PLAINTIFF'S EXHIBIT 4211R
Comes v. Microsoft

Q95-2 BOARD OF DIRECTORS' REPORT

CONTENTS

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This report was prepared with Win Word 6.0. All tables were created in Win 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" revenue unless otherwise stated. Gross revenue is net of returns.

Microsoft Results

Q95-2 EXECUTIVE SUMMARY

Highlights

- *Net revenue exceeded plan by 6% and reached an all time high of $1,482 million for the quarter.* Q95-2 revenue exceeded the same period last year by 31%. Year-to-date net revenue was $2,729 million, or 8% over plan, and 29% greater than last year. Foreign exchange rate fluctuations contributed $61 million to net revenue in Q95-2 and $85 million FYTD, as compared to plan.
- *Net income for the quarter was $373 million, or $0.60 per share, a 29% increase over Q94-2.* Year to date net income was $689 million, or $1.10 per share.
- *Gross margin improved by 1.3 points FYTD versus the prior year, primarily due to a continued shift in sales mix from the finished goods channel to OEM, and from full packaged product to Select and other corporate licensing programs.*
- *Life-to-date Windows shipments reached 75 million in Q95-2.*
- *Sales of Office represents 43% of MS finished goods gross revenue.* To date, seven million units of Office and Office Pro have been shipped.
- *Tele-Communications, Inc. (TCI) and MS entered a joint venture agreement to form MS Online Services Partnership which is 80% owned by MS and 20% by TCI.*
- *MS agreed to purchase 8% of UUNet, a leading Internet access provider.* UUNet will build a dedicated TCP/IP network for MSN.
- *Bob Herbold was named Executive Vice President and Chief Operating Officer.* Promotions during the quarter included: Jim Allchin (SVP, Business Systems), Brad Silverberg (SVP, Personal Systems) and Patty Stonesfier (SVP, Consumer).
- *Quarter-end headcount of 16,379 was 11% above one year ago, but 7% below plan.*

Summary of Results

	Q93-1	Q93-2	Q93-3	Q93-4	Q94-1	Q94-2	Q94-3	Q94-4	Q95-1	Q95-2
Net revenue *(in millions)*	$818	$938	$958	$1,039	$983	$1,129	$1,244	$1,293	$1,247	$1,482
Gross margin	83%	83%	83%	83%	84%	84%	83%	84%	85%	85%
Net income	26%	25%	25%	26%	24%	26%	21%	28%	25%	25%
Earnings per share	$0.35	$0.39	$0.40	$0.43	$0.39	$0.48	$0.42	$0.59	$0.51	$0.60
Marketing expense % net revenue	10%	12%	10%	7%	9%	9%	8%	9%	10%	13%
R&D expense % net revenue	13%	12%	12%	13%	14%	13%	12%	13%	14%	13%
PSS expense % net revenue	5%	4%	4%	5%	5%	5%	5%	6%	5%	5%
Net revenue per employee *(in 000's)*	$275	$299	$287	$294	$271	$308	$337	$347	$326	$371
People expense per employee	69	68	66	71	73	74	73	87	85	90
Infrastructure expense per employee	23	23	23	26	21	23	24	28	29	29
Headcount	12,220	12,888	13,802	14,430	14,609	14,737	14,773	15,017	15,605	16,379

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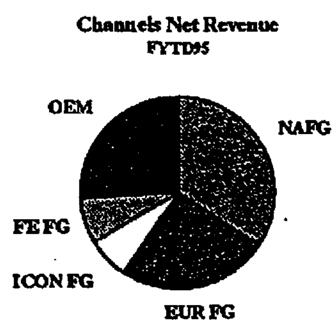
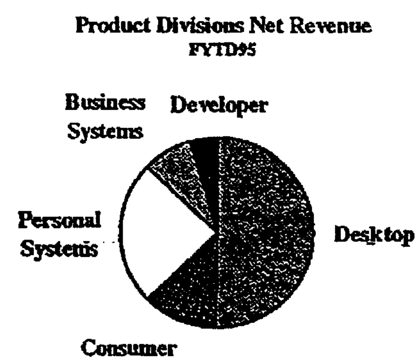
CHANNEL AND PRODUCT HIGHLIGHTS

Channels

- *Q95-2 net finished goods revenue exceeded plan across all regions.* As compared to the same quarter last year, North America was up 23%, Europe 41%, ICON 70%, and the Far East 100%.
- *OEM net revenue in Q95-2 increased 44% as compared to last year, and comprised 26% of total net revenue versus 24% during the same period last year.* OEM is expected to exceed FY95 plan by at least 10%.
- *Currently, 85% of eligible strategic OEM accounts have signed Windows 95 marketing agreements in which they agreed to promote Windows 95 in return for reduction in royalty rates.*
- *Finished goods revenue from Select and other corporate license programs continues to increase as a percentage of revenue, representing approximately 26% of total finished goods revenue in Q95-2, compared to approximately 17% last year.* This trend has had a significant impact in reducing total cost of revenue.
- *Marketing and Broad Reach spending reached $321 million for the year, compared with $192 million last year, a 68% increase.*
- *MS Consulting Services has added eight new practices year to date.*





Product Divisions

- *Desktop Applications revenue was over plan for the quarter, with Office and Office Pro revenue exceeding plan by more than 44%.* Year-to-date sales of Office and Office Pro total almost $961 million, 87% over the same period last year.
- *Personal Systems revenue was over plan by 33% reflecting continued strong sales of Windows and MS-DOS. On a year to date basis, Windows revenue is up 54% and MS-DOS is up 38% over the same period last year.*
- *Sales of Windows NT were very strong during Q95-2, exceeding plan by over 57%.* Windows NT Server *is being shipped by 36 OEMs, up 400% over last year.*
- *The second Windows 95 beta shipped in early November.* Windows 95 Preview Program (the final beta) is scheduled to be sold to 400,000 customers worldwide. The product will ship in March and sell for $30.
- *Consumer revenue was lower than plan in all regions except ICON, but excluding hardware and Works, was about 49% ahead of FYTD94.* During Q95-2, 33 titles were shipped with an additional 42 expected to be released in Q95-3, including Bob (Utopia) which is expect to RTM late in January.
- *FYTD Product group spending (excluding product marketing) totaled $377 million, 16% less than planned, but almost 37% more than the same period last year.*

INCOME STATEMENT

(IN MILLIONS, EXCEPT NET INCOME PER SHARE)

	Q95-2 Actual		Q95-2 Plan		Q95-2 Variance		Q94-2 Actual		Q94-2 Growth	
Net revenue	$1,482.1	100.0%	$1,402.2	100.0%	$79.9	5.7%	$1,129.0	100.0%	$353.1	31.3%
Cost of revenue	221.9	15.0	225.3	16.1	3.4	1.5	184.8	16.4	37.1	20.1
Gross profit	1,260.1	85.0	1,176.9	83.9	83.2	7.1	944.2	83.6	315.9	33.5
Operating expenses										
Product R&D	199.4	13.5	229.3	16.4	29.9	13.0	144.9	12.8	(54.5)	(37.6)
Sales expense	285.9	19.3	289.9	20.7	4.0	1.4	232.1	20.6	(53.8)	(23.2)
Marketing	139.4	9.4	139.8	10.0	0.4	0.3	103.4	9.2	(36.0)	(34.8)
Broad Reach	53.6	3.6	37.5	2.7	(16.1)	(42.9)	0.0	0.0	(53.6)	NM
G&A	62.0	4.2	68.3	4.9	6.3	9.2	48.4	4.3	(13.6)	(28.1)
	740.3	49.9	764.8	54.5	24.5	3.2	528.8	46.8	(211.5)	(40.0)
Operating income	519.8	35.1	412.1	29.4	107.7	26.1	451.4	40.0	68.4	15.2
Other income	37.5	2.5	30.6	2.2	6.9	22.5	22.1	2.0	15.4	69.7
Income taxes	(183.9)	(12.4)	(150.6)	(10.7)	33.3	(22.1)	(148.7)	(13.2)	(35.2)	23.7
Net income	$373.4	25.2%	$292.1	20.8%	$81.3	27.8%	$288.7	25.6%	$84.7	29.3%
Avg shares outstanding	625.0		625.6		(0.6)		607.9		17.1	
Earnings per share	$0.60		$0.47		$0.13		$0.47		$0.13	

	FYTD95 Actual		FYTD95 Plan		FYTD95 Variance		FYTD94 Actual		FYTD94 Growth	
Net revenue	$2,728.8	100.0%	$2,527.8	100.0%	$201.0	8.0%	$2,111.6	100.0%	$617.2	29.2%
Cost of revenue	408.2	15.0	407.2	16.1	(1.0)	(0.2)	343.7	16.3	(64.5)	(18.8)
Gross profit	2,320.6	85.0	2,120.6	83.9	200.0	9.4	1,767.9	83.7	552.7	31.3
Operating expenses										
Product R&D	377.5	13.8	451.4	17.9	73.9	16.4	276.3	13.1	(101.2)	(36.6)
Sales expense	552.2	20.2	575.9	22.8	23.7	4.1	454.0	21.5	(98.2)	(21.6)
Marketing	263.9	9.7	263.9	10.4	0.0	0.0	190.7	9.0	(73.2)	(38.4)
Broad Reach	57.2	2.1	75.0	3.0	17.8	23.7	0.0	0.0	(57.2)	NM
G&A	113.1	4.1	148.7	5.9	35.6	23.9	88.6	4.2	(24.5)	(27.7)
	1,363.9	50.0	1,514.8	59.9	150.9	10.0	1,009.6	47.8	(354.3)	(35.1)
Operating income	956.7	35.1	605.8	24.0	350.9	57.9	758.3	35.9	198.4	26.2
Other income	71.7	2.6	58.2	2.3	13.5	23.2	40.8	1.9	30.9	75.7
Income taxes	(339.4)	(12.4)	(225.9)	(8.9)	113.5	(50.2)	(271.7)	(12.9)	67.7	(24.9)
Net income	$689.0	25.2%	$438.1	17.3%	$250.9	57.3%	$527.4	25.0%	$161.6	30.6%
Avg shares outstanding	625.0		625.6		(0.6)		607.9		17.1	
Earnings per share	$1.10		$0.70		$0.40		$0.87		$0.23	

COMPARATIVE BALANCE SHEET AND CASH FLOW

Balance Sheet (in millions)

	Sep. 30, 1994		Dec. 31, 1994		Change	
Assets						
Current assets:						
Cash and short-term investments	$3,776	67%	$3,839	64%	$63	2%
Accounts receivable - net	527	9	591	10	64	12
Inventories	108	2	117	2	9	8
Other	143	2	149	3	6	4
Total current assets	4,554	80	4,696	79	142	3
Property, plant, and equipment - net:						
Land	163	3	163	3	0	0
Buildings	390	7	391	7	1	0
Leasehold improvements	77	1	73	1	(4)	(5)
Furniture & equipment	106	2	118	2	12	11
Computer equipment	200	4	232	4	32	16
Total property, plant, and equipment - net	936	17	977	16	41	4
Other assets	147	3	288	5	141	96
Total assets	$5,637	100%	$5,961	100%	$324	6
Liabilities and stockholders' equity						
Current liabilities:						
Accounts payable	$ 354	6%	$ 431	7%	$ 77	22
Accrued compensation	81	1	110	2	29	36
Income taxes payable	369	10	364	7	(5)	(1)
Other	200	4	191	3	(9)	(5)
Total current liabilities	1,004	21	1,096	19	92	9
Minority interest	0	0	125	2	125	NM
Put warrants	203	4	297	5	94	46
Stockholders' equity:						
Common stock and paid-in capital	1,606	29	1,699	30	93	6
Retained earnings	2,824	50	2,744	46	(80)	(3)
Total stockholders' equity	4,430	79	4,443	76	13	0
Total liabilities and stockholders' equity	$5,637	100%	$5,961	100%	$324	6

- *Other assets and Minority interest reflect the $125 million contribution of TCI common stock in exchange for a 20% share in MS Online Partnership.*
- *During Q95-2, MS sold an additional 4 million put warrants on MS stock.*
- *In December, MS retired $35 million in fully depreciated capital assets,* comprised of $31 million of PCs and $4 million of manufacturing equipment.

Cash Flow Summary (in millions)

	Q95-1	Q95-2
Beginning cash and short-term investments	$ 3,614	$ 3,776
Net income	316	373
Depreciation and amortization	67	66
Change in accounts receivable	(59)	(75)
Change in inventories	(7)	(10)
Change in other assets	(23)	(7)
Change in liabilities	96	98
Cash flow from operations	390	445
Cash provided from stock issued, net of buyback	(122)	(220)
Cash used for purchase of property and equipment	(67)	(103)
Cash used for long-term investments	(35)	(55)
Effect of exchange rates on cash	(4)	(4)
Ending cash and short-term investments	$ 3,776	$ 3,839

REVENUE SUMMARY
(REVENUE IN MILLIONS, LICENSES IN THOUSANDS)

	Q95-2				FYTD95			
	Gross Revenue		Licenses		Gross Revenue		Licenses	
	Actual	% of Plan	Actual	% of Plan	Actual	% of Plan	Actual	% of Plan
Finished Goods:								
Office	$311.2	128 %	1,231	148 %	$573.1	129 %	2,226	150 %
Office Professional	143.7	182	475	239	236.7	171	810	232
Excel	73.3	83	420	81	126.4	82	706	76
Word	82.4	84	597	91	154.7	90	1,096	95
Graphics	10.1	80	65	83	21.6	99	135	100
Access	32.5	110	187	112	61.5	115	368	121
Project	35.2	114	110	114	63.5	112	199	113
Desktop Apps New Users	698.3	119	3,086	121	1,237.5	119	5,540	122
Office	47.1	158	303	193	91.3	165	590	199
Office Professional	27.1	240	120	299	40.4	201	184	255
Excel	12.0	54	142	63	20.6	53	262	64
Word	16.7	55	183	60	34.0	71	411	82
Graphics	1.2	45	26	96	2.1	46	47	100
Access	3.9	86	69	150	11.7	129	177	193
Project	4.7	137	41	133	10.6	138	92	130
Desktop Apps Existing Users	112.7	108	884	106	210.7	115	1,764	118
Windows	73.5	237	1,384	276	132.6	201	2,509	236
MS-DOS	28.1	309	740	311	50.1	254	1,357	270
Windows 95	(0.0)	(0)	(0)	(0)	(0.0)	(0)	(0)	(0)
Personal Systems	101.6	251	2,124	285	182.7	211	3,866	245
At Work	0.3	50	5	48	0.7	61	11	49
Family Reference	24.2	69	389	71	33.0	55	536	59
Input Device	54.6	117	1,111	121	84.5	111	1,729	112
Kids/Games	33.0	72	1,057	72	50.9	80	1,651	82
Personal Tools	11.2	40	272	40	20.2	53	459	52
Transactions	1.8	33	88	35	2.8	40	174	56
Works	28.3	93	436	90	49.7	90	801	90
Lifestyle	19.2	133	478	122	25.1	125	625	116
Consumer	172.2	84	3,831	81	266.1	83	5,974	84
Mail - Servers	5.6	101	17	103	10.1	96	29	93
Mail - Users	2.5	36	105	45	5.2	38	203	44
Other Network	7.1	252	13	188	12.6	240	25	190
SMS, SNA Server	5.3	143	107	206	6.4	111	109	152
SQL Server - Servers	10.6	148	17	233	21.4	107	22	167
SQL Server - Users	4.2	42	85	92	4.2	31	85	61
Mail - AddOns, Upgrades	5.9	145	100	126	11.2	139	200	128
Windows NT Server-Servers	32.0	260	80	262	43.2	186	97	195
Windows NT Workstation	23.9	197	163	213	28.8	139	191	153
Windows NT Server-Users	3.5	27	163	40	4.2	22	195	30
Backoffice	0.2	1219	2	12172	0.2	882	2	8764
Business Systems	100.8	130	853	85	147.6	185	1,158	68
Developer Kits	7.2	1361	25	619	16.4	1720	63	880
Fox	11.1	99	95	108	24.7	114	212	124
Languages	26.0	140	125	123	41.9	119	207	107
Visual Basic	19.0	98	112	87	35.9	117	209	104
MSDN	7.9	108	20	75	12.6	88	33	65
Developer	71.2	125	377	108	131.4	128	724	116
MS Education Services	1.7	63	6	53	3.7	68	14	58
Total Product Group	1,258.8	117	11,166	109	2,180.6	116	19,851	112
Other	19.7	228	1,272	237	29.2	181	2,684	253
FG Gross Revenue	1,278.5	118	12,437	115	2,209.8	116	21,735	120
OEM	375.4	112	19,914	108	683.9	103	37,140	103
Press	10.8	125	0	NM	20.4	129	0	NM
Online	0.0	NM	0	NM	0.0	NM	0	NM
Other AT	7.3	86	4	523	14.4	96	7	571
Other	(0.3)	NM	0	NM	0.0	NM	0	NM
MS Gross Revenue	1,671.7	116	32,355	111	2,928.5	113	58,852	109
Revenue Adjustments	(189.7)				(199.7)			
Net Revenue	$1,482.1				$2,728.8			

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KEY PRODUCTS RELEASE SCHEDULE

Business Unit / Product:	Act/Fcst	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	Feb-95	Oct-94
Win Office 95	Aug-95	Aug-95
Business Systems:		
Win NT Workstation 3.5	Sep-94	Sep-94
Win 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 1.0	Nov-94	Oct-94
Win NT Workstation 3.51	Mar-95	Feb-95
Windows NT Server 3.51	Mar-95	Feb-95
File & Print Service for NetWare	Apr-95	Apr-95
MS Mail 3.5	May-95	May-95
MS SQL Server 95	May-95	May-95
MS Exchange Server 1.0	Oct-95	Jun-95
Personal Operating Systems:		
Windows 95 Preview Program	Feb-95	Dec-94
Windows 95	Jun-95	Feb-95
Developer:		
Visual C++ 2.0	Sep-94	Sep-94
FoxPro 3.0	Mar-94	Mar-95
Visual Basic 4.0	Jun-95	Oct-94
Visual C++ 3.0	May-95	May-95
Advanced Technology Divisions		
Timex Data Link Watch	Sep-94	Sep-94
Marvel 1.0	Jun-95	Feb-95
Softimage Digital Studio	Aug-95.	Apr-95
Softimage 3-D V 3.0	Jan-95	Jan-95
Softimage Toonz V3.5	Jan-95	Jan-95

