period last year.
- Though the company continues to have positive cash flow, its overall liquidity remains tight. However, due to cost containment measures, management's outlook for the balance of calendar 1994 is optimistic.
- MS's approximately $3 million investment included the purchase of Monotype's font library ($1.6 million), warrants for approximately 85% of the company and a loan of $1.2 million. The current outstanding loan balance is $600,000.

Natural Language Incorporated

	Quarter Ended Sep. 30, 1993	Quarter Ended Sep. 30, 1994	Change $	Change %
Net revenue	$ 0.7	$ 0.3	$ (0.4)	(57) %
Cost of revenue	0.2	0.0	(0.2)	(100)
Gross profit	0.5	0.3	(0.2)	(40)
Controllable expenses	0.9	0.5	(0.4)	(44)
Net income	$ (0.4)	$ (0.2)	$ 0.2	(50)

- As reported last quarter, NLI's headcount is down to the core development staff of eight and the company is conserving cash as it readies itself for sale.
- Revenue in the recent quarter was slightly higher than anticipated as modest levels of orders were received despite the lack of any sales or marketing staff.
- NLI's cash position is $431,000, which should be sufficient to remain solvent for at least three more months. While this appears to be long enough to allow for the sale of the company, morale is low and it is unclear how long NLI will be able to keep its employees.
- The company has retained Emerald Partners, a small California investment banking partnership to manage the sale.
- The Developer Division is considering making an offer to purchase the company for approximately $4 million. The medium term goal would be to incorporate the Natural Language technology into Access 96, but there are also numerous other potential uses for the technology within MS.

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Citrix Systems, Inc.

	Nine Months Ended Sep. 30, 1993	Nine Months Ended Sep. 30, 1994	Change $	Change %
Net revenue	$ 3.4	$ 7.1	$ 3.7	109 %
Cost of revenue	0.6	1.5	0.9	150
Gross profit	2.8	5.6	2.8	100
Controllable expenses	4.9	5.8	0.9	18
Net income	$ (2.1)	$ (0.2)	$ 1.9	NM

- In the third quarter ended September 30th, Citrix shipped WinView 2.3, its new Internet-capable product. This product was named Best of Show and awarded the Grand Prize for new products at the recent Networld and Interop show in Atlanta.
- Citrix experienced its first $1.0 million month in September.
- MS and Citrix appear to have reached agreement and are apparently ready to sign a contract outlining their working relationship for the NT-version of WinView. Citrix has released the beta version of the product and installed it at a test site at Tektronix Corporation.

ASCII Network Technology, Inc.

- In late May, MS agreed to make an equity investment of ¥100 million (approximately $1.0 million) to purchase 1,990 shares of common stock of a new company, ASCII NT. This gave MS a 19.9% equity interest in the company. Other investors include ASCII Corp, which has approximately a 50% stake., and CSK Corp. Fifty percent of the investment took place in early June, and the balance was funded in Q95-1.
- ASCII NT will provide smaller and medium-size participants in the Japanese Solution Provider program and ISVs with education, support, network software distribution, localization and maintenance services for Windows NT and other Microsoft products.
- ASCII NT is beginning to focus its strategy. Significant long range goals of the company now are to become profitable in two years and achieve cumulative positive retained earnings in four years. In addition, the focus of the core investors is also positive.

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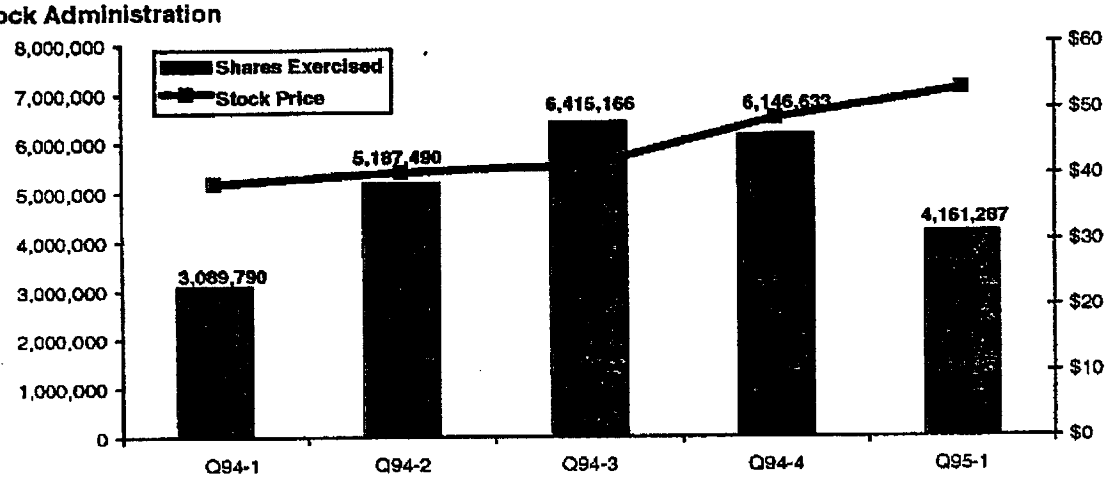
STOCK MATTERS

Stock Administration



- **Stock Option Exercises:** In Q95-1, a total of 4,161,287 shares were exercised, a 35% increase from the same period in FY94. The stock traded at an all time high of $59.25 during Q95-1.

  The cumulative outstanding options as of 9/30/94 are 124,403,813 at an average price of $26.58. The range of option prices is from $.0011 to $55.25 per share. The authorized but unissued options total 220,449,276.

- **On Hire Options:** During Q95-1, 523 stock option grants totaling 1,833,580 shares were processed.

- **Review Options:** The option price for August Review 1994 was set on 7/21/94, at $47.75. A total of 14,302,266 shares were granted to 10,602 employees. Due to inadequate documentation, the review grants for Canada, United Kingdom and Italy were not processed in Q95-1. These grants will be processed as soon as the information is complete.

- **ESPP Program:** A total of 129,646 ESPP shares were issued to 2,233 international employees and 444,248 ESPP shares were issued to 7,364 domestic employees for the period ending June 30, 1994 at a price of $34.05.