Business Unit / Product:	Act/Fcst	Plan
Consumer:		
Consumer Mouse	Aug-94	Aug-94
Mac Haunted House	Sep-94	Sep-94
Win Encarta 95	Sep-94	Aug-94
Creative Writer & Fine Artist 1.1	Sep-94	Sep-94
Win Magic School Bus Human Body	Sep-94	Sep-94
PC Space Simulator	Sep-94	Sep-94
Win Golf 2.0	Sep-94	Oct-94
Win Cinemania 95	Sep-94	Dec-94
Nexus Keyboard	Sep-94	Sep-94
Mac Arcade	Oct-94	Sep-94
Win Ultimate Robot	Oct-94	Sep-94
Mac Dangerous Creatures	Oct-94	Jul-94
Mac Works 4.0B	Nov-94	Oct-94
Win Complete Basketball	Nov-94	Oct-94
Win Magic School Bus Solar System	Nov-94	Mar-95
Win Ultimate Frank Lloyd Wright	Nov-94	Oct-94
Win Explorapedia/Nature	Nov-94	Dec-94
Utopia	Jan-95	Nov-94
Mac Encarta 95	Jan-95	Nov-94
Win Explorapedia/People	Feb-95	Nov-94
Win Rabbit Ears/Leopard	Feb-95	Apr-95
Win Road Atlas 4.0 (Automap)	Feb-95	N/A
Bookshelf 95	Mar-95	Feb-95
Win Exploration Series: Dogs	Mar-95	Apr-95
Win Baseball - The Game (Diamond)	May-95	Apr-95
Win Works 95	Jun-95	May-95
Win Publisher 3.0	Jun-95	Feb-95
PC Flight Simulator 5.1	Apr-95	Sep-94

Sales, Mktg & PSS

SUMMARY

Results of Operations (in millions)

Q95-2

	Net Revenue		Gross Profit		Responsibility Margin		Contribution Margin	
	Actual	% of Plan	Actual	% of Plan	Actual	% of Plan	Actual	% of Plan
North America FG	$514.8	104 %	$413.8	106 %	$312.0	121 %	$160.9	140 %
Europe FG	458.2	116	398.7	119	308.2	125	196.5	139
ICON FG	103.7	125	84.0	131	57.5	149	34.4	253
Far East FG	107.9	140	89.1	151	64.6	170	39.5	348
WW OEM	385.1	115	363.4	113	343.0	115	245.0	132
Press	10.5	123	5.3	122	2.4	190	(0.1)	NM
Other AT	8.0	81	5.5	83	(1.5)	NM	(3.6)	NM
Online	0.0	NM	(4.6)	NM	(5.1)	NM	(12.1)	NM
Other	(106.1)	NM	(95.2)	NM	(183.0)	NM	(140.7)	NM
Worldwide	$1,482.1	106	$1,260.1	107	$898.3	107	$519.8	126

	Net Revenue Mix		Gross Profit % Net Revenue		Responsibility Margin		Contribution Margin	
	Actual	Plan	Actual	Plan	Actual	Plan	Actual	Plan
North America FG	35 %	35 %	80 %	78 %	61 %	52 %	31 %	23 %
Europe FG	31	28	87	85	67	63	43	36
ICON FG	7	6	81	78	55	47	33	16
Far East FG	7	6	83	77	60	49	37	15
WW OEM	26	24	94	96	89	90	64	56
Press	1	1	51	51	23	15	(1)	(19)
Other AT	1	1	70	68	(18)	(23)	(45)	(58)
Online	0	0	NM	NM	NM	NM	NM	NM
Other	(7)	0	90	NM	172	NM	133	NM
Worldwide	100 %	100 %	85	84	61	60	35	29

FYTD95

	Net Revenue		Gross Profit		Responsibility Margin		Contribution Margin	
	Actual	% of Plan	Actual	% of Plan	Actual	% of Plan	Actual	% of Plan
North America FG	$954.5	109 %	$772.0	113 %	$573.7	134 %	$307.0	214 %
Europe FG	710.4	107	612.9	110	454.3	116	259.8	142
ICON FG	192.7	121	157.4	129	107.8	153	64.8	313
Far East FG	203.9	150	164.4	160	122.9	205	76.2	1060
WW OEM	733.5	111	696.5	109	658.4	111	471.7	128
Press	19.7	126	10.2	128	5.1	273	0.4	(10)
Other AT	15.8	91	11.1	94	(2.0)	NM	(6.2)	NM
Online	0.0	NM	(5.6)	151	(6.4)	NM	(19.8)	NM
Other	(101.7)	NM	(98.3)	NM	(239.5)	NM	(197.2)	NM
Worldwide	$2,728.8	108	$2,320.6	109	$1,674.4	115	$956.7	158

	Net Revenue Mix		Gross Profit % Net Revenue		Responsibility Margin		Contribution Margin	
	Actual	Plan	Actual	Plan	Actual	Plan	Actual	Plan
North America FG	35 %	35 %	81 %	78 %	60 %	49 %	32 %	16 %
Europe FG	26	26	86	84	64	59	37	28
ICON FG	7	6	82	77	56	44	34	13
Far East FG	7	5	81	75	60	44	37	5
WW OEM	27	26	95	96	90	90	64	56
Press	1	1	52	51	26	12	2	(25)
Other AT	1	1	70	68	(12)	(33)	(39)	(72)
Online	0	0	NM	NM	NM	NM	NM	NM
Other	(4)	0	97	NM	235	NM	194	NM
Worldwide	100 %	100 %	85	84	61	58	35	24

"Other" includes certain accruals and adjustments related to GAAP (Generally Accepted Accounting Principles), unusual and non-recurring charges, and other amounts not reflected for management P&L purposes.

FINISHED GOODS REVENUE SUMMARY
GROSS REVENUE (IN MILLIONS)

Q95-2

	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	$130.3	120	$124.3	122	$26.9	116	$39.7	234	$321.2	128
Office Professional	63.5	273	60.0	125	19.5	296	0.7	73	143.7	182
Excel	20.7	60	25.1	72	3.8	82	23.7	169	73.3	83
Word	28.7	73	43.6	94	7.5	113	2.7	50	82.4	84
Graphics	6.3	75	2.9	138	0.5	112	0.4	26	10.1	80
Access	14.7	122	9.5	78	1.6	100	6.6	186	32.5	110
Project	21.6	114	10.6	114	2.7	111	0.3	88	35.2	114
Desktop Apps New Users	285.8	116	275.9	108	62.5	137	74.1	173	698.3	119
Office	15.5	147	25.7	185	5.2	151	0.7	39	47.1	158
Office Professional	5.9	751	19.5	211	1.6	153	0.1	37	27.1	240
Excel	4.2	44	7.8	87	0.6	62	(0.6)	(21)	12.0	54
Word	5.0	34	9.9	103	0.9	62	0.9	21	16.7	55
Graphics	0.5	26	0.6	125	0.1	65	0.0	34	1.2	45
Access	1.0	62	2.5	108	0.2	42	0.1	514	3.9	86
Project	2.8	123	1.6	187	0.3	107	0.0	197	4.7	137
Desktop Apps Existing Users	34.8	84	67.6	149	9.4	113	1.3	14	113.1	108
Windows	37.3	334	22.6	227	8.8	142	4.7	128	73.5	237
MS-DOS	17.4	658	7.4	198	2.5	123	0.9	119	28.1	309
Windows 95	0.0	NM	(0.0)	NM	0.0	N/A	0.0	N/A	(0.0)	(0)
Personal Systems	54.7	396	30.0	219	11.3	136	5.6	119	101.6	251
At Work	0.2	65	0.0	12	0.0	NM	0.0	NM	0.3	50
Family Reference	17.7	58	4.0	141	2.4	147	0.1	49	24.2	69
Input Devices	38.1	122	11.7	102	3.5	125	1.3	109	54.6	117
Kids/Games	20.7	66	7.3	68	2.0	138	3.0	136	33.0	72
Personal Tools	7.0	29	3.1	98	1.0	95	0.2	145	11.2	40
Transactions	0.1	4	1.4	68	0.2	111	0.0	2	1.8	33
Works	12.4	122	13.2	88	1.8	74	0.9	32	28.3	93
Lifestyle	11.5	126	5.8	165	1.6	171	0.2	32	19.2	133
Consumer	107.5	77	46.5	95	12.6	119	5.7	77	172.2	84
Mail - Servers	2.4	104	2.0	108	0.8	92	0.4	79	5.6	101
Mail - Users	1.3	33	0.7	37	0.3	35	0.3	66	2.5	36
Other Network	3.3	222	3.0	295	0.3	213	0.4	301	7.1	252
SMS, SNA Server	2.5	144	2.1	151	0.5	161	0.2	69	5.3	143
SQL Server - Servers	7.1	186	1.8	111	0.5	73	1.2	116	10.6	148
SQL Server - Users	2.7	46	0.7	39	0.4	35	0.5	62	4.2	42
Mail - AddOns, Upgrades	3.8	125	1.3	161	0.8	325	0.1	388	5.9	145
Windows NT Server-Servers	14.9	311	12.3	273	3.0	229	1.7	102	32.0	260
Windows NT Workstation	12.9	294	4.5	98	0.7	63	5.7	299	23.9	197
Windows NT Server-Users	1.5	20	1.2	31	0.5	38	0.3	57	3.5	27
BackOffice	0.0	NM	0.0	23	0.2	NM	0.0	NM	0.2	1219
Business Systems	52.3	136	29.7	124	8.1	101	10.7	149	100.8	130
Developer Kits	1.9	1796	3.4	1004	0.7	824	1.2	NM	7.2	1362
Fox	4.8	154	3.2	67	2.1	111	1.0	67	11.1	99
Languages	15.6	163	4.9	101	0.6	75	4.9	147	26.0	140
Visual Basic	8.8	80	5.3	95	1.1	83	3.8	250	19.0	98
MSIN	4.7	85	1.8	174	0.3	129	1.1	221	7.9	108
Developer	35.7	122	18.6	112	4.8	118	12.0	176	71.2	125
MS Education Services	1.7	63	0.0	N/A	0.0	NM	0.0	NM	1.7	63
Other	8.4	147	7.8	435	0.8	505	1.7	592	19.7	228
FG Gross Revenue	$582.1	113	$476.3	117	$109.2	129	$111.1	141	$1,278.5	118

FYTD95

	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	$252.1	129	$188.9	110	$51.5	115	$80.6	238	$573.1	129
Office Professional	110.4	261	86.7	106	38.0	303	1.6	102	236.7	171
Excel	42.5	65	40.8	69	6.6	75	36.5	169	126.4	82
Word	65.8	94	68.6	88	12.7	103	7.6	72	154.7	90
Graphics	14.0	93	4.7	136	1.3	139	1.6	65	21.6	99
Access	30.2	136	16.0	76	4.2	130	11.1	165	61.5	115
Project	39.8	113	17.6	109	5.4	113	0.8	114	63.5	112
Desktop Apps New Users	554.6	125	423.4	98	119.4	137	139.8	180	1,237.5	119
Office	42.1	217	37.2	156	9.7	146	2.3	42	91.3	165
Office Professional	8.6	509	28.9	179	2.8	140	0.1	31	40.4	201
Excel	7.8	41	13.0	85	1.8	95	(1.9)	(66)	20.6	53
Word	12.3	52	16.7	102	2.0	70	3.0	64	34.0	71
Graphics	0.8	22	1.1	146	0.2	91	0.0	65	2.1	46
Access	3.1	80	7.4	186	1.0	88	0.2	436	11.7	129
Project	6.4	116	3.3	237	0.8	118	0.1	198	10.6	138
Desktop Apps Existing Users	81.1	306	107.6	158	18.3	119	3.7	28	210.7	115
Windows	69.4	255	36.9	193	17.5	137	6.8	128	132.6	201
MS-DOS	30.7	407	13.1	195	4.9	119	1.4	106	50.1	254
Windows 95	0.0	NM	(0.0)	NM	0.8	N/A	0.0	N/A	(0.0)	(0)
Personal Systems	100.1	288	50.0	193	23.3	131	10.3	117	182.7	211
At Work	0.5	61	0.1	41	0.0	NM	0.0	NM	0.7	41
Family Reference	24.1	46	5.2	120	3.5	115	0.2	45	33.0	55
Input Device	60.9	121	16.2	89	5.1	98	2.3	95	84.5	111
Kids/Games	34.9	84	9.6	61	2.6	98	3.8	108	50.9	80
Personal Tools	14.3	46	4.1	85	1.6	83	0.2	111	20.2	53
Transactions	0.6	17	1.9	64	0.3	77	0.0	3	2.8	40
Works	23.3	103	21.0	89	3.7	80	1.7	40	49.7	90
Lifestyle	15.2	136	7.2	136	2.1	118	0.6	33	25.1	125
Consumer	173.3	82	65.2	87	18.8	96	8.8	68	266.1	83
Mail - Servers	4.9	109	3.5	99	1.1	71	0.6	65	10.1	96
Mail - Users	2.8	37	1.4	39	0.5	28	0.6	77	5.2	38
Other Network	6.0	209	4.8	270	0.7	218	1.0	415	12.6	240
SMS, SNA Server	3.1	112	2.4	120	0.6	109	0.3	66	6.4	111
SQL Server - Servers	12.2	88	4.3	143	1.5	110	3.3	199	21.4	107
SQL Server - Users	2.7	43	0.7	18	0.4	18	0.5	34	4.2	31
Mail - AddOns, Upgrades	7.5	126	2.3	154	1.2	234	0.1	366	11.2	139
Windows NT Server-Servers	21.4	208	14.3	180	3.9	160	3.5	139	43.2	186
Windows NT Workstation	16.7	199	5.2	68	0.9	46	5.9	222	28.8	139
Windows NT Server-Users	2.2	21	1.2	20	0.5	21	0.3	96	4.2	22
Backoffice	0.0	NM	0.0	17	0.2	NM	0.0	NM	0.2	882
Business Systems	79.6	109	40.3	99	11.6	77	16.1	141	147.6	105
Developer Kits	5.4	3031	7.2	1226	1.3	705	2.5	NM	16.4	1720
Fox	18.6	157	6.2	75	5.1	139	2.8	135	24.7	114
Languages	20.6	118	7.4	84	1.3	75	12.6	176	41.9	119
Visual Basic	16.2	111	9.4	92	2.4	91	8.0	247	35.9	117
MSIN	8.4	77	2.7	154	0.3	64	1.1	112	12.6	88
Developer	61.3	120	32.9	111	10.4	120	26.9	200	131.4	128
MS Education Services	3.7	68	0.0	546	0.0	NM	0.0	NM	3.7	68
Other	12.2	101	14.0	437	(0.1)	(41)	3.1	565	29.2	181
FG Gross Revenue	$1,066.4	117	$733.5	107	$201.1	123	$208.8	151	$2,209.8	116

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FINISHED GOODS PRICING SUMMARY

(U.S.$ PER LICENSE)

Q95-2

	North America		Europe		ICON		Far East		Worldwide	
	Actual	Plan	Actual	Plan	Actual	Plan	Actual	Plan	Actual	Plan
Finished Goods:										
Office	$225	$301	$328	$319	$209	$265	$276	$261	$261	$301
Office Professional	265	372	372	424	274	327	265	330	303	397
Excel	135	151	212	193	122	139	204	180	174	169
Word	119	126	163	177	120	133	104	139	138	148
Graphics	140	161	228	207	104	140	184	138	156	162
Access	161	155	191	213	114	145	211	172	173	176
Project	315	328	352	326	255	261	327	315	319	321
Desktop Apps New Users	201	213	271	242	193	212	229	197	226	230
Office	132	193	163	216	131	139	163	149	156	190
Office Professional	131	168	295	319	198	182	107	322	226	282
Excel	64	97	119	105	41	75	123	96	85	99
Word	75	101	113	103	46	75	100	92	91	98
Graphics	33	93	74	113	30	77	82	70	45	95
Access	25	98	99	105	61	79	73	55	56	98
Project	108	110	134	139	90	71	98	99	114	110
Desktop Apps Existing Users	93	115	167	149	97	104	112	103	127	125
Windows	50	66	57	59	51	55	69	71	53	62
MS-DOS	40	44	38	38	29	33	34	37	38	38
Windows 95	NM	NM	128	NM	NM	58	NM	63	128	61
Personal Systems	46	60	51	51	44	48	60	62	48	54
At Work	48	43	(172)	85	65	NM	54	NM	54	51
Family Reference	66	68	72	46	40	53	29	74	62	64
Input Device	55	59	45	40	28	36	47	41	49	51
Kids/Games	30	30	31	33	26	30	51	40	31	31
Personal Tools	42	39	42	60	40	50	25	26	41	41
Transactions	3	16	38	34	21	26	20	53	20	21
Works	57	53	79	69	42	46	97	187	65	62
Lifestyle	43	37	40	38	29	32	41	42	40	37
Consumer	46	43	48	44	32	39	51	54	45	43
Mail - Servers	297	273	441	436	306	319	230	490	331	356
Mail - Users	28	27	32	36	9	30	32	30	24	29
Other Network	594	571	550	532	292	161	400	92	534	399
SMS, SNA Server	69	50	77	113	59	118	5	125	49	71
SQL Server - Servers	531	930	1,029	1,040	513	970	1,227	1,107	621	980
SQL Server - Users	99	108	123	121	72	102	10	82	49	108
Mail - AddOns, Upgrades	60	50	71	61	46	43	31	47	59	52
Windows NT Server-Servers	398	355	539	434	403	343	131	607	399	403
Windows NT Workstation	148	132	186	176	135	151	126	221	147	159
Windows NT Server-Users	20	34	27	30	19	32	18	28	21	32
BackOffice	NM	NM	126	944	94	NM	NM	NM	95	944
Business Systems	131	47	170	89	75	78	42	122	118	77
Developer Kits	257	55	302	186	202	236	382	NM	285	130
Fox	92	104	154	141	138	137	150	145	117	128
Languages	196	208	200	169	147	165	287	148	207	182
Visual Basic	156	149	169	152	134	144	243	181	170	152
MSIN	378	348	382	156	357	169	587	188	398	275
Developer	172	178	200	154	151	147	271	156	189	164
MS Education Services	270	225	NM	NM	NM	NM	NM	NM	270	225
FG Gross Revenue	$83	$83	$142	$133	$87	$97	$142	$125	$103	$101