Stock Repurchases

	Shares adjusted for all splits	Amount (millions)	Average Cost
FY90	3,570,750	$ 46	$13.07
FY91	10,939,500	197	17.98
FY92	3,959,656	135	34.09
FY93	6,257,000	250	39.96
FY94	8,639,000	348	40.24
Q95-1	4,525,000	252	55.67
LTD	37,890,906	$1,228	32.41

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In Q95-1 MS sold 4 million put warrants on MS stock, with strike prices ranging from $48.46 to $52.93 and maturities of 3-18 months. Approximately 1.6 million of these puts expire in Q95-2. MS received a $10 million premium on the sale of these puts. A liability of $203 million was recorded as an offset to retained earnings to recognize the amount that would be required to purchase all 4 million shares at their respective strike prices.

Finance

Industry Watch

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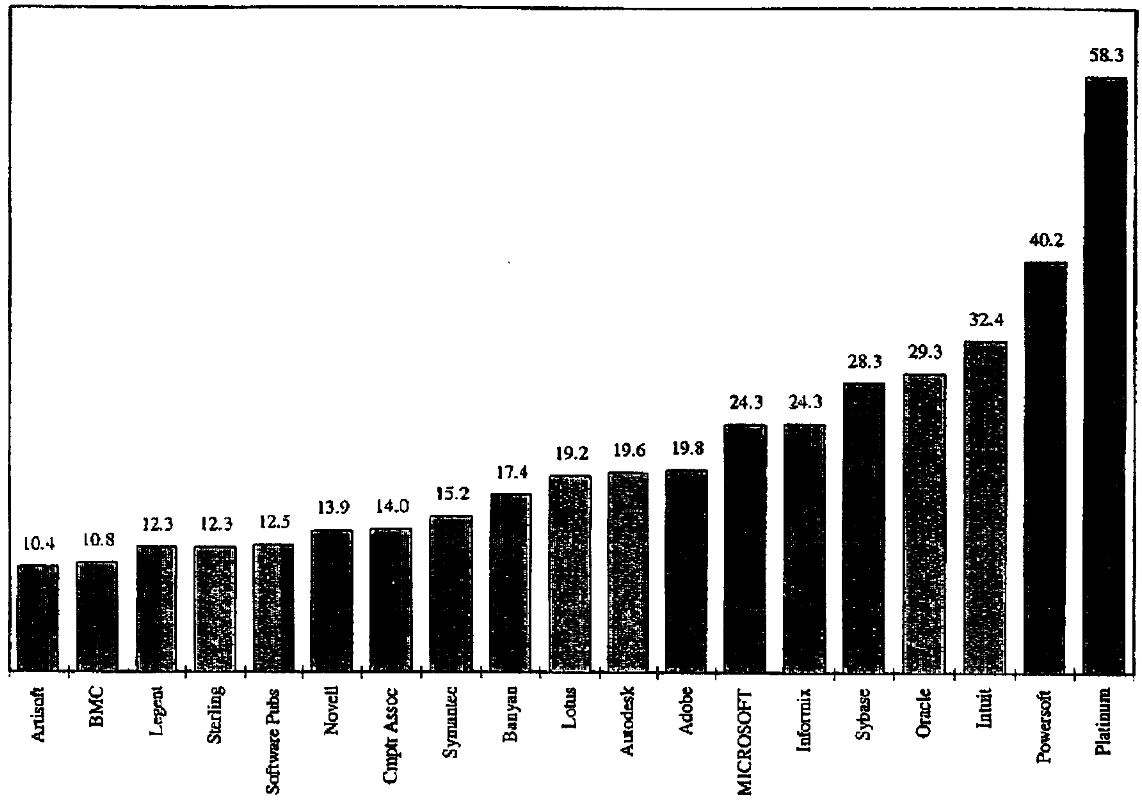
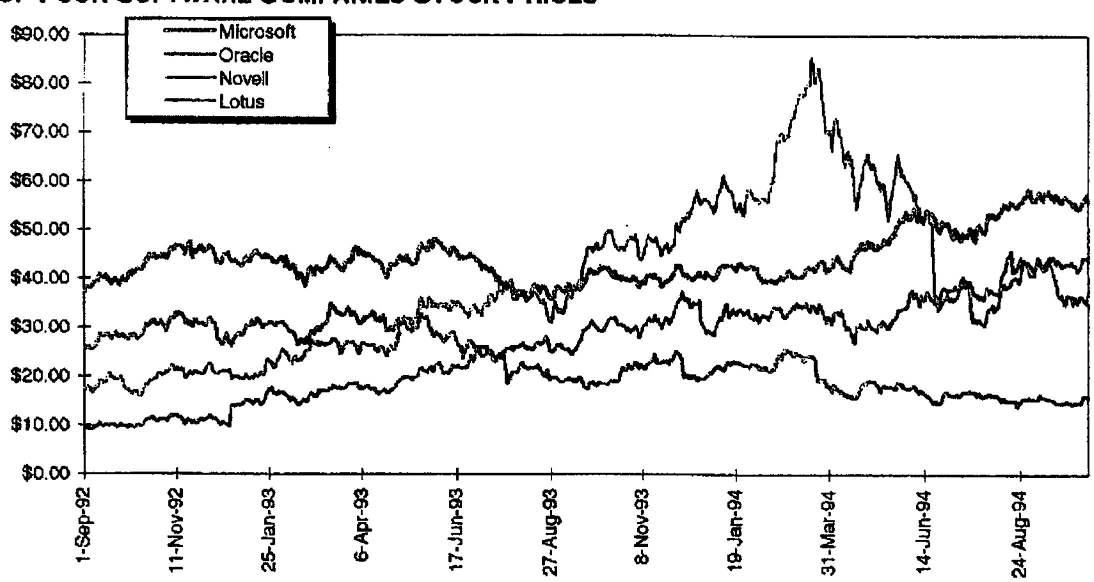
Industry Watch

SOFTWARE INDUSTRY FORWARD P/E RATIOS



Forward P/E ratios are calculated based upon Sept. 30, 1994 stock prices and analysts's consensus estimates for the next four quarters.