MX 6012446
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Author: Steve Hoberecht (SteveHob)

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FYTD95

	North America		Europe		ICON		Far East		Worldwide	
	Actual	Plan	Actual	Plan	Actual	Plan	Actual	Plan	Actual	Plan
Finished Goods:										
Office	$229	$299	$331	$320	$204	$265	$267	$263	$257	$299
Office Professional	256	370	367	426	276	328	306	320	292	396
Excel	150	151	207	195	124	136	212	180	179	168
Word	124	129	167	179	123	133	142	143	141	149
Graphics	153	161	217	205	115	140	152	138	160	163
Access	149	154	196	213	121	144	222	170	167	175
Project	319	327	347	327	252	264	334	313	319	320
Desktop Apps New Users	201	213	270	264	195	212	234	200	223	230
Office	139	193	182	218	139	138	176	142	155	187
Office Professional	126	176	289	318	184	183	96	320	219	279
Excel	73	91	93	105	52	73	111	96	79	95
Word	78	97	90	104	55	71	91	90	83	95
Graphics	26	94	84	112	45	77	77	70	44	95
Access	33	99	110	105	75	79	73	55	66	98
Project	109	110	134	140	100	68	99	99	115	108
Desktop Apps Existing Users	99	111	147	150	100	101	115	109	119	123
Windows	50	67	57	59	51	55	70	70	53	62
MS-DOS	38	46	37	38	31	33	35	37	37	39
Windows 95	NM	NM	128	NM	NM	56	NM	63	128	61
Personal Systems	46	61	50	52	45	47	41	41	47	55
At Work	54	43	144	84	58	NM	75	NM	62	50
Family Reference	65	69	72	46	39	53	38	74	62	66
Input Device	52	57	46	40	31	36	48	41	49	49
Kids/Games	30	31	30	33	25	30	50	40	31	31
Personal Tools	44	41	47	60	43	50	28	27	44	43
Transactions	5	16	36	34	21	26	20	51	16	22
Works	54	55	77	69	44	46	128	108	62	62
Lifestyle	43	37	39	38	29	32	44	42	40	37
Consumer	44	45	45	45	34	39	54	53	45	45
Mail - Servers	309	271	443	437	315	311	281	495	344	333
Mail - Users	26	27	32	36	13	29	38	30	26	29
Other Network	549	584	579	512	300	171	338	92	510	403
SMS, SNA Server	84	61	88	112	71	115	7	144	59	81
SQL Server - Servers	775	1,844	1,454	1,094	952	972	1,869	1,072	966	1,503
SQL Server - Users	99	88	123	118	72	103	10	80	49	96
Mail - AddOns, Upgrades	54	50	73	60	47	45	39	47	56	52
Windows NT Server-Servers	436	502	581	460	451	351	250	546	447	470
Windows NT Workstation	152	150	189	178	136	154	129	212	151	166
Windows NT Server-Users	21	31	27	30	19	32	18	27	22	30
BackOffice	NM	NM	126	940	94	NM	NM	NM	95	940
Business Systems	128	75	181	91	90	77	87	113	127	82
Developer Kits	237	55	293	189	162	236	336	NM	261	134
Fox	92	106	146	143	130	138	185	145	116	127
Languages	179	208	184	172	151	166	297	152	203	182
Visual Basic	158	148	167	151	137	143	239	200	172	153
MSIN	363	349	393	157	357	171	387	188	382	280
Developer	161	178	193	155	140	147	249	162	183	165
MS Education Services	266	225	20	NM	22	NM	NM	NM	265	225
FG Gross Revenue	$83	$88	$139	$137	$89	$97	$163	$127	$103	$105

FL AG 0085316
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SUBSIDIARY PERFORMANCE

NET REVENUE AND RESPONSIBILITY MARGIN (IN MILLIONS)

Q95-2

	Finished Goods				Total Business			
	Net Revenue		Responsibility Margin		Net Revenue		Responsibility Margin	
	Actual	% of Plan	Actual	% of Plan	Actual	% of Plan	Actual	% of Plan
North America								
United States	$467.9	102 %	$280.5	120 %	$587.0	86 %	$278.1	73 %
Canada	46.9	116	31.6	135	48.1	119	32.4	139
Other	0.0	NM	0.0	NM	8.0	186	1.8	NM
	514.8	104	312.0	121	643.1	89	312.4	77
Europe								
Denmark	11.3	132	7.8	138	12.5	134	8.9	141
Finland	7.1	165	3.9	141	10.8	150	7.5	134
Norway	10.1	134	7.1	142	12.9	143	9.7	153
England	82.2	116	53.5	121	99.0	126	68.3	134
Sweden	32.2	146	24.5	161	34.5	146	26.6	160
Hungary	3.5	126	2.3	152	3.8	118	2.5	134
Russia	3.0	191	1.8	419	3.3	161	2.0	237
Czechoslovakia	5.7	142	4.4	166	7.1	149	5.8	170
Switzerland	27.7	118	20.4	132	28.9	119	21.6	133
Germany	102.1	94	72.4	98	124.2	90	91.1	90
Poland	3.4	111	2.2	162	4.5	105	3.2	130
Austria	10.0	77	6.0	70	10.3	77	6.3	69
Netherlands	16.3	174	10.3	207	19.6	159	13.5	177
Spain	11.4	200	7.2	297	13.5	185	9.2	237
France	87.5	130	61.5	135	94.5	130	67.4	136
Italy	30.0	113	20.9	120	38.7	115	29.4	121
Belgium	14.9	151	9.6	159	16.5	156	11.0	163
Portugal	3.9	117	2.1	117	4.4	118	2.5	119
Slovenia	0.5	79	0.4	148	0.5	87	0.4	166
EHQ / Other	(4.6)	NM	(10.1)	129	(4.0)	NM	(10.2)	131
	458.2	116	306.2	125	535.8	116	376.8	122
ICON								
Caribbean	1.7	143	1.0	270	2.1	154	1.4	257
Ecuador	0.6	162	0.2	208	0.6	109	0.2	90
Chile	2.2	132	1.1	154	2.3	130	1.3	146
Colombia	2.8	117	1.4	124	2.9	111	1.5	109
Venezuela	2.7	204	1.8	269	2.7	186	1.8	224
Brazil	17.9	176	13.0	224	20.7	172	15.6	205
Argentina	3.7	110	1.5	101	3.8	103	1.6	90
Mexico	12.9	132	7.9	150	15.0	132	9.8	146
Morocco	0.7	93	0.4	105	0.7	92	0.3	101
Middle East	3.2	92	1.2	90	3.4	89	1.4	110
Turkey	1.5	291	0.7	NM	1.5	225	0.7	555
South Africa	7.5	134	4.7	186	9.0	147	6.0	203
Greece	1.1	114	0.4	103	1.2	105	0.4	84
Israel	2.8	145	1.8	172	3.5	147	2.3	184
India	2.6	262	1.7	360	3.0	236	2.1	282
Thailand	1.7	146	1.1	156	1.9	141	1.2	143
Malaysia	2.3	149	1.5	179	2.4	118	1.6	121
Singapore	3.6	123	2.2	134	8.5	110	6.8	110
New Zealand	5.1	92	2.4	82	6.1	102	3.4	102
Australia	25.1	98	13.1	100	31.4	107	18.3	114
Phil/Indo	1.0	129	0.7	150	1.0	127	0.7	146
Peru	0.9	130	0.4	166	1.0	136	0.4	191
RHQ/Other	0.0	NM	(2.6)	85	0.8	168	(2.0)	67
	103.7	125	57.5	149	125.4	127	77.0	145
Far East								
China	0.8	49	0.2	43	0.9	55	0.3	54
Korea	7.3	119	4.9	146	18.8	148	15.9	166
Taiwan	5.3	67	2.7	59	19.5	125	16.6	144
Japan	89.0	156	53.8	195	129.0	165	92.7	194
Hong Kong	5.4	121	3.5	139	9.6	115	7.1	116
RHQ/Other	0.1	NM	(0.5)	111	0.1	NM	(0.5)	114
	107.9	140	64.6	170	177.8	152	132.1	176
Microsoft	$1,184.6	113	$742.3	128	$1,482.1	106	$898.3	107

FYTD95

	Finished Goods				Total Business			
	Net Revenue		Responsibility Margin		Net Revenue		Responsibility Margin	
	Actual	% of Plan	Actual	% of Plan	Actual	% of Plan	Actual	% of Plan
North America								
United States	$881.6	109 %	$528.2	134 %	$1,259.6	102 %	$693.1	105 %
Canada	72.9	114	45.5	132	74.8	117	46.9	136
Other	0.0	NM	0.0	NM	15.8	174	1.9	NM
	954.5	109	573.7	134	1,350.2	103	741.9	107
Europe								
Denmark	15.7	116	9.6	123	17.5	116	11.2	122
Finland	10.5	156	5.5	145	17.1	134	11.9	124
Norway	16.2	139	10.5	156	19.8	133	13.8	141
England	146.6	114	96.7	126	169.1	116	116.0	125
Sweden	43.7	127	30.5	143	47.3	126	33.7	140
Hungary	5.4	152	3.3	229	5.7	130	3.7	165
Russia	4.8	170	2.5	470	5.1	137	2.9	203
Czechoslovakia	9.2	157	6.9	205	11.1	151	8.8	182
Switzerland	41.6	98	28.0	102	43.5	98	29.9	104
Germany	148.7	82	94.8	80	182.9	75	123.8	70
Poland	5.5	129	3.4	207	7.0	104	4.8	121
Austria	16.2	75	9.6	70	16.9	74	10.2	69
Netherlands	26.1	144	16.3	160	31.9	135	21.8	144
Spain	15.8	189	9.4	348	18.8	169	12.2	234
France	132.1	113	89.4	120	142.2	112	97.7	119
Italy	46.8	120	33.5	140	59.9	113	46.3	123
Belgium	22.3	146	13.7	161	25.2	151	16.1	165
Portugal	7.7	135	4.6	145	8.2	131	5.1	135
Slovenia	0.5	56	0.4	91	0.5	63	0.4	105
EHQ / Other	(4.9)	NM	(14.5)	105	(3.9)	NM	(14.4)	106
	710.4	107	454.3	116	826.0	103	555.9	107
ICON								
Caribbean	3.0	134	1.7	273	3.8	146	2.5	261
Ecuador	0.7	113	0.1	91	0.7	72	0.1	31
Chile	3.8	120	2.0	147	4.1	117	2.2	135
Colombia	6.7	146	4.1	176	6.9	135	4.2	151
Venezuela	3.9	169	2.3	237	3.9	153	2.4	188
Brazil	28.4	147	18.5	178	33.6	143	23.4	164
Argentina	7.4	113	3.7	123	7.8	109	4.0	115
Mexico	24.5	126	15.1	151	27.6	123	18.0	140
Morocco	1.1	93	0.4	92	1.1	93	0.4	92
Middle East	5.6	98	1.8	108	6.0	105	2.1	136
Turkey	1.8	285	0.5	NM	1.8	209	0.5	NM
South Africa	15.0	135	9.9	215	17.4	144	12.1	222
Greece	1.8	111	0.7	119	1.9	102	0.7	95
Israel	4.3	109	2.3	118	5.4	112	3.3	118
India	3.7	188	2.3	251	4.4	176	3.0	208
Thailand	2.5	134	1.6	162	2.8	127	1.8	141
Malaysia	3.9	152	2.6	210	4.1	117	2.7	129
Singapore	6.9	118	4.5	140	23.3	149	19.0	154
New Zealand	10.3	100	5.7	107	11.7	105	7.0	117
Australia	54.4	106	31.7	123	65.6	111	41.0	127
Phil/Indo	1.5	95	1.1	110	1.5	95	1.1	110
Peru	1.4	113	0.6	200	1.4	116	0.7	225
RHQ/Other	0.0	NM	(5.4)	87	0.9	98	(4.7)	82
	192.7	121	107.6	153	237.6	124	147.4	148
Far East								
China	1.2	38	0.1	14	1.4	44	0.2	27
Korea	14.7	124	9.5	152	27.6	111	21.7	116
Taiwan	10.5	86	6.0	107	35.5	126	30.5	149
Japan	166.9	167	101.4	236	234.0	155	166.1	181
Hong Kong	10.5	116	6.7	135	16.4	93	11.7	89
RHQ/Other	0.1	NM	(0.9)	93	0.2	NM	(1.6)	102
	203.9	150	122.9	205	314.9	140	228.8	159
Microsoft	$2,061.5	112	$1,258.7	132	$2,728.8	108	$1,674.4	115

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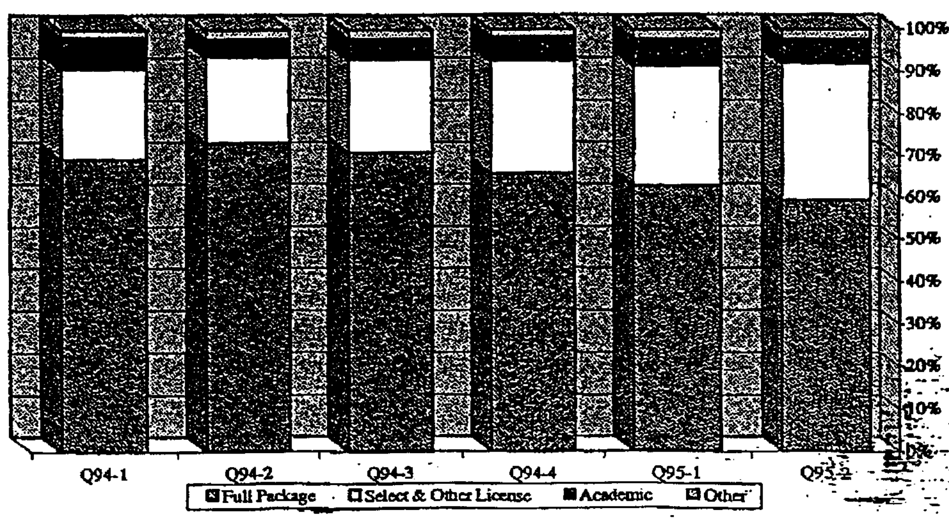
GROSS REVENUE HIGHLIGHTS

Revenue Summary:

- *Net revenue reached an all-time high and exceeded plan across all regions!* For the first time, North American revenue exceeded half a billion dollars for the quarter and Far East and ICON both exceeded $100 million.
- *Office and Office Professional significantly exceeded plan 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 continues to improve and is estimated to be 85% in North America. Sales volumes of Office Professional in North America and ICON were particularly strong.
- *Personal Systems revenue exceeded plan in all regions.* Sales of these products are comparable to a year ago, even with the pending release of Windows 95 and high penetration of Windows and MS-DOS on OEM machines.
- *Consumer revenue was lower than plan in all regions except ICON.* Revenue was up significantly from prior year, but sales were below plan due to delayed product releases of Encarta 95, Bob (Utopia), Flight Simulator; reduced pricing to match competition (e.g. Encarta, Creative Writer); and difficulties expanding into new distribution channels.
- *Business Systems exceeded plan in all regions for the quarter and FYTD after a slow first quarter.* Windows NT Advanced Server and Windows NT Workstation showed particularly strong revenue, however, client licenses on these products continue to be lower than plan and at much lower ratios to server sales than expected. MS introduced a new pricing scheme during Q95-1 which separated prices for servers and clients. The scheme caused confusion in the channel regarding stocking of client license products. It is anticipated that the ratio of clients to servers will increase throughout the year.
- *Developer revenue exceeded plan in all regions.*

Pricing Summary:

- *Office and Office Professional revenue per license was lower than plan across all regions except the Far East.* This variance is primarily due to an increased trend toward Select and other license programs not assumed in the FY95 plan. The revenue per unit for Office Pro was below plan in ICON following promotion of the product in Australia to gain market share. An increase in academic sales in North America contributed to a lower revenue per license than planned 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 for Desktop products.