TOP FOUR SOFTWARE COMPANIES STOCK PRICES



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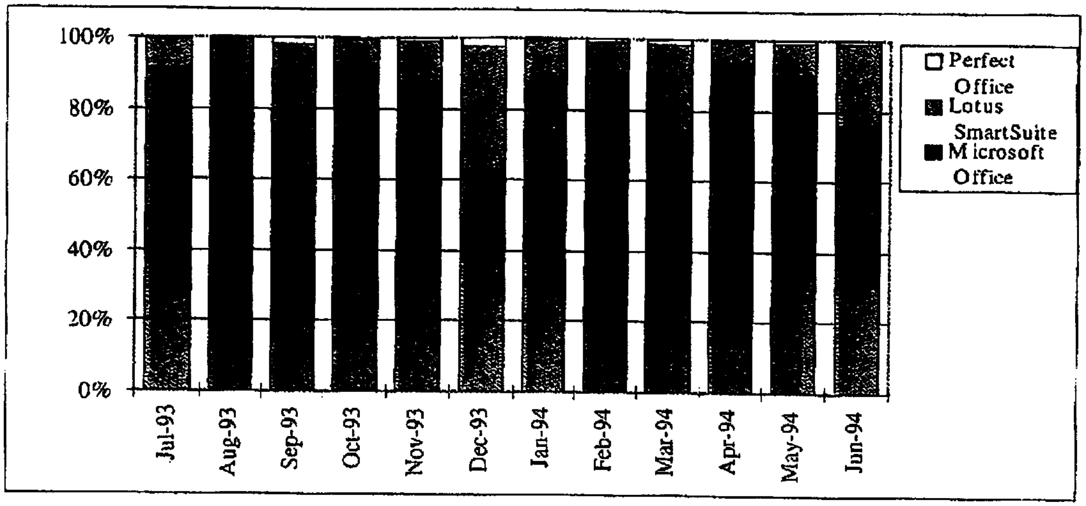
WORLDWIDE MARKET SHARE

Bundled Suites (Units)



Information presented is for the Windows environment on a worldwide basis.
Market share is calculated by Microsoft Office marketing personnel and is based on SPA, IDC, and DataQuest information.

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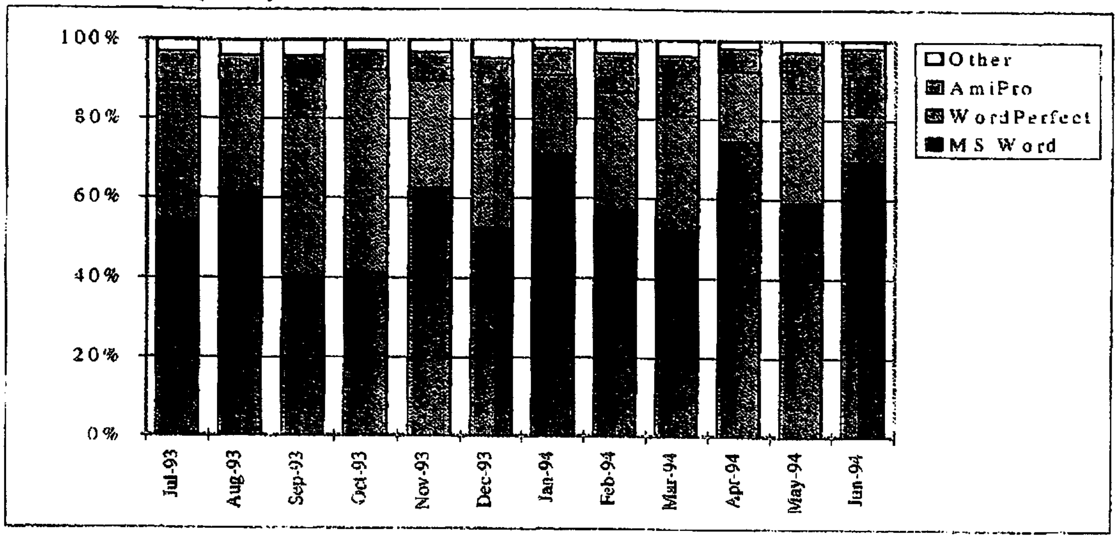
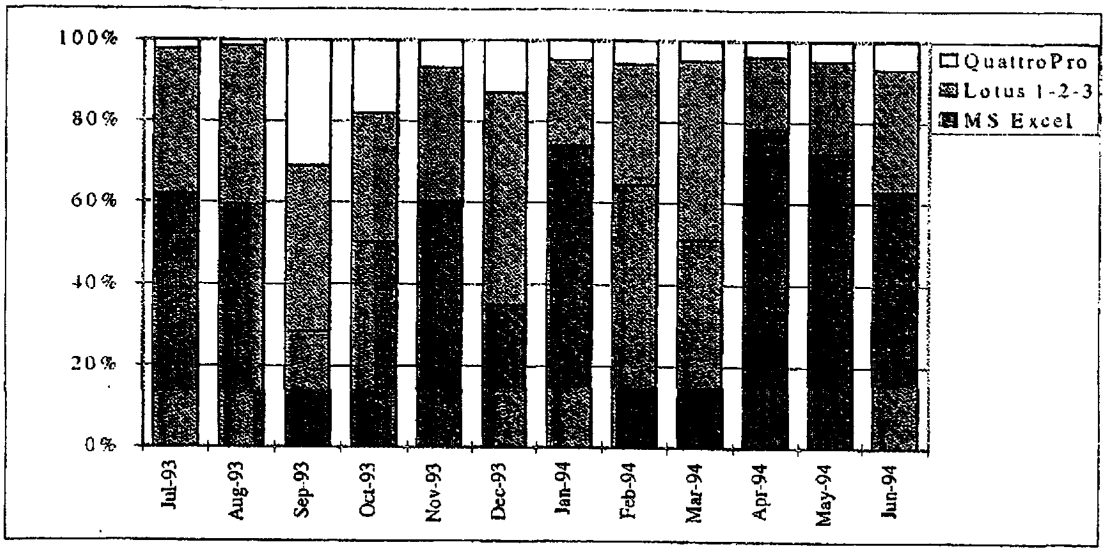
Word Processors (Units)



Information presented is not version specific and includes MS-DOS, Windows, and Macintosh environments on a worldwide basis.
Market share is calculated by Microsoft Office marketing personnel and is based on SPA, IDC, and DataQuest information.
Market share includes stand-alone products and units allocated from bundled suites.