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- *Revenue per license was lower than plan for existing users of all Desktop products.* This was primarily due to a higher than planned mix of Select maintenance as well as maintenance contracts with shorter duration than the planned two years.
- *Revenue per license for Personal Systems was also lower than plan, except in the Far East, primarily due to this trend toward licensing.*
- *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 a low mix of license programs in FY95.*

Q95-2 Returns

Customers may return product in accordance with distribution contract terms. These terms vary by country, but typically allow returns for a certain percentage (e.g. 4%) of the previous quarters purchases and for channel clearing associated with new product releases. Generally, returns must be accompanied by a purchase order for replacement value equal to the return. Actual returns, including certain billing errors and rework as discussed below, as a percentage of gross revenue were as follows:

	NA	Europe	ICON	FE	Total
Desktop, New User	5%	11%	7%	6%	8%
Desktop, Existing User	7%	11%	6%	73%	11%
Personal Systems	4%	19%	9%	2%	9%
Consumer	5%	7%	9%	10%	6%
Business Systems	4%	9%	12%	8%	7%
Developer	4%	11%	8%	2%	6%
Total	5%	11%	8%	9%	8%

- *North America return percentages approximate the terms and conditions of distributor contracts during Q95-2.*
- *To broaden the distribution channel for consumer products in North America, distributors are allowed to return up to 50% of consumer titles purchased from Nov. 94 to Jan. 95.* In addition GT Software, which distributes to WalMart, is allowed unlimited returns. An allowance of $24 million was recorded in anticipation of the estimated returns of consumer products. However, the actual returns will be processed against gross revenue in Q95-3, which will result in higher percentage returns than Q95-2.
- *European and ICON returns appear to be significantly higher than the terms of MS distribution contracts.* In Europe, the delta is primarily due to errors in Select billing (that were corrected by issuing credit notes and rebilling the proper amount) and significant returns for product rework to meet marketing needs. ICON returns are estimated to be less than 5% and relate primarily to stock taken back from Merisel in Australia. The remainder of the ICON returns relates principally to processing billing adjustments.
- *Far East returns were high primarily because of significant sell-in of Excel upgrades in Q94-4 which didn't sell through and resulted in Q95-2 returns.*

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CHANNEL METRICS
(ANNUALIZED IN THOUSANDS)

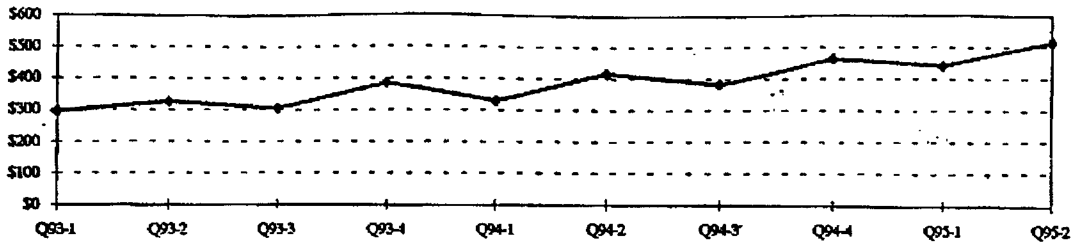
	Finished Goods					
	NA	Europe	ICON	Far East	Worldwide	OEM
Net revenue per employee						
Actual Q95-2	$559	$771	$641	$1,031	$665	$7,478
Plan	515	593	461	621	544	5,704
Q95-1	497	431	583	987	510	7,129
Q94-4	522	632	541	626	569	7,206
Q94-3	423	655	441	945	533	6,982
Q94-2	464	545	417	590	494	5,657
Marketing expense % net revenue						
Actual Q95-2	9%	10%	7%	12%	10%	1%
Plan	14%	11%	9%	14%	13%	1%
Q95-1	10%	10%	7%	8%	9%	0%
Q94-4	18%	12%	11%	11%	14%	1%
Q94-3	11%	8%	9%	7%	9%	0%
Q94-2	13%	12%	9%	12%	12%	0%

- *North American revenue per employee continued higher than plan during Q95-2 as a result of strong performances in the Desktop Application, Personal Systems, Business Systems and Developer divisions and lower than planned average headcount during the quarter.* Marketing expenses trailed plan due to the continuing lag in actual spending.
- *European revenues exceeded plan due to record revenues for the quarter and average headcount 10% below plan.*
- *As with other geographies, ICON had record revenues in Q95-2, matched with lower than plan headcount as hiring plans did not meet timelines anticipated in the budget.*
- *Far East revenue per employee was well above plan due to a record revenue level achieved during the quarter.* The surge in Office and Excel sales in Japan was largely responsible for the region's $1 million per employee revenue figure. Marketing expenses in Q95-2 were above plan in absolute terms yet below plan as a percent of net revenue.

(Note - People and infrastructure expense per employee metrics have been excluded due to inconsistencies with data from previous quarters.)

NORTH AMERICA FINISHED GOODS REVIEW

Net Revenue Stream (in millions)



Key Highlights

- *Net revenue exceeded $500 million for the quarter.* All product divisions except Consumer exceeded plan. FYTD net revenue exceeded plan by 9%.
- *Desktop Application Division gross revenue for Q95-2 exceeded plan by 12% (22% FYTD) due to continued strong demand for Office and Office Professional demonstrated by combined sell-in amounting to $215 million, 50% better than plan.* Current market share is approximately 85% up from 80% in June 1994. The growing popularity of the suite products has negatively impacted demand for standalone Word and Excel products resulting in under plan performance of $20.5 million (93%) and $19.2 million (43%), respectively. Demand for Macintosh products, particularly Office 4.2 which began selling-in during Q95-1, was only $21.4 million, 73% less than plan. The Mac Office applications have not been well received in the market to date due to a combination of factors including concern over performance, resource requirements and "fit" in the Macintosh environment.
- *Personal Systems Division performance for Q95-2 significantly surpassed expectations in which gross revenue amounted to $55 million, 296% better than plan ($100 million, 188% FYTD)* reflecting continuing strong demand for MS-DOS and Windows products.
- *Business Systems Division gross revenue for Q95-2 exceeded plan by 36% (9% FYTD) resulting from strong sales of Windows NT Workstation and Server products, offset by under plan sales of client licenses for Win NT Server, SQL Server and Mail.*
- *Developer Division gross revenue for Q95-2 exceeded plan by 22% (20% FYTD) resulting from strong sales of Visual C++ and FoxPro products, offset somewhat by the delayed release of Visual Basic 4.0.*
- *Consumer Division gross revenue for Q95-2 trailed plan by 23% (18% FYTD) resulting from less than planned sales of Encarta, Basketball, Fine Artist, Publisher, Money and Bob (Utopia), offset somewhat by strong keyboard sales.* It is anticipated that Consumer results will fall short of plan for FY95.

Operational Issues

- *Product returns represented approximately 5% of Q95-2 gross revenue, primarily due to update exchanges and stock balancing.* Additionally, a provision for consumer product returns of approximately $18 million was charged against net revenue during Q95-2 in anticipation of returns resulting from new distribution programs.
- *US order backlog was approximately $29 million at December 31, 1994 compared to $56 million at September 30, 1994, of which approximately $15 million and $27 million, respectively, was due to stock outs.* The key products comprising the stock outs were Serial Mouse 2.0 and the Nexus Keyboard.

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Results of Operations (in millions)

	Q95-2			FYTD95		
	Actual	Plan	Variance	Actual	Plan	Variance
Net revenue	$514.8	$497.0	$17.8	$954.5	$875.0	$79.5
Cost of revenue	101.0	107.6	6.7	182.5	192.5	10.0
Gross profit	413.8	389.4	24.5	772.0	682.5	89.4
People	38.1	39.3	1.2	74.5	79.9	5.4
Infrastructure	12.9	15.0	2.1	25.5	30.9	5.4
Marketing	45.3	71.6	26.2	88.2	133.3	45.1
MCS	(1.5)	(0.8)	0.7	(2.2)	(1.1)	1.1
Bad debt & taxes	8.0	5.3	(2.7)	12.2	9.4	(2.8)
Other	(1.0)	1.2	2.2	0.0	2.3	2.3
Controllable expenses	101.8	131.6	29.8	198.2	254.7	56.5
Responsibility margin	312.0	257.8	54.3	573.7	427.8	145.9
Shared resources	71.3	50.1	(21.2)	115.1	99.6	(15.5)
Shared resource margin	$240.7	$207.7	$33.0	$458.6	$328.2	$130.5
Key ratios						
Annualized per employee (in thousands)						
Net revenue	$559	$515	$45	$525	$466	$59
% Net revenue						
Cost of revenue	20 %	22 %	2 %	19 %	22 %	3 %
Marketing expense	9	14	6	9	15	6
Controllable expenses	20	26	7	21	29	8
Shared resource margin	47	42	5	48	38	11

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

Cost Driver Analysis

Q95-2

- *Gross profit margin during Q95-2 was 80% of net revenue compared to plan of 78% continuing the FYTD favorable trend due to higher sales volumes and lower than planned freight, processing and manufacturing costs, offset somewhat by unplanned sales mix shifts toward academic and other lower price point full package products.*
- *Controllable expenses were under plan in all significant categories during Q95-2.* Lower than planned headcount resulted in people expenses being under plan by 3% (7% FYTD). Lower than planned telecommunications and depreciation favorably impacted infrastructure costs resulting in these expenses being under plan by 14% (17% FYTD).
- *Marketing expense during Q95-2 trailed plan by 36% (34% FYTD) although committed marketing expense trailed plan by only 11% (20 % FYTD).* It is expected that this trend will reverse in future quarters with increased marketing associated with the launch of Windows 95 and Office 95.

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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	Q95-2
Ingram Micro	$ 72	$ 61	$ 92	$ 72	$ 89	$ 146	$ 113	$ 140	$ 143	$ 183
Merisel	51	56	56	51	67	99	95	99	106	120
Egghead	22	51	46	22	22	49	36	44	45	51
Software Spectrum	14	11	18	14	10	22	19	20	18	30
Corporate Software	10	11	17	10	9	22	18	20	24	24
Intelligent Electronics	5	4	5	2	5	14	9	13	14	18
Tech Data	—	—	—	—	6	12	9	18	13	30
800 Software	8	7	8	8	8	11	9	10	8	12
Softmart	6	6	8	6	6	10	9	15	10	17
Vanstar	8	8	6	9	6	6	6	8	6	6
	$ 196	$ 215	$ 256	$ 194	$ 228	$ 391	$ 323	$ 387	$ 387	$ 491
Percent of gross revenue	73%	75%	77%	73%	74%	81%	81%	81%	80%	84%

- *The increasing percent of sales to significant customers reflects Microsoft's ongoing effort to reduce the number of direct customers.*
- *Inventory in the channel for key products as of December 31, 1994 based on recent sell-through rates was approximately 45 days of Win Office, Win Word, and Win NT Workstations and Servers; 60 days of Win Excel and approximately five months of Win NT Server User licenses.* Inventory of these products at September 30, 1994 was approximately 30 days.
- *To broaden distribution of MS-Home products MS signed a distribution agreement in September 1994 with GT Software, a specialty consumer products distributor, to supply MS Home products to the Walmart chain.* Under the terms of the agreement, GT Software has the right to unlimited returns of these products through March 1995. Total sell-in to date has been approximately $18 million and the latest available information indicates that as much as $7.5 million of product may be returned.
- *Receivables from sales to significant customers have remained fairly consistent at approximately 40 to 45 days sales outstanding during the quarter.* Customers on the accounts receivable watch list include Merisel, Egghead and GT Software.

Marketing, Advertising and Sales Programs

- *The Avalanche reseller rebate program was launched in January and will run through the release of Office 95.* The Office product marketing group will use the Avalanche program as a vehicle to send the "MS makes software decisions safe and easy" message and to sustain momentum. The campaign will include a major market advertising campaign, direct mailing, PR and press tours. Direct accounts and key channel partners will be offered incremental rebates for sales over predetermined quotas of up to 15%.
- *Corporate Broad Reach advertising campaign spending charged to the North American finished goods channel amounted to approximately $24 million during Q95-2, representing slightly over 50% of the worldwide total spent on this campaign.* Significant additional Broad Reach spending is anticipated in Q95-3.

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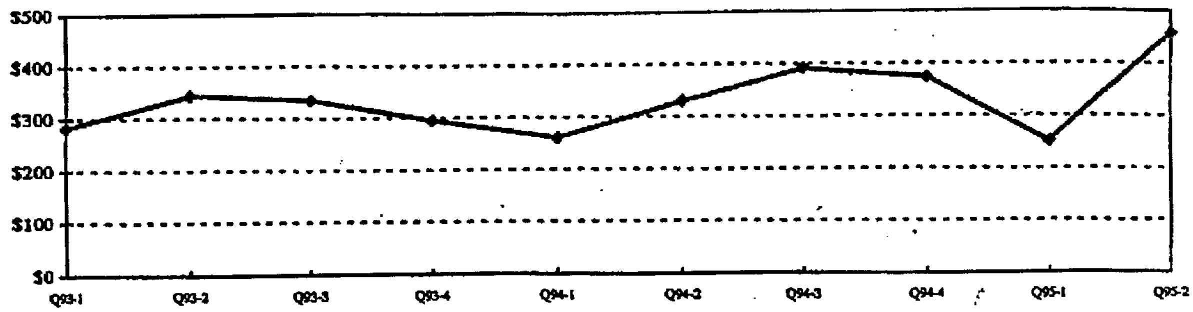
EUROPE FINISHED GOODS REVIEW

Net Revenue Stream (in millions)



Key Highlights

- *Q95-2 was a record quarter in Europe with FG net revenue ($458 million) 17% above plan, although a weaker than plan dollar contributed $57 million to this variance.* At budget FX rates, Q95-2 net revenues approximated plan. Net revenue increased 82% over Q95-1, reversing the trend of two consecutive quarters of declining revenue.
- *All divisions exceeded plan with the exception of Consumer (96% of plan).* Europe FG continues to be heavily dependent on desktop applications with the Desktop division accounting for 62% of total product group revenue, as compared to 55% in North America.
- *Business Systems division gross revenue grew by 191% over Q95-1, and was 124% of plan.* New versions of Windows NT contributed to total division revenues of $29.7 million, a sharp increase over Q95-1 of $10.2 million.
- *Select revenue of $86 million was 203% of plan, which also had a favorable impact on product costs.*

Geographic Factors

- *France and Germany rebounded from a poor first quarter with net revenue increasing 96% and 119% respectively.* Germany, however, remained under plan by $6.7 million for the quarter.
- *Strong performing subsidiaries with over 50% positive net revenue variances fiscal year to date include Spain (89%), Russia (70%), Czechoslovakia (57%), Finland (56%), and Hungary (52%).*
- *All subsidiaries exceeded net revenue plan during the quarter with the exception of Germany (94% of plan), Slovenia (79% of plan) and Austria (77% of plan).*

Marketing, Advertising and Sales Programs

- *The Fall Office Campaign was successful in increasing Office sales in most major markets.* Office revenue in Q95-2 was approximately double Q95-1.
- *Most major subsidiaries conducted a year-end Consumer program for the Christmas season and launched an introduction to BackOffice campaign in December.*

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Results of Operations (in millions)

	Q95-2 Actual	Q95-2 Plan	Q95-2 Variance	FYTD95 Actual	FYTD95 Plan	FYTD95 Variance
Net revenue	$458.2	$393.3	$64.9	$710.4	$662.3	$48.1
Cost of revenue	59.5	59.2	(0.2)	97.5	103.7	6.2
Gross profit	398.7	334.1	64.6	612.9	558.6	54.2
People	31.4	32.2	0.8	63.5	62.5	(1.0)
Infrastructure	10.3	10.1	(0.2)	19.8	20.5	0.7
Marketing	45.0	42.1	(3.0)	70.0	77.7	7.7
MCS	0.5	0.0	(0.4)	1.0	0.5	(0.5)
Cost recovery programs	(0.1)	(0.5)	(0.5)	(0.0)	(0.7)	(0.7)
Bad debt & taxes	3.2	2.5	(0.6)	4.1	4.6	0.5
Other	0.2	0.2	(0.0)	0.2	0.3	0.1
Controllable expenses	90.5	86.6	(3.9)	158.6	165.4	6.7
Responsibility margin	308.2	247.5	60.7	454.3	393.3	61.0
Shared resources	50.7	34.9	(15.9)	78.2	69.0	(9.2)
Shared resource margin	$257.5	$212.6	$44.9	$376.1	$324.3	$51.8
Key ratios						
Annualized per employee (in thousands)						
Net revenue	$771	$593	$178	$598	$518	$81
% Net revenue						
Cost of revenue	13 %	15 %	2 %	14 %	16 %	2 %
Marketing expense	10 %	11 %	1	10 %	12 %	2
Controllable expenses	20 %	22 %	2	22 %	25 %	3
Shared resource margin	56 %	54 %	2	53 %	49 %	4

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

Cost Driver Analysis

- *A weaker dollar in comparison to plan had a $10.7 million unfavorable impact on controllable operating expenses.* Taking into consideration the foreign exchange effect, controllable operating expenses had a $6.8 million favorable variance.
- *Marketing expenses increased from $25.0 million in Q95-1 to $45.0 million in Q95-2.* Year to date marketing is $70 million ($7.7 million below plan) compared to $57.2 million one year ago. This represents a 22% increase and is just slightly higher than the 21% comparable growth rate in net revenue.
- *Shared Resources were over plan by $15.9 million due to Broad Reach costs ($16.5 million) which were not budgeted at the European level.*

Significant Customers (in millions)

	Q93-2	Q93-3	Q93-4	Q94-1	Q94-2	Q94-3	Q94-4	Q95-1	Q95-2
C2000	$ 75	$ 68	$ 57	$ 51	$ 71	$ 79	$ 72	$ 50	$ 98
Ingram	21	26	26	21	35	47	42	33	69
Merisel	31	33	27	35	33	48	36	22	42
Olivetti	8	11	13	10	14	21	14	15	21
Scribona AB	9	10	7	4	7	9	14	4	15
Softmart	11	9	5	5	8	7	7	4	12
Macrotron	10	14	8	13	17	16	14	4	11
Also ABC	4	4	4	5	7	11	7	3	9
Raab Karcher	–	–	–	6	16	13	10	5	6
Corporate S/W	–	–	–	–	–	4	4	3	10
	$ 169	$ 175	$ 147	$ 150	$ 208	$ 255	$ 220	$ 143	$ 293
Percent of gross revenue	45%	51%	47%	57%	60%	63%	59%	55%	62%

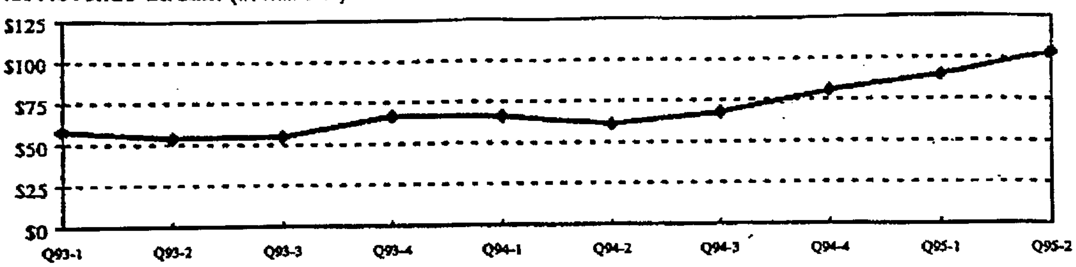
- *Continued consolidation in the European distribution channel is reflected in the increased share of the top 10 customers.* The strengthening of full package product sales to distributors in Germany was also a factor.
- *Ingram purchases include Datateam, a Nordic distributor aquired by Ingram in Q95-2.*
- *Select revenue accounted for 12% of top 10 customer purchases.* This compares with 28% Select purchases for the segment consisting of lower tier customers (i.e. non top 10 customers).
- *Corporate Software purchases more than tripled from Q95-1.* 98% of these purchases were through the Select program.