Spreadsheets (Units)



Information presented is not version specific and includes MS-DOS, Windows, and Macintosh environments on a worldwide basis.
Market share is calculated by Microsoft Office marketing personnel and is based on SPA, IDC, and DataQuest information.
Market share includes stand-alone products and units allocated from bundled suites.

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TOP FOUR SOFTWARE COMPANIES
(IN MILLIONS)

Most recent quarter	Microsoft 9/30/94		Novell (a) 7/31/94		Lotus 9/30/94		Oracle 8/31/94	
Net revenue	$ 1,247	100.0%	$ 489	100.0%	$ 235	100.0%	$ 556	100.0%
Cost of revenue	186	14.9	106	21.7	42	17.9	156	28.1
Gross profit	1,061	85.1	383	78.3	193	82.1	400	71.9
Research and development	178	14.3	91	18.6	42	17.9	55	9.9
Sales and marketing	395	31.6	146	29.8	124	52.6	218	39.2
General and administrative	51	4.1	37	7.6	18	7.7	39	7.0
Non-recurring charge	–	–	114 (b)	23.3	77	32.8 (d)	–	–
Total operating expenses	624	50.0	388	79.3	261	111.0	312	56.1
Operating income	437	35.1	(5)	(1.0)	(68)	(28.9)	88	15.8
Nonoperating income	34	2.7	–	–	3	1.3	4	0.7
Income before income taxes	471	37.8	(5)	(1.0)	(65)	(27.6)	92	16.5
Provision (benefit) for income taxes	155	12.5	(1)	(0.2)	1	0.5	31	5.5
Net income	$ 316	25.3%	$ (4)	(0.8)%	$ (66)	(28.1)%	$ 61	11.0%
Average shares outstanding	622		368		48		295	
EPS	$ 0.51		$ (0.01)		$ (1.39)		$ 0.21	

Trailing twelve months	Microsoft		Novell (a)		Lotus		Oracle	
Net revenue	$ 4,913	100.0%	$ 2,021 (c)	100.0%	$ 985	100.0%	$ 2,160	100.0%
Cost of revenue	790	16.1	472	23.4	183	18.6	556	25.7
Gross profit	4,123	83.9	1,549	76.6	802	81.4	1,604	74.3
Research and development	654	13.3	338	16.7	145	14.7	206	9.5
Sales and marketing	1,467	29.9	540	26.7	489	49.7	803	37.2
General and administrative	182	3.7	168	8.3	69	7.0	142	6.6
Nonrecurring charge	–	–	129 (b)	6.4	77	7.8	–	–
Total operating expenses	2,303	46.9	1,175	58.1	780	79.2	1,151	53.3
Operating income	1,820	37.0	374	18.5	22	2.2	453	21.0
Interest income - net	115	2.3	32	1.6	7	0.7	5	0.2
Nonoperating expense	(104)	(2.1)	(7)	(0.4)	–	–	–	–
Nonoperating income	11	0.2	25	1.2	7	0.7	5	0.2
Income before income taxes	1,831	37.2	399	19.7	29	2.9	458	21.2
Provision (benefit) for income taxes	608	12.3	110	5.4	35	3.5	150	6.9
Net income	$ 1,223	24.9%	$ 289	14.3%	$ (6)	(0.6)%	$ 308	14.3%
Average shares outstanding	614		369		48		296	
EPS	$ 1.99		$ 0.78		$ (0.12)		$ 1.04	

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(a) Novell results includue WordPerfect operations for all periods presented.
(b) Novell nonrecurring charges were primarily related to acquisition of Quattro Pro from Borland.
(c) Novell trailing twelve month results include $81 million in royalty revenue and $35 million in costs related to the UNIX license to Sun.
(d) Lotus September quarter results inlcude a European restructuring charge of $9 million and a $68 million write-off of purchased R&D in connections with the acquisitions of SoftSwitch and Edge Research.

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TOP FOUR SOFTWARE COMPANIES (CONTINUED)
(IN MILLIONS)

	Microsoft 9/30/94		Novell 7/31/94		Lotus 9/30/94		Oracle 8/31/94	
Balance sheets								
Current assets:								
Cash and short-term investments	$ 3,776	67%	$ 758	41%	$ 389	45%	$ 493	30%
Accounts receivable - net	527	9	384	21	194	22	436	27
Inventories	108	2	30	2	19	2	–	–
Other	143	3	160	7	25	3	154	10
Total current assets	4,554	81	1,332	71	627	72	1,083	67
Property, plant and equipment - net	936	17	407	22	133	15	389	24
Capitalized software	–	–	–	–	98	11	100	6
Other assets	147	2	124	7	16	2	50	3
	$ 5,637	100%	$ 1,863	100%	$ 874	100%	$ 1,622	100%
Current liabilities	$ 1,004	18%	$ 396	21%	$ 292	33%	$ 672	41%
Long-term liabilities	–	–	24	1	50	6	132	8
Other liabilities	–	–	–	–	–	–	–	–
Put warrants	203	4	–	–	–	–	38	2
Stockholders' equity	4,430	78	1,443	78	532	61	780	49
	$ 5,637	100%	$ 1,863	100%	$ 874	100%	$ 1,622	100%

Other data	Microsoft	Novell	Lotus	Oracle
Closing stock price (Sept. 30, 1994)	$56.13	$14.75	$36.75	$43.00
Common shares outstanding	622	368	48	295
Market value	$34,913	$5,428	$1,764	$12,685
Price/revenue ratio	7.1x	2.7x	1.8x	5.9x
Price/earnings ratio - trailing twelve	28.2x	18.9x	*	41.3x
Price/earnings ratio - future 4 quarters	24.3x	13.9x	19.2x	29.3x
Headcount (most recent disclosure)	15,605	9,463	4,738	12,058
Net revenue/employee	$314,835	$213,569	$207,894	$179,134
Book value per share	$7.12	$3.92	$11.08	$2.64
Price/book value ratio	7.9x	3.8x	3.3x	16.3x
Growth statistics (over comparable quarter):				
Revenue	27%	13%	(2%)	40%
Research and development	33%	20%	29%	18%
Sales and marketing	27%	2%	8%	32%
General and administrative	44%	(3%)	1%	23%
Net income	32%	(2%)	(463%) (a)	64%

(a) Lotus September quarter results included $77 million of non-recurring charges. Absent the charges, operating income would have been $9 million, a decrease of 69% from the comparable quarter of the prior year.

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INDUSTRY REVIEW

SOFTWARE COMPANY METRICS

(IN MILLIONS)

	Adobe	Aldus	Artisoft	Autodesk	BMC	Banyan
Income statement	8/31/94	6/30/94	6/30/94	7/31/94	6/30/94	6/30/94
Most recent quarter						
Net revenue	$88	$63	$34	$110	$78	$37
Net income (loss)	18 (a)	5 (b)	4	17	22	4
EPS	0.38	0.35	0.28	0.68	0.86	0.22
Trailing twelve months						
Net revenue	$347	$240	$107	$417	$302	$135
Net income (loss)	65	16	14	63	60	3
EPS	1.38	1.16	0.89	2.56	2.33	0.17
Net income (loss) as a % of net revenues	19%	7%	13%	15%	20%	2%
Balance sheet						
Cash	$303	$83	$22	$179	$58	$51
Other current assets	60	60	52	111	85	32
Other assets	57	62	24	124	283	29
	$420	$205	$98	$414	$426	$112
Liabilities	$85	$48	$25	$107	$171	$43
Equity	335	157	73	307	255	69
	$420	$205	$98	$414	$426	$112
Other data						
Closing stock price (Sept. 30, 1994)	$32.50	n/a	$10.38	$62.50	$45.00	$17.38
Common shares outstanding (in millions)	48 (c)	14 (c)	15	25	26	18
Market value (in millions)	$1,560	n/a	$156	$1,563	$1,170	$313
Price/revenue ratio	19.8x	n/a	1.4x	3.7x	3.9x	2.3x
Price/earnings ratio - trailing twelve	23.6x	n/a	11.7x	24.4x	19.3x	103.5x
Price/earnings ratio - future 4 qtrs.	19.8x	n/a	10.4x	19.6x	10.8x	17.4x
Headcount (most recent disclosure)	999	1,052	426	1,788	987	692
Net revenue/employee	$346,992	$227,688	$252,183	$233,308	$305,471	$195,643
Book value per share	$6.98	$11.21	$4.87	$12.28	$9.81	$3.83
Price/book value ratio	4.7x	n/a	2.1x	5.1x	4.6x	4.5x
Growth statistics (over comparable quarter):						
Revenue	12%	38%	71%	6%	20%	15%
Research and development	4%	30%	0%	24%	17%	31%
Sales and marketing	1%	7%	43%	9%	16%	23%
General and administrative	(6%)	10%	(34%)	9%	n/a	26%
Net income	59%	2,181%	91%	1%	21%	15%

(a) Adobe net income included $4 million ($0.05 per share) nonoperating gain on the sale of common stock held as an investment.
(b) Aldus net income included $2 million ($0.14 per share) in after-tax costs related to acquisition of Computation, Inc.
(c) Adobe and Aldus merged in September 1994.

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SOFTWARE COMPANY METRICS (CONTINUED)
(IN MILLIONS)

Income statement	Borland 6/30/94	Computer Assoc. 6/30/94	Informix 6/30/94	Intuit 6/30/94	Legent 6/30/94	Platinum 3/31/94
Most recent quarter						
Net revenue	$69	$477	$106	$33	$121	$14
Net income (loss)	61	(86)	13	(9)	13	(13)
EPS	1.88 (a)	(0.53)	0.20	(0.45)	0.36	(1.04)
Trailing twelve months						
Net revenue	$339	$2,202	$393	$220	$477	$63
Net income (loss)	(11)	285	58	(166)	0	(36)
EPS	(0.41)	1.69	0.86	(10.54) (b)	0.01	(2.74)
Net income (loss) as a % of net revenues	(3%)	13%	15%	(75%)	0%	(57%)
Balance sheet						
Cash	$144	$361	$152	$88	$126	$18
Other current assets	38	650	117	37	230	19
Other assets	181	1,932	69	118	289	27
	$363	$2,943	$338	$243	$645	$64
Liabilities	$160	$1,829	$122	$57	$228	$29
Equity	203	1,114	216	186	417	35
	$363	$2,943	$338	$243	$645	$64
Other data						
Closing stock price (Sept. 30, 1994)	$11.06	$44.25	$27.75	$43.75	$26.50	$12.25
Common shares outstanding (in millions)	33	162	67	19	36	12
Market value (in millions)	$365	$7,169	$1,859	$831	$954	$147
Price/revenue ratio	1.1x	3.3x	4.7x	3.8x	2.0x	2.3x
Price/earnings ratio - trailing twelve	*	26.2x	32.2x	*	2,900.6x	*
Price/earnings ratio - future 4 qrts.	276.6x	14.0x	24.3x	32.4x	12.3x	58.3x
Headcount (most recent disclosure)	1,650	6,900	1,718	1,300	2,400	485
Net revenue/employee	$205,616	$319,090	$228,920	$169,427 (c)	$198,572	$129,293
Book value per share	$6.15	$6.88	$3.22	$9.79	$11.58	$2.92
Price/book value ratio	1.8x	6.4x	8.6x	4.5x	2.3x	4.2x
Growth statistics (over comparable quarter):						
Revenue	(44%)	13%	25%	50%	21%	52%
Research and development	10%	501%	35%	204%	(14%)	205%
Sales and marketing	(23%)	(3%)	38%	106%	24%	159%
General and administrative	n/a	n/a	(10%)	142%	n/a	743%
Net income	892%	(378%)	10%	(1671%)	40%	(1588%)

(a) Borland's results included $25 million of revenues related to one million Paradox licenses sold to Novell; a $100 million gain on the sale of Quattro Pro to Novell; and a $16 million writeoff related to its acquisition of ReportSmith. Excluding these transactions, Borland would have reported an operating loss of $32 million in the June quarter.

(b) Intuit trailing twelve month results included merger costs of $26 million and the write-off of $150 million of purchased R&D related to the acquisition of ChipSoft.