Operational Issues

- *All remaining subsidiaries were converted to the central system and their warehouses transferred to EOC in Dublin.* Order entry remains locally managed in most subsidiaries at present but will be transferred to the EOC by June 30, 1995.
- *The transfer of Select billing and reporting to the EOC was completed during Q95-2.*
- *The EOC commissioned a customer survey and significant effort is underway to improve distribution service and information flow to customers and subsidiaries.*

ICON FINISHED GOODS REVIEW

Net Revenue Stream (in millions)



Key Highlights

- *Net revenue exceeded $100 million for the quarter.* Revenue increased 70% over Q94-2, primarily due to sales of Office and Windows.
- *FYTD revenue in Brazil grew by 116% over the prior year.* Although relatively small, India, Malaysia and Thailand all grew by more than 100% FYTD. Australia, Brazil, Mexico and South Africa, represented 64% of ICON net revenue, and were 98%, 176%, 132% and 134% of Q95-2 plan, respectively.
- *Revenue per license for key DAD products were significantly below plan across the region in part due to a pronounced shift in license mix, but also due to aggressive pricing deals in both Australia and Brazil.*
- *Revenue in all product divisions exceeded plan.*

Geographic Factors

- *The devaluation of the Mexican peso in late December had little impact on quarterly revenue, but is anticipated to lead to a write-off in accounts receivable of up to $2.5 million.* Also, Q95-3 revenue is expected to decrease significantly in Mexico. The so-called "Tequila effect" may also cause economic uncertainty in other Latin American countries.
- *Political uncertainty continues to dominate markets in Turkey, Venezuela, and the Middle East.* Contraction of government spending in Saudi Arabia and other key Arab markets has halted anticipated growth in those geographies and is limiting new business opportunities.

Operational Issues

- *A distributed manufacturing site is being established in Brazil and will be operational in Q95-3.*
- *New subsidiaries are planned in the second half of FY95 for Indonesia and the Philippines.*

Marketing, Advertising and Sales Programs

- *Revenue from sales through Select and MOLP programs has exceeded plan across the ICON region.* While this shift in sales mix has contributed to lower revenue per license, it has also resulted in lower cost of sales and consequently higher margins.
- *Corporate Broad Reach advertising campaign spending charged to the ICON channel amounted to approximately $1.2 million during Q95-2 for advertising in Australia.* Significant additional spending is anticipated in Q95-3.

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Results of Operations (in millions)

	Q95-2			FYTD95		
	Actual	Plan	Variance	Actual	Plan	Variance
Net revenue	$103.7	$82.7	$21.0	$192.7	$159.2	$33.5
Cost of revenue	19.7	18.4	(1.3)	35.3	36.7	1.4
Gross profit	84.0	64.3	19.7	157.4	122.5	34.9
People	11.4	11.4	(0.1)	21.8	22.8	1.0
Infrastructure	3.8	4.2	0.3	7.3	8.3	1.0
Marketing	7.4	7.7	0.3	14.0	15.5	1.5
MCS	0.1	0.2	0.1	0.5	0.7	0.2
Cost recovery programs	0.7	0.7	(0.0)	0.9	1.4	0.5
Bad debt & taxes	2.6	1.3	(1.3)	4.1	2.6	(1.5)
Other	0.5	0.4	(0.1)	1.0	0.8	(0.2)
Controllable expenses	26.5	25.8	(0.7)	49.6	52.2	2.6
Responsibility margin	57.5	38.5	19.0	107.8	70.3	37.5
Shared resources	7.9	7.2	(0.7)	14.1	14.6	0.5
Shared resource margin	$49.6	$31.3	$18.3	$93.7	$55.7	$38.0
Key ratios						
Annualized per employee (in thousands)						
Net revenue	$641	$461	$179	$612	$471	$141
% Net revenue						
Cost of revenue	19 %	22 %	3 %	18 %	23 %	5 %
Marketing expense	7	9	2	7	10	2
Controllable expenses	26	31	6	26	33	7
Shared resource margin	48	38	10	49	35	14

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

Cost Driver Analysis

- *Cost of revenue, as a percent of net revenue, continued to be under plan reflecting a shift in sales mix from FPP to Select and MOLP.* In addition, the distributed manufacturing site in Australia is beginning to result in lower manufacturing costs.
- *The devaluation of the Mexican peso has led to increased bad debt reserves.*
- *The Broad Reach advertising allocation of $1.2 million led to the negative variance in shared resources.*

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Significant Customers in Major Subsidiaries (in millions)

	Q93-2	Q93-3	Q93-4	Q94-1	Q94-2	Q94-3	Q94-4	Q95-1	Q95-2
Australia & SE Asia									
Tech Pacific	$ 4.8	$ 4.8	$ 8.1	$ 8.8	$ 10.1	$ 8.7	$ 12.5	$ 9.5	$ 15.3
Merisel	3.8	6.1	9.0	5.7	5.2	3.6	6.2	6.2	7.1
Datacom	-	-	-	-	1.7	4.8	2.0	7.0	1.5
Aus. Govt. Services	-	-	-	-	-	-	-	4.7	3.7
Mexico									
Ingram-Dicom	3.9	2.1	4.8	1.4	1.7	3.9	2.1	3.0	4.9
Brazil									
Compucenter	1.8	1.7	2.2	2.3	2.2	2.5	4.1	4.2	7.0
South Africa									
Workgroup	2.6	2.0	3.5	3.0	2.9	2.6	3.0	3.7	3.9
	$ 16.9	$ 16.7	$ 27.6	$ 21.2	$ 23.8	$ 26.1	$ 29.9	$ 38.3	$ 43.4
Percent of gross revenue	31%	30%	41%	32%	36%	38%	36%	43%	40%

- *Tech Pacific was appointed during the quarter as a distributor in Indonesia and in the Philippines and now distributes for Microsoft in eight Australasian countries.*
- *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 under a contract similar to Select and represents MS's largest single customer in Australia.*
- *Compucenter of Brazil has gained market share in the last three quarters due to the insolvency of a local competitor, Agoal, at the end of last fiscal year.* Venture capitalists have funded the growth and introduced solid management and they are expected to continue growing.

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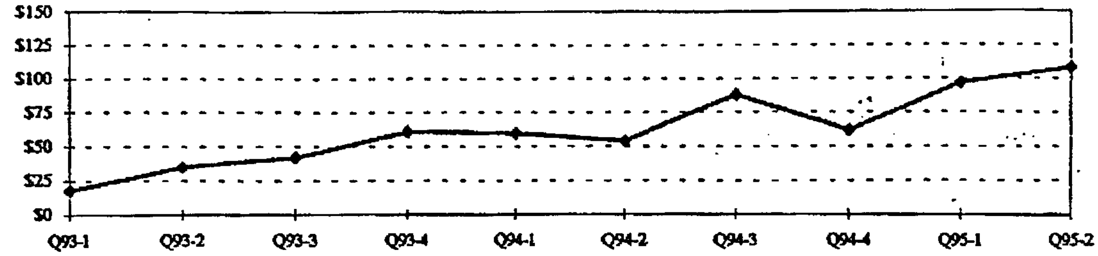
FAR EAST FINISHED GOODS REVIEW

Net Revenue Stream (in millions)



Key Highlights

- *Q95-2 net revenue of $107.9 million were 40% above plan and 100% above Q94-2 net revenue.* The $30.6 million favorable variance against plan was contributed by the following subsidiaries: Japan $31.9 million, Korea $1.2 million and Hong Kong $0.9 million. Net revenue for the quarter from Taiwan and China were below plan by $2.6 million and $0.8 million, respectively. Higher than expected PC sales growth combined with increasing Windows penetration rates in the Far East contributed to the strong quarter.
- *Office comprised $41.2 million, or 37%, of the region's net revenue for the quarter.* This was $21.2 million, or 106% above plan. Japan's Office revenue was $21.7 million over plan due to continued strong demand for a new version of localized Office which was released in Q95-1.
- *Developer Division recorded revenue of $12.0 million in Q95-2, which was $5.2 million (76%) over plan.* Languages were $1.6 million (47%) above plan due to strong C++ sales in Japan. Visual Basic revenue for the period was $2.3 million (150%) over plan, but the Fox product unit was $0.5 million (33%) under plan. Develop Kits, for which there is no budget, generated $1.2 million.
- *Business Systems Division finished the quarter with revenue of $10.7 million compared with a plan of $7.2 million.* The favorable variance was due to strong sales of Windows NT in Japan following the successful launch of the localized version of Windows NT 3.5.
- *Consumer Division sales were $1.7 million under plan at $5.7 million.* Japan was the only location with below-budget revenues for Consumer. This was primarily due to the variance in the Works business unit. Delays of product releases until after the holiday season also adversely affected Consumer revenues.

Geographic Factors

- *Foreign exchange rate variances contributed approximately $8.2 million (27%) of the favorable variance in Q95-2.* Virtually all of this favorable exchange rate variance relative to plan was from Japan.

Operational Issues

- *Cost of revenue as a percent of net revenue was seven points below plan for Q95-2.* This variance was due to favorable pricing (total revenue per license for the quarter was 14% over plan) and a shift in sales mix towards higher gross profit products such as Office.

Marketing, Advertising and Sales Programs:

- *The primary marketing focus in the Far East during Q95-2 was the launch Windows NT 3.5.*
- *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 (BillL)

Results of Operations (in millions)

	Q95-2 Actual	Q95-2 Plan	Q95-2 Variance	FYTD95 Actual	FYTD95 Plan	FYTD95 Variance
Net revenue	$107.9	$77.3	$30.6	$203.9	$136.0	$67.9
Cost of revenue	18.8	18.2	(0.7)	39.5	33.3	(6.2)
Gross profit	89.1	59.1	30.0	164.4	102.7	61.7
People	7.8	7.3	(0.5)	13.9	14.1	0.3
Infrastructure	2.6	2.4	(0.2)	5.1	4.8	(0.3)
Marketing	13.3	10.7	(2.5)	21.0	22.6	1.6
MCS	0.0	0.0	(0.0)	0.1	0.1	0.0
Bad debt & taxes	0.6	0.5	(0.2)	1.1	0.8	(0.3)
Other	0.2	0.1	(0.0)	0.3	0.3	(0.0)
Controllable expenses	24.5	21.0	(3.5)	41.5	42.7	1.3
Responsibility margin	64.6	38.1	26.5	122.9	59.9	63.0
Shared resources	10.1	9.2	(0.8)	18.1	18.0	(0.1)
Shared resource margin	$54.5	$28.9	$25.7	$104.8	$41.9	$62.9
Key ratios						
Annualized per employee (in thousands)						
Net revenue	$1,031	$621	$411	$992	$586	$406
% Net revenue						
Cost of revenue	17 %	23 %	6 %	19 %	25 %	5 %
Marketing expense	12 %	14 %	2	10 %	17 %	6
Controllable expenses	23 %	27 %	5	20 %	31 %	11
Shared resource margin	51 %	37 %	13	51 %	31 %	21

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

Cost Driver Analysis

- *Controllable expenses were $3.5 million (17%) over plan for the quarter but were slightly under plan year-to-date; Japan alone was over plan by $3.6 million.* The regional variance of $3.5 million included an unfavorable foreign exchange impact of $1.8 million.
- *People expenses were $0.5 million (7%) over plan as headcount hiring was accelerated relative to a slower rate in the first quarter.* Measured in local currency, however, all locations and the region were under plan in people expenses during the quarter.
- *Marketing expenses of $13.3 million were $2.5 million, or 24%, over plan.* Marketing expenses in Hong Kong and China were under plan, while Japan, Taiwan and Korea had unfavorable variances of $2.5 million, $0.2 million and $0.1 million, respectively. Year-to-date marketing expenses were $1.6 million under plan, reflecting the lower expenditure rate in Q95-1. Marketing expenses for FY95 are forecast to be slightly over plan reflecting aggressive growth in this region.

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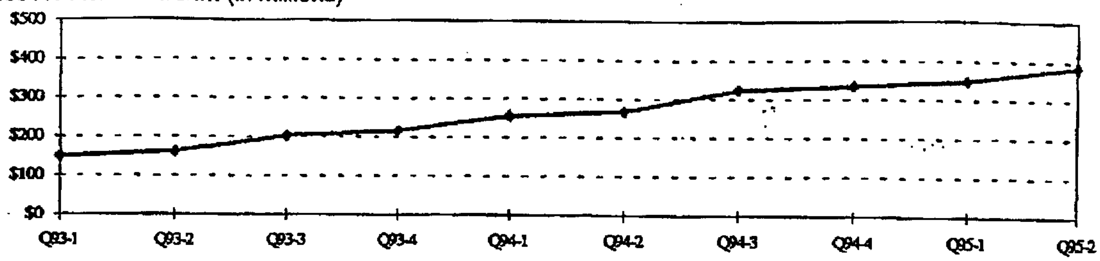
Significant Customers in Major Subsidiaries (in millions)

	Q93-2	Q93-3	Q93-4	Q94-1	Q94-2	Q94-3	Q94-4	Q95-1	Q95-2
Japan									
Softbank	$7.2	$7.1	$11.6	$9.4	$11.8	$25.4	$9.0	$22.9	$20.7
Software Japan	3.3	3.5	5.1	6.2	6.4	7.4	6.0	9.5	10.7
Soft Wing	3.5	3.1	4.5	4.0	4.1	6.7	3.7	7.3	9.6
Fujitsu	0.9	1.9	1.4	1.9	2.2	3.7	2.8	6.2	4.6
Otsuka Shokai	0.3	0.6	0.7	0.9	1.1	2.2	2.2	2.7	3.7
Canon Sales	1.2	2.3	1.7	2.0	1.0	2.6	1.9	2.3	3.2
Taiwan									
Acer Sertek	0.8	0.6	1.3	2.3	0.5	1.9	2.1	2.1	2.3
Eten	0.5	0.9	1.9	2.4	0.6	1.5	1.8	1.4	1.3
Korea									
Infotech	0.4	0.5	1.7	3.0	1.9	1.3	0.8	2.0	1.5
	$18.1	$20.5	$29.9	$32.0	$29.5	$52.7	$30.3	$56.4	$57.7
Percent of gross revenue	52%	49%	49%	53%	52%	58%	49%	57%	52%

- *The ten customers above comprised 52% of the region's revenue in Q95-2.* This is a somewhat lower share of sales than during Q95-1 and during the previous record sales quarter, Q94-3.
- *Softbank accounted for 22% of MS Japan's sales in Q95-2, compared with 29% in Q95-1 and 26% in FY94.* This trend reflects an effort to broaden the Japanese distribution channel.
- *Infotech's share of MS Korea's sales was 20% in Q95-2, compared with 27% in Q93-1 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 other distributors, including Softline and Samtech.
- *There was significant progress made in the Channel Measurement System (CMS) effort in the Far East during Q95-2.* In Japan, three distributors accounting for approximately 60% of the subsidiary's sales are reporting sales information regularly. Infotech, MS Korea's largest distributor, will start reporting during Q95-3. Five of MS Hong Kong's six accounts are reporting sales information regularly. In Japan, Korea and Taiwan the double byte requirements for customer names and other data has been a further challenge for CMS, but it is being addressed currently. None of Microsoft's significant distributors in Japan, Korea or Taiwan have been persuaded yet to provide competitive sales information to allow determination of market share, but the subsidiaries are able to estimate market shares with good accuracy nonetheless.

OEM REVIEW

Net Revenue Stream (in millions)



Key Highlights

- *OEM net revenue of $385 million was 24% of MS consolidated net revenue.* The OEM channel is on track to exceed FY95 plan of $1.4 billion by at least 10%.
- *To date, 85% of eligible strategic accounts have signed Windows 95 marketing agreements in which they committed to promote Windows 95 in return for reductions in royalty rates.* All the Big 6 and Solution Provider OEMs are close to complying with the PC 95 "plug and play" hardware specification.
- *Q95-2 revenues of $35 million from the Delivery Service Partner (DSP) program more than doubled over the prior quarter.* DSPs supply product to lower-volume OEMs, who are no longer directly licensed by MS.

Geographic Factors

- *Devaluation of the Mexican Peso and temporary collapse of the economy are expected to create collection problems in the Mexican market and could impact PC shipments longer term.* OEM accounts receivable of $1.9 million is fully reserved.
- *ICON business was 33% ahead of plan year-to-date and 140% greater than the first half of FY94.* Improved distribution and, in general, stabilizing economies supported this growth. Multinational OEMs increased their market penetration in these regions at the expense of local middle-tier OEMs.
- *Germany's $8.1 million revenue shortfall resulted from late royalty reports from several of the larger OEMs.* IBM's aggressive marketing of OS/2 Warp challenged MS's relationship with some German OEMs.

Operational Factors

- *Development of the Authorized Replicator and Developer (AR/AD) reporting system and revisions to the Forecast system to support monthly reporting are both on track: the Forecast system was released to OEM in December, and the AR/AD system beta will be available in January.* ITG also upgraded business system software and hardware.
- *Demand for CD titles (both MS-DOS/Windows and Consumer) increased from 450,000 in September to 1.1 million units in November.* Piracy of consumer titles also increased and is being addressed.
- *A MS conference for Authorized Replicators was well-attended, enhancing cooperation, communication, and consistent procedures.* Improvement in reporting was immediately noted.