(c) Intuit revenue per employee is negatively impacted by the purchase of ChipSoft and Parsons: new employees are included in headcount data but incremental revenues from the acquired companies are only accounted for on a prospective basis.

SOFTWARE COMPANY METRICS (CONTINUED)
(IN MILLIONS)

Income statement	Powersoft 6/30/94	Software Publishing 6/30/94	Sterling 6/30/94	Sybase 9/30/94	Symantec 6/30/94
Most recent quarter					
Net revenue	$33	$10	$115	$183	$83
Net income (loss)	3	(0)	15	19	1
EPS	0.25	(0.04)	0.66	0.36	0.03
Trailing twelve months					
Net revenue	$90	$62	$449	$617	$292
Net income (loss)	11	(43) (a)	(9) (b)	65	(3) (c)
EPS	0.96	(3.51)	(0.49)	1.20	(0.10)
Net income (loss) as a % of net revenues	12%	(70%)	(2%)	10%	(1%)
Balance sheet					
Cash	$39	$51	$142	$199	$65
Other current assets	32	12	134	157	79
Other assets	15	6	174	143	39
	$86	$69	$450	$499	$183
Liabilities	$27	$43	$295	$197	$115
Equity	59	26	155	302	68
	$86	$69	$450	$499	$183
Other data					
Closing stock price (Sept. 30, 1994)	$53.88	$4.38	$31.00	$45.88	$14.94
Common shares outstanding (in millions)	13	12	20	55	36
Market value (in millions)	$700	$53	$620	$2,523	$538
Price/revenue ratio	7.8x	0.8x	1.4x	4.1x	1.8x
Price/earnings ratio - trailing twelve	55.9x	*	*	38.2x	*
Price/earnings ratio - future 4 qrts.	40.2x	12.5x	12.3x	28.3x	15.2x
Headcount (most recent disclosure)	292	463	2,800	2,528	1,024
Net revenue/employee	$308,438	$133,579	$160,293	$244,182	$284,859
Book value per share	$4.54	$2.17	$7.75	$5.49	$1.89
Price/book value ratio	11.9x	2.0x	4.0x	8.4x	7.9x
Growth statistics (over comparable quarter):					
Revenue	218%	(52%)	10%	63%	41%
Research and development	188%	(43%)	28%	56%	32%
Sales and marketing	221%	(59%)	(5%)	54%	29%
General and administrative	165%	(43%)	n/a	39%	6%
Net income	97%	92%	200%	76%	115%

(a) Software Publishing trailing twelve month results included restructuring costs of $26 million related to workforce reductions and leases.
(b) Sterling trailing twelve month results included restructuring costs of $91 million related to the merger with Systems Center in July 1993.
(c) Symantec trailing twelve month results included acquisition and restructuring costs of $31 million.

HARDWARE COMPANY METRICS
(IN MILLIONS)

Income statement	Apple 9/30/94	Compaq 6/30/94	DEC 6/30/94	Dell 7/31/94	Gateway 6/30/94
Most recent quarter					
Net revenue	$2,493	$2,499	$3,923	$791	$617
Net income (loss)	115 (a)	254	(1,746) (c)	26	4
EPS	0.95	0.78	(12.64)	0.62	0.05
Trailing twelve months					
Net revenue	$9,189	$8,725	$13,451	$3,058	$2,178
Net income (loss)	310	725	(2,087)	69	111
EPS	2.61	2.75	(15.24)	1.72	1.49
Net income (loss) as a % of net revenues	3%	8%	(16%)	2%	5%
Balance sheet					
Cash	$1,258	$573	$1,181	$333	$101
Other current assets	3,218	4,194	5,707	798	395
Other assets	827	901	3,692	110	81
	$5,303	$5,668	$10,580	$1,241	$576
Liabilities	$2,920	$2,530	$7,300	$715	$268
Equity	2,383	3,138	3,280	526	309
	$5,303	$5,668	$10,580	$1,241	$576
Other data					
Closing stock price (Sept. 30, 1994)	$33.69	$32.63	$26.50	$37.44	$18.63
Common shares outstanding (in millions)	120	269 (b)	139	41	78
Market value (in millions)	$4,043	$8,776	$3,684	$1,535	$1,461
Price/revenue ratio	0.4x	1.0x	0.3x	0.5x	0.7x
Price/earnings ratio - trailing twelve	12.9x	11.8x	*	21.7x	12.5x
Price/earnings ratio - future 4 qtrs.	10.4x	9.6x	n/m	10.5x	13.9x
Headcount (most recent disclosure)	11,963	10,541	85,000	7,500	3,836
Net revenue/employee	$768,097	$827,740	$158,245	$407,781	$567,873
Book value per share	$19.86	$11.67	$23.60	$12.83	$3.93
Price/book value ratio	1.7x	2.8x	1.1x	2.9x	4.7x
Growth statistics (over comparable quarter):					
Revenue	16%	53%	0%	13%	69%
Research and development	(13%)	33%	(8%)	34%	n/a
Sales and marketing	(9%)	52%	19%	(6%)	109%
General and administrative	n/a	n/a	n/a	n/a	n/a
Net income	4,204%	148%	(1,643%)	135%	(87%)

(a) Apple's current quarter reflected shipments of more than one million units for the second time in Apple history.
(b) Compaq split its stock 3-for-1 effective May 31, 1994.
(c) DEC EPS for the current quarter included restructuring charges of $1.2 billion plus reductions in the carrying value of intangible and deferred tax assets of $380 million. Excluding these charges, EPS was $1.22 per share vs. $0.85 per share a year ago.

HARDWARE COMPANY METRICS (CONTINUED)
(IN MILLIONS)

Income statement	Hewlett Packard 7/31/94	IBM 6/30/94	Intel 6/30/94	Silicon Graphics 6/30/94	Sun 10/2/94
Most recent quarter					
Net revenue	$6,053	$15,351	$2,770	$433	$1,273
Net income (loss)	347	668 (a)	640	43	38
EPS	1.33	1.14	1.46	0.28	0.40
Trailing twelve months					
Net revenue	$23,676	$62,863	$10,059	$1,482	$5,003
Net income (loss)	1,421	1,331	2,435	141	218
EPS	5.49	2.30	5.53	0.91	2.07
Net income (loss) as a % of net revenues	6%	2%	24%	9%	4%
Balance sheet					
Cash	$2,475	$8,951	$2,320	$401	$783
Other current assets	9,434	30,214	3,206	623	1,456
Other assets	6,594	40,707	6,760	495	571
	$18,503	$79,872	$12,286	$1,519	$2,810
Liabilities	$9,082	$59,298	$3,276	$598	$1,120
Put Warrants	0	0	682	0	0
Equity	9,421	20,574	8,328	921	1,690
	$18,503	$79,872	$12,286	$1,519	$2,810
Other data					
Closing stock price (Sept. 30, 1994)	$87.38	$69.63	$61.50	$25.75	$29.38
Common shares outstanding (in millions)	261	584	437	156	96
Market value (in millions)	$22,805	$40,661	$26,876	$4,017	$2,820
Price/revenue ratio	1.0x	0.6x	2.7x	2.7x	0.6x
Price/earnings ratio - trailing twelve	15.9x	30.3x	11.1x	28.2x	14.2x
Price/earnings ratio - future 4 qtrs.	13.9x	15.1x	9.3x	22.4x	12.3x
Headcount (most recent disclosure)	96,200	235,000	29,500	3,750	13,300
Net revenue/employee	$246,112	$267,502	$340,978	$395,094	$376,154
Book value per share	$36.10	$35.23	$19.06	$5.90	$17.60
Price/book value ratio	2.4x	2.0x	3.2x	4.4x	1.7x
Growth statistics (over comparable quarter):					
Revenue	22%	(1%)	30%	36%	33%
Research and development	16%	(21%)	16%	33%	11%
Sales and marketing	9%	(12%)	30%	34%	26%
General and administrative	n/a	n/a	n/a	n/a	n/a
Net income	28%	108%	13%	24%	131%

(a) IBM EPS of $1.14 for the June quarter was about double analysts' expectations.

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KEY RELATIONSHIPS
(IN MILLIONS)

	Egghead 6/30/94	Merisel 6/30/94	RR Donnelley 6/30/94
Income statement			
Most recent quarter			
Net revenue	$194	$1,210	$1,117
Net income (loss)	(1)	3	58
EPS	(0.06)	0.09	0.38
Trailing twelve months			
Net revenue	$754	$4,045	$4,622
Net income (loss)	0	29	249
EPS	0.03	0.96	1.61
Net income (loss) as a % of net revenues	0%	1%	5%
Balance sheet			
Cash	$29	$0	$20
Other current assets	214	873	1,143
Other assets	24	169	2,784
	$267	$1,042	$3,947
Liabilities	$124	$804	$2,040
Equity	143	238	1,907
	$267	$1,042	$3,947
Other data			
Closing stock price (Sept. 30, 1994)	$7.13	$10.13	$30.00
Common shares outstanding (in millions)	17	31	155
Market value (in millions)	$121	$314	$4,650
Price/revenue ratio	0.2x	0.1x	1.0x
Price/earnings ratio - trailing twelve	225.4x	10.6x	18.6x
Price/earnings ratio - future 4 qtrs.	71.3x	9.5x	16.2x
Headcount (most recent disclosure)	2,500	2,502	34,000
Net revenue/employee	$301,584	$1,616,743	$135,932
Book value per share	$8.41	$7.68	$12.30
Price/book value ratio	0.8x	1.3x	2.4x
Growth statistics (over comparable quarter):			
Revenue	(11%)	70%	12%
Sales, general, and administrative	(23%)	52%	12%
Net income	46%	(55%)	11%

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CONSUMER SOFTWARE COMPANIES
(IN MILLIONS)

Income statement	Broderbund 8/31/94	Electronic Arts 6/30/94	Davidson & Assoc. 6/30/94	Sierra OnLine 6/30/94
Most recent quarter				
Net revenue	$28	$74	$18	$12
Net income (loss)	4	12	(3)	(4)
EPS	0.44	0.24	(0.16)	(0.56)
Trailing twelve months				
Net revenue	$112	$413	$64	$64
Net income (loss)	11	49	3	(9)
EPS	1.10	0.98	0.20	(1.23)
Net income (loss) as a % of net revenues	10%	12%	5%	(15%)
Balance sheet				
Cash	$75	$125	$23	$65
Other current assets	15	91	14	22
Other assets	8	45	7	21
	$98	$261	$44	$108
Liabilities	$18	$77	$6	$62
Equity	80	184	38	46
	$98	$261	$44	$108
Other data				
Closing stock price (Sept. 30, 1994)	$53.50	$18.50	$20.00	$20.50
Common shares outstanding (in millions)	10 (a)	50	17	8
Market value (in millions)	$535	$925	$340	$164
Price/revenue ratio	4.8x	2.2x	5.3x	2.6x
Price/earnings ratio - trailing twelve	48.7x	18.8x	100.8x	*
Price/earnings ratio - future 4 qtrs.	25.1x	18.0x	40.0x	nm
Headcount (most recent disclosure)	460	1,077	327	540
Net revenue/employee	$242,987	$383,502	$197,113	$117,781
Book value per share	$8.00	$3.68	$2.24	$5.75
Price/book value ratio	6.7x	5.0x	8.9x	3.6x
Growth statistics (over comparable quarter):				
Revenue	26%	(7%)	29%	8%
Research and development	12%	7%	135%	19%
Sales and marketing	22%	(6%)	120%	(1%)
General and administrative	(1%)	3%	n/a	n/a
Net income	52%	61%	(389%)	(19%)

(a) Broderbund's BOD declared a two-for-one stock split effective October 25, 1994.

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Finance

Supplemental Information

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Supplemental Info.