Marketing, Advertising and Sales Programs

- *Marketing initiatives included regional briefings in the Middle East, APAC, and Latin America, events with DSPs, and roll-out of an international campaign to reduce naked systems.*

Top Products (units in thousands, revenue in millions)

Q95-2

	Q95-2			Q95-2 Plan			Variance		
	Units	Revs	$/Unit	Units	Revs	$/Unit	Units	Revs	$/Unit
Windows	6,798	$ 150	$ 22	6,617	$ 132	$ 20	181	$ 18	$ 2
MS-DOS	8,405	147	17	7,137	128	18	1,268	19	(1)
Mouse	2,270	25	11	1,251	13	10	1,019	12	1
Office/Pro	180	17	94	176	13	74	4	4	20
Works	1,542	11	7	1,315	10	8	227	1	(1)
Other		25	N/A		38	N/A	–	(13)	N/A
		375			334			41	
Revenue adjustments		10			–			10	
Net Revenue		$ 385			$ 334			$ 51	

- *The increase in $/unit for Windows was caused by a shift in product mix from Windows to Windows for Workgroups, which carries a higher royalty rate, and a late IBM report.* IBM's high volume and relatively low royalty rate normally lowers $/unit.
- *Mouse sales continued to increase due to more competitive pricing made possible by the low cost Defender mouse.* OEM Operations is reviewing alternative international distribution methods to improve product availability and simplify reporting.
- *Shipments of Office and Office Pro resulted primarily from agreements with Creative Technologies and Gateway 2000.* Virtually all Office royalty rates are higher than budgeted.
- *Budgeted but unbilled minimum commitments created most of the "Other" variance.* The Department of Justice ruling precludes MS minimum commitments. This shortfall was partially offset by higher product-specific billings.
- *Revenue adjustments of $10 million related to a revenue accrual for product shipped but not yet reported by OEMs.*

FYTD95

	FYTD95			FYTD95 Plan			Variance		
	Units	Revs	$/Unit	Units	Revs	$/Unit	Units	Revs	$/Unit
Windows	14,058	$ 294	$ 21	13,128	$ 256	$ 20	930	$ 38	$ 1
MS-DOS	15,974	279	17	14,190	249	18	1,784	30	(1)
Mouse	3,883	42	11	2,384	25	10	1,499	17	1
Office/Pro	206	20	97	286	22	77	(80)	(2)	20
Works	2,303	17	7	2,573	20	8	(270)	(3)	(1)
Other		32	N/A		90	N/A	–	(58)	N/A
		684			662			22	
Revenue adjustments		50			–			50	
Net Revenue		$ 734			$ 662			$ 72	

- *The negative Works variance stemmed from an aggressive budget and low IBM shipments.* IBM Works royalties were $2.2 million versus a plan of $6.6 million in part because of channel-stuffing in Q94-4.
- *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 $50 million related to a revenue accrual for product shipped but not yet reported by OEMs.*

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Significant Customers (in millions)

	Q95-2 Actual	Q95-2 Plan	Q95-2 Variance	FYTD95 Actual	FYTD95 Plan	FYTD95 Variance
Large Accounts						
Compaq	$ 40.9	$ 38.8	$ 2.1	$ 74.2	$ 75.3	$ (1.1)
Gateway 2000	17.6	21.3	(3.7)	47.0	40.1	6.9
IBM	6.8	27.6	(20.8)	29.7	55.6	(25.9)
Packard Bell	16.1	10.7	5.4	26.1	20.2	5.9
AST	11.1	12.8	(1.7)	21.3	24.8	(3.5)
Dell	9.2	10.8	(1.6)	21.2	21.4	(0.2)
Solution Providers						
DEC	17.3	6.5	10.8	28.3	14.0	14.3
Hewlett Packard	9.7	7.5	2.2	25.0	13.7	11.3
AT&T GIS	7.8	5.3	2.5	13.0	11.3	1.7
Unisys	2.7	3.2	(0.5)	5.0	6.4	(1.4)
Other	8.1	5.6	2.5	15.6	13.5	2.1
Named Accounts	23.6	22.8	0.8	45.3	40.4	4.9
New Business Accounts	39.4	39.8	(0.4)	67.7	70.5	(2.8)
International Accounts						
Toshiba	14.4	7.9	6.5	26.6	14.0	12.6
NEC	10.9	7.3	3.6	16.2	12.5	3.7
Acer	8.4	2.8	5.6	13.4	5.7	7.7
Creative Tech.	4.3	2.9	1.4	13.4	5.7	7.7
Olivetti	5.8	5.4	0.4	8.9	10.7	(1.8)
Epson	4.3	–	4.3	7.7	6.2	1.5
Other	117.0	94.7	22.3	178.3	200.3	(22.0)
Gross revenue	375.4	333.7	41.7	683.9	662.3	21.6
Revenue adjustments	9.7	–	9.7	49.6	–	49.6
Net revenue	$ 385.1	$ 333.7	$ 51.4	$ 733.5	$ 662.3	$ 71.2

- *Compaq and Packard Bell continued to increase market share by expanding distribution channels and emphasizing consumer products.* Both reported a very strong Christmas quarter, which MS will see in Q95-3 royalty reports. Despite its success, Packard Bell continued to have cash flow problems and is being closely monitored.
- *AST and IBM lagged the rest of the Big 6 due to product and distribution problems.* A late IBM report understates their royalties by $10 million.
- *DEC and Hewlett Packard continued to grow.* DEC is shifting its image to be more consumer and small office oriented with well-designed machines in all lines from Servers through Desktops to Laptops.
- *Without Personal Systems minimum commitments to offset recoupments, OEMs continued to deplete their prepaid balances, reducing the total from $168 million in Q94-4 to $86 million in Q95-2.*

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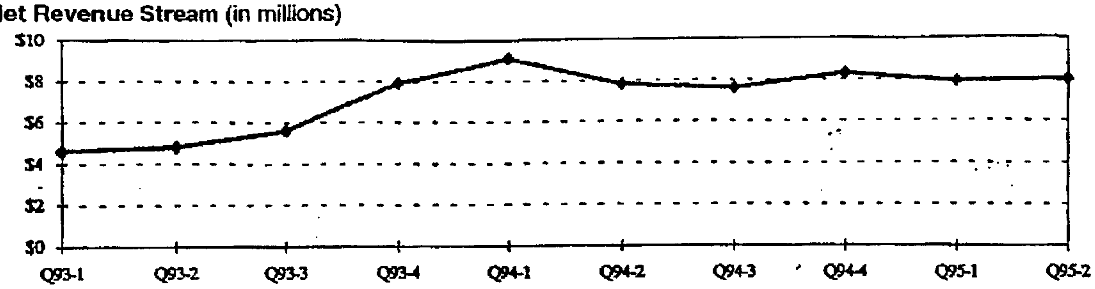
OTHER ADVANCED TECHNOLOGY CHANNEL REVIEW

Net Revenue Stream (in millions)



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

Key Highlights

- *As noted in Q95-1, Other Advanced Technology is a new sales channel in FY95.* This channel consists of the Softimage sales group as part of the overall Softimage acquisition and the Advanced Technology sales group which was formed in Q94-4. Both groups report to Richard Fade, VP AT Sales.
- *David Macrae, previously the Softimage Sales group manager resigned in November and joined a competitor, Discreet Logic.*
- *The AT Sales Group now consists of three regional focuses with the America's managed by Steve Wells based in Redmond, Europe managed by Georges Nahon, and Far East/APAC currently covered by Richard Fade with Daniel Petre in Australia.*

Softimage

- *Softimage net revenue for the quarter was $8.0 million versus a plan of $9.8 million.* FYTD net revenue was $15.8 million versus a plan of $17.4 million, or 91% of plan.
- *Softimage product revenue continues to be strong for Softimage 3D (Creative Environment), Hardware, and Options/tools.* Future quarter revenues will be negatively impacted versus plan due to product RTM slips with version 3.0 of Softimage 3D on Irix and NT as well as with Digital Studio, the planned flagship 2D product offering.
- *At the January Consumer Electronics Show (CES), Microsoft announced version 3.0 of Softimage 3D on Irix, a high-end image modeling and rendering software solution, and version 3.5 of Softimage Toonz, the leading cell-animation software for animation in film, video, and interactive games.*

AT Sales

- *Microsoft signed agreements with major partners at the ACT Summit meeting on interactive broadband networks, including Deutsche Telekom, Telstra of Australia, Rogers Cable, US West, Southwestern Bell, PacBell, HongKong Telecom, Sprint, Comcast, BT, Viacom, and Cox Cable and NTT to conduct testing on Microsoft's end-to-end software solution for interactive broadband networks.*
- *Multiple system integrators have committed to provide service and support for both testing and global deployment of Microsoft broadband technology.* These integrators include Alcatel, Anderson Consulting, Lockheed Missiles & Space Co, NTT Data Communications, and Olivetti. Currently, providers for continuous media servers include NEC, Compaq, and Intel while providers of set-top boxes include Hewlett-Packard, NEC and General Instruments.
- *The AT sales platform team finalized the license and development agreement and RTM with Timex for the Data Link Schedule+ watch, which began shipping during the quarter.*

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Operational Issues

SoftImage

- *Priorities for sales operations include re-staffing for David Macrae's position and other sales personnel that resigned to join Discreet Logic during the quarter.*
- *Preparations occurred during the quarter to support the new pricing and bundling plan for the overall Softimage product line announced at the Consumer Electronics Show (CES) in January.*
- *Integration of Softimage into Microsoft continues from an operations standpoint.* Implementation of the 'Platinum' accounting and order management system in Montreal is nearing completion. Additional focus is required to complete the integration of the Softimage subsidiaries with Microsoft and to support the planned establishment of a Softimage subsidiary in Germany.

AT Sales

- *Product plans and business models are being finalized for set-top boxes and Information Highway PC software (IHPC).*
- *Staffing for private networks continues to be a high priority to address this market opportunity.*
- *System engineer (SE) and other technical support positions are being staffed to support upcoming ITV trials with TCI and Southwest Bell.*
- *Contract license management and administration plans are being developed with the OEM Operations ("Pipe") group.*

Marketing, Advertising and Sales Programs

SoftImage

- *New pricing and bundling for the Softimage product line was developed during the quarter.* This included renaming and bundling many options previously sold as separate product offerings into Softimage 3D, Softimage 3D Extreme, Softimage Toonz and Softimage Eddie. Pricing for Softimage 3D has been revised from previous configurations of between $16,000-$40,000 to approximately $7,995 with Softimage 3D Extreme available for approximately $13,995. Softimage Toonz has been re-priced from previous configurations of between $15,000-$25,000 to approximately $16,995. Softimage Eddie 3.2 previously available in configurations of between $7,500-$10,000 has been reduced to $7,995. Upgrades and price protection will also be offered at various levels.
- *A key large account program win occurred during the quarter with Sega announcing their intent to choose Softimage 3D as their official 3D development tool for Sega's new SegaSaturn 32 bit game platform.* Microsoft will be providing a specific toolkit with extensions, file output filters, and other options.

AT Sales

- *The ACT Industry Summit took place in November with significant partner development as noted above.*
- *Microsoft announced the "Insight" program during the quarter.* This program offers technical information, extensive training, prerelease software and participation in technical design reviews to network operators for early adoption of interactive broadband-network solutions.

Results of Operations (in millions)

	Q95-2			FYTD95		
	Actual	Plan	Variance	Actual	Plan	Variance
Net revenue	$8.0	$9.8	($1.8)	$15.8	$17.4	($1.5)
Cost of revenue	2.4	3.1	0.7	4.7	5.5	0.9
Gross profit	5.5	6.7	(1.2)	11.1	11.8	(0.7)
People	4.2	4.8	0.6	7.5	9.1	1.6
Infrastructure	1.0	0.9	(0.1)	1.7	1.6	(0.1)
Marketing	1.8	2.7	0.9	3.5	5.8	2.3
Bad debt & taxes	(0.2)	0.3	0.5	(0.1)	0.5	0.6
Other	0.2	0.3	0.0	0.5	0.5	0.0
Controllable expenses	7.0	8.9	1.9	13.1	17.6	4.5
Responsibility margin	(1.5)	(2.2)	0.8	(2.0)	(5.7)	3.8
Shared resources	(0.7)	0.0	0.7	(1.2)	0.0	1.2
Shared resource margin	($.7)	($2.2)	$1.5	($.7)	($5.7)	$5.0
Key ratios						
Annualized per employee ($ in thousands)						
Net revenue	$212	$216	($4)	$211	$192	$19
% Net revenue						
Cost of revenue	30 %	32 %	1 %	30 %	32 %	2 %
Marketing expense	22	28	5	22	34	12
Controllable expenses	88	91	3	83	101	18
Shared resource margin	(9)	(23)	14	(5)	(33)	29

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

Cost Driver Analysis

Q95-1

- *People expenses were under plan in Q95-2 and FYTD due to lower than planned hiring in Softimage Sales, ACT Sales and Softimage Product Support.* The spending rate per head is above plan FYTD by 4% due to unbudgeted management bonuses and higher than planned spending on temporary help and consulting involved in the integration of Softimage.
- *Cost of revenue was favorable to plan resulting in gross profit for Q95-2 and FYTD at 70% of net revenue versus a plan of 68%.* This was largely due to a result of a mix shift away from royalty bearing products and specific SGI hardware re-sales.
- *Marketing expense was below plan for Q95-2 and FYTD due to various events, collateral, and market research planned which has been delayed to future quarters.* Marketing expenses include both Other AT Channel specific marketing and AT Product Marketing from the ACT, BMA, and APD divisions.

MICROSOFT CONSULTING SERVICES REVIEW

Mission

- *The mission of Microsoft Consulting Services organization (MCS) is to leverage and transfer capabilities in Microsoft technology, methodologies, tools, training, and experiences to empower large numbers of corporate/government developers, Solution Providers (SPs), Independent Software Vendors (ISVs), Value-Added Resellers (VARs), and other third parties, to make the transition to the Microsoft client-server computing platform.*

Organization

- *MCS currently has practices in 16 countries and is providing services in over 30 countries world-wide.* Each MCS business entity reports directly to local region or country management, while MCS strategy and business infrastructure is developed and managed by Bob McDowell, Vice President of Microsoft Consulting Services.
- *MCS operates on a cost recovery basis, that is their intent is to break-even.* The net result of MCS financial results are recorded as a component of controllable expenses.

Key FY95 Business Initiatives

- *MCS plans to broadly penetrate large organizations, increase account depth, and leverage third-parties by further developing long-term, on-site customer relationships, subcontracting with SPs world-wide, and dedicating consultant hours to the SP community.* MCS has contributed over 6,000 investment hours FYTD to the SP community. The investment hours were spent helping SPs port and build infrastructures on Windows NT, and in training local SPs.
- *MCS has focused on influencing the adoption of BackOffice products in large organizations through architecting technology infrastructures, designing business applications, and providing technology transfer to customers and SP's.*
- *MCS has started 8 new practices FYTD and plans to start-up an additional 6 world-wide.* The new and proposed practices are based in Eastern and Western Europe, Latin America, Middle East, Southeast Asia, and the Far East.

Results of Operations (in thousands)

	Q95-2			FYTD95		
	Actual	Plan	Variance	Actual	Plan	Variance
Net Billings	$20,928	$18,172	$2,757	$36,187	$33,277	$2,910
People	13,277	13,983	705	24,103	26,548	2,445
Infrastructure	2,546	2,189	(357)	4,542	4,248	(294)
Marketing	62	21	(41)	10	45	35
Bad Debt & taxes	496	418	(78)	1,114	783	(331)
Other	3,644	999	(2,645)	5,859	1,938	(3,921)
Controllable Expenses	20,025	17,610	(2,416)	35,628	33,562	(2,066)
Responsibility Margin	903	562	341	558	(285)	844
Headquarters Alloc.	966	1,756	790	1,759	3,291	1,531
Contribution Margin	($63)	($1,194)	$1,131	($1,201)	($3,576)	$2,375

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Cost Driver Analysis

- *Net Billings were 9% above plan FYTD due to higher than planned demand for MCS services.* In the U.S., MCS consultant billings were 2% below plan, while subcontractor billings were 212% above plan FYTD. Consultant billings were below plan due to below plan headcount and billing rates, while utilization was 64% compared to plan of 61%. Consultant billing rates range from $160 to $340 per hour with consultant discounts averaging 26% in the U.S. compared to plan of 15%.
- *Headcount and resulting people expenses were 9% below plan FYTD.* Headcount was below plan due to slower than planned international practice start-ups and difficulties in sourcing qualified people.
- *Infrastructure expenses were 7% above plan FYTD due to higher than plan depreciation expenses.* Depreciation expenses were 18% above plan due primarily to unplanned depreciation expenses in North America.
- *Bad Debt expenses were 42% above plan FYTD primarily due to unplanned bad debt provisions recorded for certain large slow paying customers in the U.S.* Charge-offs of MCS accounts receivable have historically been low.
- *Other expenses were 202% above plan FYTD due to above plan subcontractor costs.* Subcontractor costs were above plan due to below plan consultant headcount and above plan demand for MCS services.
- *Headquarters expenses were 46% below plan FYTD due to below plan headcount and below plan product development costs (Microsoft Solutions Framework).*

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WORLDWIDE PSS

Highlights

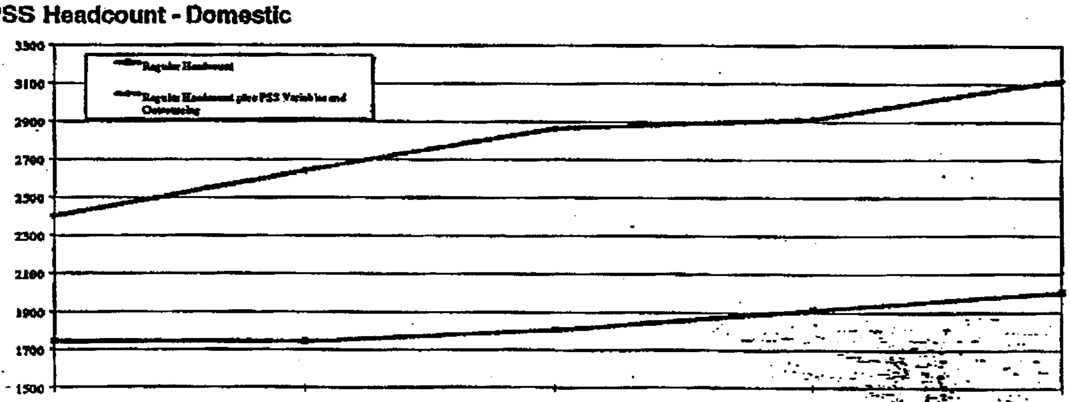
- *The selection of the Windows 95 Launch Support Team was announced after contracts were signed with the following five third party organizations; Digital Equipment Corporation, Keane Inc., Microage, Softmart and Unisys.* At launch, these partners will handle roughly 70% of forecasted volume. PSS is engaging in several PR/marketing activities with the Launch Team organizations to broaden industry awareness of their support capabilities. This will result in significant cost reductions for the Windows 95 business and also advances PSS objectives of building a third party support channel.
- *Quality ratings for the development customer segment have increased 10 percentage points since last year. PSS had targeted to increase this customer segment 5% for FY95.* Improved support service has resulted from open-ended questions added to the daily surveys that now provide additional actionable feedback from customers, and implementation of tighter escalation procedures with our outsourcing partner.
- *PSS complemented the suite of Internet services (FTP, Gopher) with the addition of the World Wide Web (WWW).* Response to this increased presence has been phenomenal, showing on average, 2,500+ logons per hour. To date, over 1,200 gigabytes of technical information has been passed to over 4 million customers who have accessed this service.
- *Call volumes in the holiday period for Consumer Division titles were 140% higher than average non-holiday volumes and were handled with reasonable service levels and no busy-out signals.* For comparative purposes, 1993 holiday volumes were also 40% higher than normal but resulted in lower service levels than in 1994 and significant busy-out signals. The improved 1994 results were due to a thorough pre-planning effort that included a 20% staffing increase with temporary employees, attentive scheduling and queue management.