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Revenue Summary Reconciliation

Q95-1

	Revenue Summary			Reconciling Items		Gross	Revenue	Net
	Non-OEM	OEM	MS	Unbundle	Other	Revenue	Adj's	Revenue
Desktop Applications (New User)	$547.7	$6.5	$554.1					
Desktop Applications (Existing User)	90.1	0.0	90.1					
Total Desktop Applications	637.7	6.5	644.2	($11.7)	$6.2	$638.6	($26.1)	$612.6
Personal Operating Systems	80.8	277.7	358.5	(1.1)	(2.0)	355.4	10.9	366.4
Consumer	93.6	27.4	121.0	1.3	2.8	125.1	(13.4)	111.7
Business Systems	46.5	8.1	54.7	11.5	4.6	70.8	(3.9)	66.9
Developer	59.0	0.5	59.5	0.0	2.3	61.8	(4.7)	57.1
Advanced Technology	7.1	0.0	7.1	0.0	0.0	7.1	0.8	7.9
Press & Other	23.6	(11.7)	11.8	0.0	(13.9)	(2.1)	26.3	24.2
Product Divisions	$948.2	$308.5	$1,256.7	$0.0	$0.0	$1,256.7	($10.0)	$1,246.7

The Revenue Summary is management's standard view of gross revenue, licenses and revenue per license which allows both a channel and product division perspective of sales in a single report. The Revenue Summary reports product revenue on an "as shipped" basis, that is, how customer buy product from MS. For example, Excel is sold both as a stand-alone product and bundled as part of Office. In the Revenue Summary, Excel sold as part of Office is reported as Office sales, but Excel sold as a stand-alone product is reported separately. Conversely, for purposes of measuring product divisions, revenue is "unbundled". For example, Mail is a component of Office, but development occurs in the Business Systems Division, thus associated revenue for Mail is attributed to BSD rather than Desktop Applications. Additionally, the Revenue Summary segregates new users from existing users for Desktop Application products. Segregating users allows channel and product division management to track sales of new licenses versus upgrades.

The table above reconciles the Revenue Summary shown on page 4 with the product division P&L's shown in the Product Division section. The primary reconciling item between Desktop Applications and BSD represents the unbundling of Mail from Office. Other reconciling items above include manuals, promotional copies of software, raw materials and recurring maintenance which are shown as "other" in the Revenue Summary, but included as specific product division revenue in product P&L's. These items are reclassified in the Revenue Summary in order to report meaningful revenue per license information.

MICROSOFT'S MANAGEMENT ACCOUNTING PRINCIPLES AND REPORTING

The financial information contained herein is prepared in accordance with MS's Management Accounting Principles and is intended for confidential internal use. MS's Accounting Principles emphasize world-wide consistency amongst product, customer, geographical, operational and cost center activities based on standard taxonomies for customers, products, vendors and employees. These principles emphasize responsibility accounting for cost centers and marginal costs of incremental activities where practical. These financial statements also include inter-unit cost and revenue allocations which may not be relevant for external and regulatory reporting.

If you have any questions or suggestions about Management Accounting Principles, or if you are interested in obtaining a copy of Microsoft's Management Accounting Principles, you should email the "MAP" alias.

Financial and management information described herein is maintained by the Management Reporting group on \\budget\measure, a share dedicated to reporting. The following describes the location and current contents of the share. Please contact the "MRPT" alias if you have any questions.

```
I:\ Budget\Measure\
├─ BUDGET95
│   ├─ COST
│   ├─ HEAD
│   ├─ OS
│   ├─ RELEASE
│   └─ SHARE
├─ MGMTP&L
│   ├─ CHANNEL
│   ├─ PRODUCTS
│   ├─ REGION
│   └─ SEC
├─ MRPT
└─ REVENUE
    ├─ 95BUDSLD
    ├─ GOLD
    ├─ PRICE
    └─ REV_SUM
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__Budget95__

\Cost - Cost.xls is a summarized view of the cost control slides presented during FY95 budget presentations.

\Head - Head.xls is a summarized view of headcount slides presented during FY95 budget presentations.

\OS - OS.xls is a pivot table summarizing the operating system market share slides during the FY95 budget presentations.

\Share - Share.xls, pivot table summarizing the Desktop Applications market share slides presented during the FY95 budget presentations.

\Release - Release.xls, pivot table view of FY95 product release schedules by language, version and sales location.

MGMTP&L

\Channel - This folder will contain the channel pivot P&L's.
- opex_mtd.xls - operating expense detail with head count averages.

\Products - 94mnthpl.xls - contains FY94 Product P&L information in FY95 format.
- mnthlypl.xls - contains FY95 Product P&L information by Month, Quarter and YTD.
- ytdpl.xls - contains FY95 Product P&L information on a YTD basis with account detail.

\Region - eu-act1.xls - Europe USD pivot P&L's (Channel, Total, and Trend views).
- fe-act1.xls - Far East USD pivot P&L's (Channel, Total, and Trend views).
- ic-act1.xls - ICON USD pivot P&L's (Channel, Total, and Trend views).
- na-act1.xls - Canada USD pivot P&L's (Channel, Total, and Trend views).
- lc-act1.xls - WW Local Currency pivot P&L's (Channel, Total, and Trend views).
- lc-bud1.xls - WW Local Currency budget pivot P&L's (Channel, and Trend views).

\SEC - SEC.xls contains the MS financial on a MTD, QTD, YTD basis.
- SEC Plus - SEC account view with responsibility rollup.

MRPT

\Folder - Rptlst.xls is a listing of all reports produced by Management Reporting, along with owners, audience, and publish times.

Revenue

\95budsld - goldbud.xls contains FY95 budgeted revenue and licenses information summarized from budget presentations.
- goldlite.xls, contains FY95 budgeted revenue and licenses information summarized from the budget presentations, less office guarantee.
- goldlng.xls, contains FY94 revenue and licenses information by language type.

\GOLD - gold.xls, contains FY95 worldwide revenue summary data.
- goldaime.xls, goldapac.xls, goldla.xls, goldfe.xls, and goldeuro.xls are regional gold files comparing against US.
- oldcomp.xls, actuals or budget, revenue or licenses as a % of United States.
- goldlang.xls, FY95 revenue licenses information by language type.
- goldrank.xls, stack ranking actual, budget revenue or licenses, MTD, QTD, or YTD.

\Price - pricebud.xls, actual versus budget comparison by location and region, with street prices.
- price09.xls, major subsidiary comparison of street price and mix.

\Rev_sum - revsumus.xls, the current revenue summary published by MS Sales.
- revsumm.xls, revenue summary comparing FY94 actuals vs. FY95 budget.