Worldwide Cost Distribution by Channel (in millions)

	Q95-2				FYTD95			
	Actual	% Net Rev	Plan	% Net Rev	Actual	% NRev	Plan	% NRev
North America	$45.3	7.1 %	$46.8	6.4 %	$88.2	6.1 %	$93.0	7.1 %
Europe	18.6	3.5	21.7	4.7	34.8	4.2	42.3	5.3
ICON	3.7	2.9	3.7	3.7	6.5	2.8	7.4	3.9
Far East	8.4	4.7	7.3	6.2	14.8	4.7	14.1	6.3
Worldwide PSS	$76.0	5.1	$79.5	5.7	$144.3	5.3	$156.8	6.2

- *The Q95-2 and FYTD favorable variances are primarily due to lower people and infrastructure spending as well as higher than planned cost recovery.*

PSS Headcount - Domestic



- *During Q95-2, US PSS increased its total headcount resources by 7% while costs increased only 6%, highlighting the effect of using less expensive resources to meet support demand.*

Worldwide Cost Distribution by Product Cluster (in millions)

	Q95-2 Actual			Q95-2 Plan		
	PSS Cost	Mix	% Net Rev	PSS Cost	Mix	% Net Rev
Desktop	$28.3	37.2 %	3.6 %	$29.8	37.4 %	4.3 %
Consumer	4.6	6.1	3.7	5.1	6.4	2.9
Personal Systems	17.9	23.5	3.9	17.8	22.4	5.1
Business Systems	12.4	16.4	9.4	12.3	15.5	10.6
Developer	12.8	16.8	18.0	14.5	18.3	25.7
Total	$76.0	100.0 %	5.1	$79.5	100.0 %	5.7

	FYTD95 Actual			FYTD95 Plan		
	PSS Cost	Mix	% Net Rev	PSS Cost	Mix	% Net Rev
Desktop	$54.6	37.9 %	3.9 %	$57.9	36.9 %	4.8 %
Consumer	8.0	5.5	4.2	9.7	6.2	3.6
Personal Systems	33.3	23.1	3.9	36.0	23.0	5.3
Business Systems	22.9	15.8	11.0	24.3	15.5	11.4
Developer	25.5	17.7	19.8	28.9	18.4	28.4
Total	$144.3	100.0 %	5.3	$156.8	100.0 %	6.2

- *For Q95-2, PSS spending was under plan in the Desktop, Consumer and Developer product clusters.*
- *For the Consumer cluster, cost as a percent of net revenue ended slightly higher than plan.* This is primarily due to lower than planned revenue.

Q95-2 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	12	4,342	3,966	91 %	44 %
Excel for Windows	12	3,187	2,933	92	53
Access	12	3,541	3,271	92	53
Windows	17	1,643	1,621	99	84
Windows for Workgroups	19	1,368	1,350	99	86
MS-DOS	15	1,021	859	84	32
Word for Mac	12	1,060	691	65	18
Fox Pro for Windows	13	550	535	97	73
Windows NT	21	509	401	79	38
PSS Weighted Average	13	24,550	22,264	91	55

- *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 Windows NT daily call volumes have increased 112% to 509 in Q95-2.* The 30 days standard support promotion for Windows NT ended 12/31/94, so service levels are expected to improve.
- *Call volumes exceeded forecast for Mac Word.* Additional engineers have been hired and trained to meet demand.
- *MS-DOS calls have been fully outsourced to third party support providers.* The providers have had start-up issues appropriately scheduling staff throughout the day. PSS has provided scheduling tools to help ease the transition.

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Product Divisions

SUMMARY

Results of Operations
(IN MILLIONS)

Q95-2

	Net Revenue		Gross Profit		Operating Margin		Burdened Operating Income	
	Actual	% of Plan	Actual	% of Plan	Actual	% of Plan	Actual	% of Plan
Desktop Apps	$781.9	114 %	$683.3	115 %	$557.6	123 %	$457.0	126 %
Consumer	195.4	84	131.2	79	68.2	76	30.7	46
Personal Op Sys	380.5	130	361.3	130	301.9	146	264.9	156
Business Systems	127.5	132	109.8	146	27.7	NM	(12.5)	NM
Developer	71.3	123	56.6	140	6.3	NM	(24.1)	NM
Advanced Technology	8.0	81	1.0	21	(27.8)	NM	(45.2)	NM
Other Product Groups	3.3	16	(2.9)	NM	(16.6)	NM	(20.1)	NM
Press	10.5	123	5.3	122	2.4	190	(0.1)	NM
Other	(96.4)	NM	(85.5)	NM	(132.3)	NM	(131.0)	NM
Total	$1,482.1	106	$1,260.1	107	$787.3	122	$519.8	126

	Net Revenue Mix		Gross Profit % Net Rev.		Oper. Margin % Net Rev.		B.O.I. % Net Revenue	
	Actual	Plan	Actual	Plan	Actual	Plan	Actual	Plan
Desktop Apps	53 %	49 %	87 %	87 %	71 %	66 %	58 %	53 %
Consumer	13	16	67	71	35	39	16	29
Personal Op Sys	26	21	95	95	79	70	70	58
Business Systems	9	7	86	78	22	(15)	(10)	(51)
Developer	5	4	79	70	9	(22)	(34)	(68)
Advanced Technology	1	1	13	49	NM	NM	NM	NM
Other Product Groups	0	1	(88)	67	NM	(31)	NM	(51)
Press	1	1	51	51	23	15	(1)	(19)
Other	(7)	0	89	103	137	NM	136	NM
Total	100 %	100 %	85	84	53	46	35	29

FYTD95

	Net Revenue		Gross Profit		Operating Margin		Burdened Operating Income	
	Actual	% of Plan	Actual	% of Plan	Actual	% of Plan	Actual	% of Plan
Desktop Apps	$1,394.5	115 %	$1,208.6	115 %	$961.8	125 %	$778.3	133 %
Consumer	307.1	84	203.6	79	91.1	78	34.1	49
Personal Op Sys	730.0	126	696.1	127	584.5	143	523.4	156
Business Systems	194.4	113	166.5	125	20.6	NM	(51.4)	NM
Developer	128.5	123	98.7	138	9.2	NM	(45.1)	NM
Advanced Technology	15.8	91	5.6	68	(52.2)	NM	(82.5)	NM
Other Product Groups	30.8	52	19.9	43	(6.9)	NM	(13.3)	NM
Press	19.7	126	10.2	128	5.1	273	0.4	NM
Other	(92.0)	NM	(88.6)	NM	(190.1)	NM	(187.3)	NM
Total	$2,728.8	108	$2,320.6	109	$1,423.2	132	$956.7	158

	Net Revenue Mix		Gross Profit % Net Rev.		Oper. Margin % Net Rev.		B.O.I. % Net Revenue	
	Actual	Plan	Actual	Plan	Actual	Plan	Actual	Plan
Desktop Apps	51 %	48 %	87 %	86 %	69 %	64 %	56 %	48 %
Consumer	11	15	66	70	30	32	11	19
Personal Op Sys	27	23	95	95	80	70	72	58
Business Systems	7	7	86	77	11	(24)	(26)	(66)
Developer	5	4	77	69	7	(32)	(35)	(84)
Advanced Technology	1	1	35	47	NM	NM	NM	NM
Other Product Groups	1	2	65	78	(22)	11	(43)	(3)
Press	1	1	52	51	26	12	[illegible]	(25)
Other	(3)	0	96	104	207	NM	[illegible]	NM
Total	100 %	100 %	85	84	52	43	35	24

"Other" includes certain accruals and adjustments related to GAAP (Generally Accepted Accounting Principles), unusual and non-recurring charges, and other amounts not reflected for management P&L purposes.

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

	Desktop	Developer	Consumer	PSD	BSD	WPG	AT	Total
Net revenue per employee								
Actual Q95-2	$3,037	$362	$1,228	$2,248	$512	$1,392	$46	$1,210
Plan	2,672	275	1,214	1,619	343	1,120	46	961
Q95-1	2,443	303	755	2,191	267	1,137	52	1,005
People expense per employee								
Actual Q95-2	$88	$100	$101	$104	$100	$97	$126	$101
Plan	85	93	97	99	98	92	110	94
Q95-1	87	97	99	95	102	99	120	99
Infrastructure expense per employee								
Actual Q95-2	$24	$25	$23	$23	$33	$25	$25	$25
Plan	25	24	21	22	29	25	27	25
Q95-1	25	26	23	23	33	26	26	26
Product development expense % of people expense								
Actual Q95-2	17%	15%	84%	35%	36%	35%	13%	32%
Plan	35%	28%	119%	57%	48%	54%	31%	50%
Q95-1	14%	16%	68%	27%	30%	29%	9%	26%
Marketing expense % net revenue								
Actual Q95-2	6%	19%	10%	3%	19%	7%	25%	7%
Plan	8%	20%	9%	6%	25%	10%	35%	10%
Q95-1	8%	9%	12%	2%	16%	10%	22%	10%

- *Net revenue per employee for Desktop Applications and Personal Systems continues to fund significant long-term investments in other product divisions.* Total net revenue per employee exceeded plan by 26% due to a positive revenue variance of 12% combined with division headcount ending the quarter at 90% of plan.
- *People expense per employee exceeded budget by 7% due a number of factors.* $1.5 million in standard relocation bonuses and $1.3 million of management and executive bonuses paid in Q95-2 were not accounted for in the FY95 budget process. A $1.7 million non-recurring adjustment for payroll taxes was recorded in Q95-2, as a result of a budget error. The error resulted from a change in federal tax law where medicare payroll taxes of 1.45% are not limited based on salary, a factor that was not included in the original budget. To the extent MS has significant employee stock option exercises, this unfavorable variance will occur throughout the year.
- *Product development expenditures are 60% of plan for Q95-2 and 54% of budget for the first half of FY95.* The FY95 product development budget increased 110% over FY94 actuals. It is unlikely that this $61 million favorable variance that resulted from an aggressive plan, will be absorbed throughout the remainder of the fiscal year. Product development includes purchased code, contractors, beta program expense and third party localization.
- *Marketing spend at the division level was 84% of plan for Q95-2 and 77% of plan for the first half of FY95.* Although some of this variance may be permanent, division management anticipates that much of this $59 million favorable variance will be absorbed throughout the remainder of the fiscal year.

DESKTOP APPLICATIONS

Results of Operations ($ in millions)

	Q95-2			FYTD95		
	Actual	Plan	Variance	Actual	Plan	Variance
Net revenue	$781.9	$684.8	$97.1	$1,394.5	$1,212.7	$181.7
Cost of revenue	98.6	89.4	(9.2)	185.9	165.6	(20.3)
Gross profit	683.3	595.4	88.0	1,208.6	1,047.1	161.5
People	22.6	21.8	(0.8)	44.4	43.8	(0.7)
Infrastructure	6.3	6.4	0.1	12.7	13.5	0.8
Marketing	45.7	55.7	10.0	91.8	107.6	15.8
Broad Reach	0.0	0.0	0.0	0.0	0.0	0.0
Bad debt & taxes	6.5	7.7	1.3	12.6	13.8	1.2
Product development	3.9	7.7	3.7	7.1	15.2	8.1
Other	0.1	0.1	(0.0)	0.2	0.1	(0.0)
Shared resources	12.4	12.3	(0.1)	23.6	24.9	1.3
Product support services	28.1	29.6	1.5	54.3	57.9	3.5
Operating expenses	125.7	141.4	15.7	246.8	276.8	30.0
Operating margin	$557.6	$453.9	$103.7	$961.8	$770.3	$191.5
% Net revenue						
Cost of revenue	13 %	13 %	0 %	13 %	14 %	0 %
Operating margin	71	66	5	69	64	5
Operating expense mix						
All product development	26 %	25 %		26 %	26 %	
Marketing	36	39		37	39	
PSS	22	21		22	21	
Other expenses	15	14		15	14	
Total costs	100 %	100 %		100 %	100 %	

Cost Driver Analysis

- *Net revenue for the Desktop Applications division, of $782 million, was 14% above plan in Q95-2.* This is a new quarterly revenue record for the Division and results from continued above-plan sales of Microsoft Office and Office Professional. Significant positive volume variances more than made up for below-plan average prices on most products.
- *Desktop Applications sales through the European channel rebounded this quarter, up 79% over a disappointing Q95-1.* A weak dollar relative to budget is contributing to the positive revenue variances in most major foreign markets. The Far East FG channel had another very successful quarter, exceeding plan by 48%. Japan has passed Germany, France and the U.K. to become the second largest market, behind the U.S., for Desktop Applications products.
- *After a strong sell-in quarter in Q95-1 ($87 million), Macintosh applications dropped off significantly to $63 million this quarter.* This is slightly higher than FY94's run rate, but well below current year's plan which assumed higher sales levels fueled by PowerMac sales.
- *Total cost of revenue, as a percent of net revenue, was slightly favorable to plan in Q95-2. More importantly, on a year-to-date basis, gross margin was over 87%, which is four percentage points higher than one year ago.* The favorable increase is due to lower bill of materials costs across all new versions of Desktop Applications products, as well as a shift in mix toward licensed product. Both of these trends are expected to continue. An important item to note – planned changes to Office 95 product documentation are expected to reduce this product's cost by as much as 30% in FY96.
- *Operating expenses were below plan, primarily due to underspending in marketing and third party product development.* It is expected the majority of the variance in marketing will reverse in future quarters as spending ramps to sustain Office momentum and support the launch of Office 95. The product development variance should result in permanent savings.

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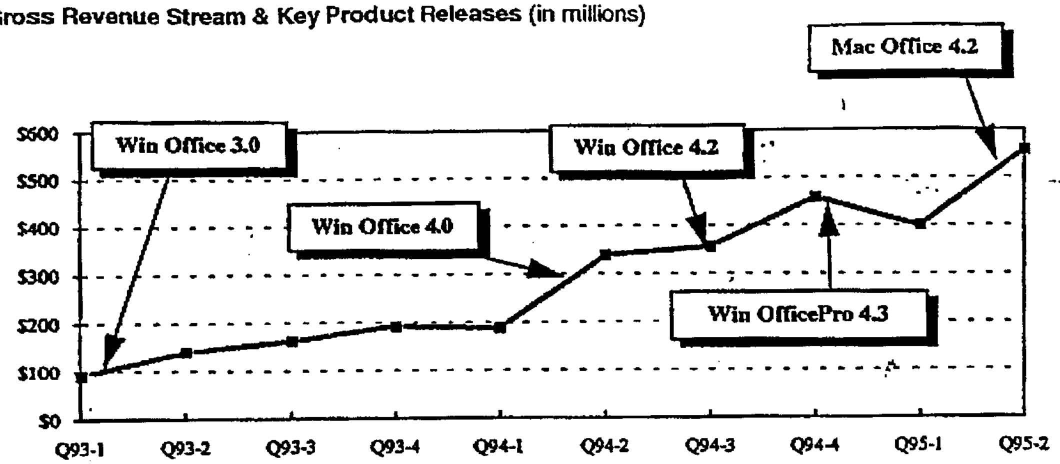
OFFICE

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

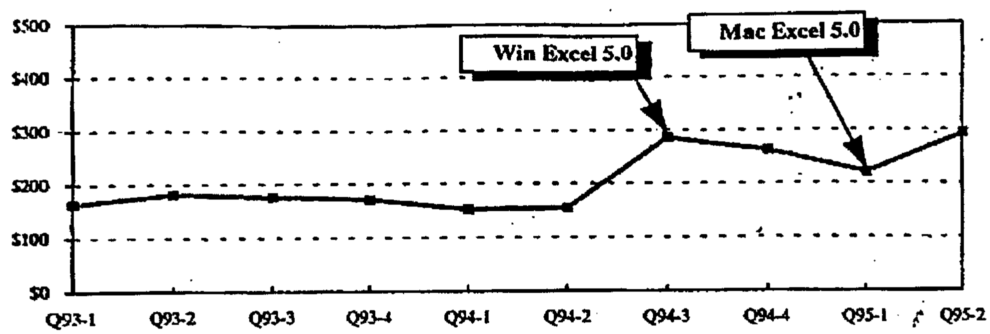
- *Microsoft Office received numerous and significant awards at COMDEX in November:* Microsoft Office Professional 4.3 received PC/Computing's MVP award for Application Suites, Microsoft Office 4.2 received PC Magazine's Technical Excellence award for Applications Suites. Microsoft Office Professional 4.3 received Home Office Computing's Editors' Picks award for Applications Suites. In addition, Microsoft PowerPoint 4.0 for Windows received PC/Computing's MVP award for presentation graphics.
- *In November, Microsoft announced that Microsoft Office sales nearly tripled since the introduction of version 4.0 in Q94-2.* Microsoft has shipped more than seven million units of Microsoft Office and Microsoft Office Professional life-to-date.
- *Instructional courses on Microsoft Office began airing nationwide to cable audiences in December.* The course first broadcast November 15, 1994, appeared on the Mind Extension University channel.
- *In October, Microsoft announced Microsoft Access Upsizing Tools which provide an upsizing path to Microsoft SQL Server from Microsoft Access databases.*

Competition

- *In late October 1994, Lotus announced NotesSuite, combining SmartSuite Release 3.0 for Windows, Lotus Notes Release 3.2 and Ready-to-use groupware applications.* The suite also includes a set of Notes applications which takes advantage of Notes and Smart Suite integration.
- *Lotus Ami Pro 3.1 and Lotus 1-2-3 Release 5 tested significantly faster than competitors on common tasks requiring a combination of word processing and spreadsheet,* based upon comparative performance tests conducted by National Software Testing Laboratories, publishers of Software Digest Ratings Report.
- *In December 1994, Novell Inc. released PerfectOffice 3.0.* Novell is positioning this product as being the desktop suite of business applications that can take advantage of the network and its services. PerfectOffice integrates WordPerfect 6.1, Quattro Pro 6.0, WordPerfect Presentation, Envoy 1.0 (workgroup publishing tool) and GroupWise 4.1 (integrated email, calendaring and scheduling.) The professional version of PerfectOffice also includes the Paradox database management application.

EXCEL

Net Revenue Stream & Key Product Releases (in millions)



Highlights

- *Microsoft Excel received several awards at COMDEX:* Microsoft Excel 5.0 for Windows received PC/Computing's MVP award for spreadsheets and Microsoft Excel 5.0 for Macintosh received Home Office Computing's Editors' Picks award for spreadsheets for the Macintosh.
- *Team Dennis Conner, contender in the America's Cup U.S. sailing trials, used Microsoft Excel version 5.0 as a critical component in the design of its newly christened yacht, Stars and Stripes.* Since the competition is so intense, teams are turning to technology to help them find the winning edge when designing and racing boats. Conner said, "Microsoft Excel enabled us to build and 'race' an unlimited number of boat-design configurations within the computer to find the ideal design before a single boat hit the water. We chose Microsoft Excel 5.0 because it was easy to use and had the powerful analysis and number-crunching capabilities we needed to find the ideal design that we believed would give us the edge over our competitors."

Competition

- *Quattro Pro 6.0 can once again be considered a serious contender in the spreadsheet market, according to November 21, 1994 edition of Infoworld magazine.* Quattro Pro's interface has been modeled after the latest release of WordPerfect for Windows. The program displays only one tool bar at a time, instead of stacking tool bars, to maximize spreadsheet space. Displaying multiple tool bars is an option. Version 6.0 introduces features that other spreadsheets take for granted, such as in-cell editing and in-place graph editing.

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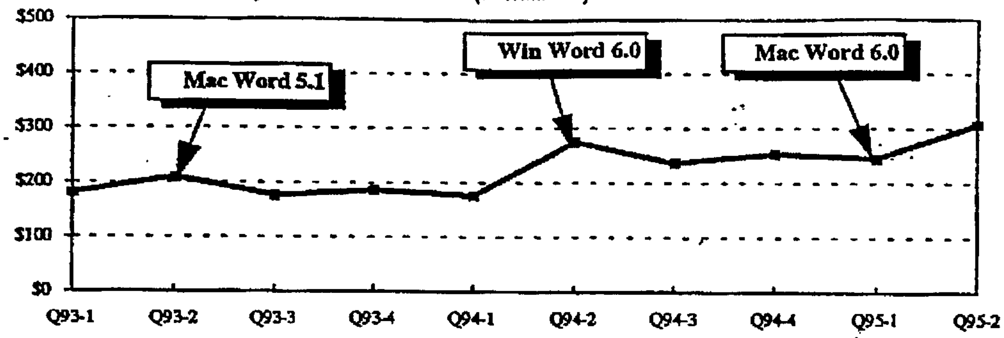
WORD

Net Revenue Stream & Key Product Releases (in millions)



Highlights

- *In November 1994, Microsoft announced Internet Assistant for Word for Windows.* Internet Assistant allows Word users to browse, read and create documents for use on the Internet. This free add-in will be available on the Microsoft Home Page of the World Wide Web.
- *Microsoft announced SGML Author, a Microsoft Word add-in which helps users create content for sophisticated document management systems.* This market has traditionally been served by expensive and cumbersome workstation based applications. SGML Author will be available for an ERP of $595 and will be sold primarily as part of vertical market solutions.

Competition

- *In early November 1994, Novell Inc. released WordPerfect 6.1 for Windows.* This new version focuses on helping users write better and faster. The focus of new feature development was in making the application easier to install and optimize over networks. The product includes more sophisticated grammar checking and linguistic technology than previous versions.

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BUSINESS SYSTEMS

Results of Operations ($ in millions)

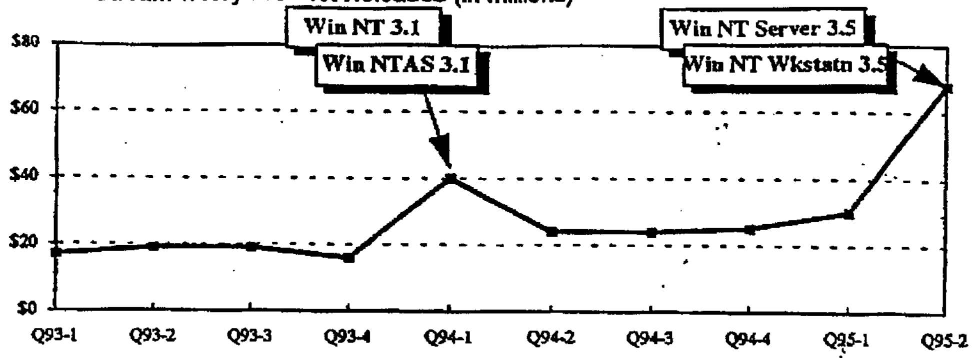
	Q95-2 Actual	Q95-2 Plan	Q95-2 Variance	FYTD95 Actual	FYTD95 Plan	FYTD95 Variance
Net revenue	$127.5	$96.9	$30.6	$194.4	$172.7	$21.7
Cost of revenue	17.7	21.6	3.9	27.9	39.5	11.6
Gross profit	109.8	75.3	34.5	166.5	133.2	33.3
People	24.6	27.1	2.6	48.9	53.6	4.7
Infrastructure	8.0	7.9	(0.1)	16.0	16.3	0.3
Marketing	24.6	24.3	(0.3)	35.5	45.4	10.0
Broad Reach	0.0	0.0	0.0	0.0	0.0	0.0
Bad debt & taxes	1.0	1.2	0.2	1.8	2.2	0.4
Product development	9.0	13.2	4.2	16.3	26.1	9.8
Other	0.1	0.1	(0.0)	0.2	0.2	(0.0)
Shared resources	3.9	5.3	1.4	7.4	10.4	3.0
Product support services	10.9	10.6	(0.4)	19.9	20.7	0.8
Operating expenses	82.1	89.7	7.5	145.9	174.8	28.9
Operating margin	$27.7	($14.4)	$42.1	$20.6	($41.6)	$62.2
% Net revenue						
Cost of revenue	14 %	22 %	8 %	14 %	23 %	9 %
Operating margin	22	(15)	37	11	(24)	35
Operating expense mix						
All product development	51 %	54 %		56 %	55 %	
Marketing	30	27		24	26	
PSS	13	12		14	12	
Other expenses	6	7		6	7	
Total costs	100 %	100 %		100 %	100 %	

Cost Driver Analysis

- *Net Revenue increased over 91% to $127.5 million between Q95-1 and Q95-2 as a result of new product introductions.* Windows NT Workstation exceeded plan by 97% or $11.8 million on strong sales in the US and Japan. Total Windows NT Server was favorable to plan by 40% or $10.1 million despite Client Access revenues falling $9.6 million short of plan. SMS 1.0 generated $3.5 million in the two months following introduction, while revenue from SQL Server was 86% of its $17.2 million plan. OEM posted another strong quarter as it exceeded its worldwide BSD plan by 57% ($5.5 million) primarily due to Lan Manager and a growing Windows NT base.
- *Cost of revenue was 14% of net revenue for Q95-2 compared to a plan of 22%.* This variance was a result of a shift to less expensive product packaging, a higher than planned OEM license business, and below plan manufacturing expenses. In addition, royalty payments to Sybase were $0.9 million less than plan due to the shortfall in SQL Server sales.
- *Marketing expense for Q95-2 was as planned, and was 22% below plan for the year,* primarily a result of industry advertising and channel promotion expenses shifting to later quarters.
- *Underspending of $1.9 million in product localization was the primary driver for the 32% variance in product development expense.* Additionally, a $1.0 million favorable variance for intellectual property rights resulted during Q95-2 as code acquisitions were delayed or treated as license agreements.

BUSINESS SYSTEMS OPERATING SYSTEMS

Net Revenue Stream & Key Product Releases (in millions)



Highlights

- *The US versions of Windows NT Workstation and Server 3.5 released to manufacturing in September 1994, while versions in 12 additional languages released during Q95-2.* The Windows NT products have been well received by the industry, garnering the following major awards during the quarter:

Windows NT Workstation 3.5	Windows NT Server 3.5
PC Magazine: Technical Excellence	PC Week: Analysts Choice
PC Magazine: Best of 1994	PC Magazine: Editors Choice
Windows Magazine: Product of the Year	Software Digest: NSTL Recommended
Network Computing: Editors Choice	Byte Magazine: Award of Excellence
Byte Magazine: Award of Excellence	Network Computing: Editor's Choice
InformationWeek: Top 10 Products of 1994	

- *Windows NT Server is currently being shipped by 36 OEM's, a 400 percent increase over the previous year.* In addition, it won the 1994 Merisel Hot List Award as the number one selling network operating system. Developers have also increased support for the product, as indicated by the availability of 1,200 applications designed to support the operating system.
- *MS announced the Solution Server Program in October where customers are provided hardware, pre-installed software, and technical information in order to develop and deploy enterprise solutions based on BackOffice technology.* The program is currently being offered in conjunction with AT&T GIS, DEC, Sequent, and NEC Technologies.

Competition

- *In November, Novell launched an aggressive advertising campaign in the business press comparing NetWare to Windows NT on seven specific points.* The aim of the ads was to inject some confusion into the marketplace following the release of Windows NT, and to set the stage for the release of the next version of NetWare. SunSoft also stepped up advertising, emphasizing how the recently released Solaris 2.4 operating system has the functionality of Windows NT at a lower price.
- *Novell began shipping NetWare 4.1 in December, touting the strength of its directory services and the improvements in network administration.* At the same time, the price was reduced to NetWare 3.x levels, with reductions approaching 25% for lower client volumes. The industry response was mixed, reflecting an increased value per dollar offset by the ongoing difficulties in migration to the new version.
- *Novell delayed the release of the UnixWare 2.0 operating system from mid-November until early 1995.* In addition, they are attempting to reposition the product as an industrial-strength application server that has close ties to NetWare's network services. This integration between the products, combined with increasing support from the company, are helping to maintain interest levels in the product.

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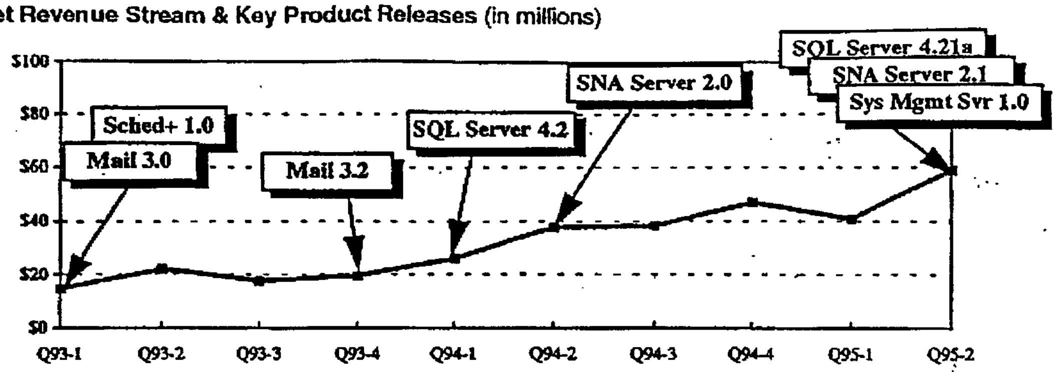
SERVER APPLICATIONS

Net Revenue Stream & Key Product Releases (in millions)



Highlights

- *Version 4.21a of MS SQL Server enterprise DBMS began shipping in October and offers improved integration with Windows NT Server.* At the same time, pricing was reduced by approximately 50% to counteract similar reductions by Sybase. Based on customer feedback, the SQL Server license agreement was also modified to provide the option of per-seat or concurrent client access licensing.
- *MS SQL Server Workstation released in October as a platform for developers and VARs looking to minimize the entry costs for client-server computing.* It offers the benefit of the standard SQL product, but is configured for desktop operation and includes a full set of development libraries and documentation.
- *MS SNA Server began shipping in October and recently won the Analyst Choice award from PC Week based on reliability, ease of installation and protocol support.* MS Systems Management Server 1.0 began shipping in November and has also received positive reviews in the industry press.
- *MS and the Mesa Group announced a distribution agreement for a Conference+ and MS-Mail bundle.* Conference+ allows groupware collaboration for MS Mail users via public folders, threaded conversations, and electronic forms. Similar technologies will be available in MS Exchange in early FY96, with the first beta scheduled to release by the end of January, 1995.
- *The beta version of MS SQL Server 95, released to customers in early November, includes database replication, and improved system administration.*

Competition

- *Lotus began bundling Notes 3.2, SmartSuite 3.0, and a set of Notes applications together as a product called NotesSuite which is discounted 20% off the stand-alone packages.*
- *Lotus released the Professional Developers version of the upcoming Notes 4.0* to approximately 200 developers in order to incent new application development. Notes 4.0 is expected to ship in mid-1995.
- *In October, Lotus announced new versions of Notes 3.2 for SCO Open DeskTop, HP-UX, IBM AIX, and Sun Solaris.* In addition, Sun announced its intention to bundle Lotus Notes at no charge with every SPARCserver system shipped worldwide during calendar year 1995.
- *Lotus and HP announced an alliance to work together on product integration, marketing, support, and system integration services.* Immediate results of the agreement include Notes bundled with HP-UX systems, and the development of NotesView, an HP OpenView based app for managing Notes networks.
- *Sybase announced an agreement to merge with Powersoft in a stock exchange in which shareholders will receive 1.6 Sybase shares for each Powersoft share.* The move was viewed as positive for both companies since products and distribution channels are generally complementary.

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PERSONAL SYSTEMS

Results of Operations (in millions)

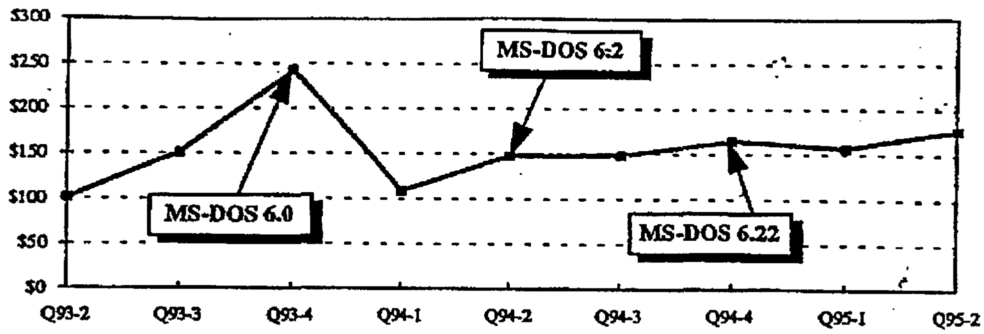
	Q95-2 Actual	Q95-2 Plan	Q95-2 Variance	FYTD95 Actual	FYTD95 Plan	FYTD95 Variance
Net revenue	$380.5	$292.8	$87.7	$730.0	$578.6	$151.5
Cost of revenue	19.3	14.8	(4.4)	33.9	29.9	(4.0)
Gross profit	361.3	278.0	83.3	696.1	548.7	147.5
People	11.8	11.0	(0.8)	22.7	21.9	(0.9)
Infrastructure	2.3	2.2	(0.1)	4.5	4.5	(0.0)
Marketing	10.2	17.7	7.4	17.6	32.7	15.0
Broad Reach	0.0	0.0	0.0	0.0	0.0	0.0
Bad debt & taxes	10.6	12.2	1.6	21.9	24.1	2.1
Product development	3.9	6.4	2.5	6.3	13.6	7.3
Other	(0.0)	(0.1)	(0.1)	(0.0)	(0.2)	(0.2)
Shared resources	3.3	4.8	1.6	6.2	9.5	3.4
Product support services	17.2	17.4	0.1	32.3	35.1	2.8
Operating expenses	59.4	71.6	12.3	111.6	141.1	29.5
Operating margin	$301.9	$206.4	$95.5	$584.5	$407.6	$177.0
% Net revenue						
Cost of revenue	5 %	5 %	(0) %	5 %	5 %	1 %
Operating margin	79	70	9	80	70	10
Operating expense mix						
All product development	30 %	27 %		30 %	28 %	
Marketing	17	25		16	23	
PSS	29	24		29	25	
Other expenses	23	24		25	24	
Total costs	100 %	100 %		100 %	100 %	

Cost Driver Analysis

- *Personal Systems net revenue exceeded plan in Q95-2 by 30%, or $88 million.* Retail demand for MS-DOS and Windows remains strong even as the Windows 95 launch approaches; Q95-2 Personal Systems sales in the FG channel grew by 25% over Q95-1 and were above plan in all regions except APAC. In North America, MS-DOS revenue exceeded plan by $15 million (558%), while Windows revenue exceeded plan by $26 million (234%). These variances accounted for 67% of the total FG revenue variance of $61 million (151%). Revenue from OEM sales also exceeded plan by $38 million (15%) due to continued strong PC shipments.
- *FYTD net revenue was 26% over plan.* FYTD OEM revenue was $70 million (14%) over plan while FYTD finished goods revenue was $96 million (111%) over plan. The North American FG channel accounts for 68% of the FYTD positive finished goods variance while Europe accounts for 25%.
- *People expense exceeded plan due primarily to costs associated with Windows 95 development.* Primary drivers of the Q95-2 negative variance were temporary help and consulting fees, an unanticipated change in payroll taxes, international payroll, and supplies and equipment purchases for network testing and development.
- *Marketing spend was below plan principally due to below plan channel marketing spending.*
- *Product development expenses were below plan by $2.5 million, primarily due to below plan beta support costs and localization expenses.* Both the Q95-2 and FYTD favorable variances are the result of product delays.
- *Product support expenses were below plan in Q95-2 as a percentage of net revenue; however, above plan sales volumes increased total product support services expenses to just under absolute planned amounts.* The $2.8 million positive FYTD variance was mainly driven by Q95-1 below plan expenses.

MS-DOS

Net Revenue Stream & Key Product Releases (in millions)



Highlights

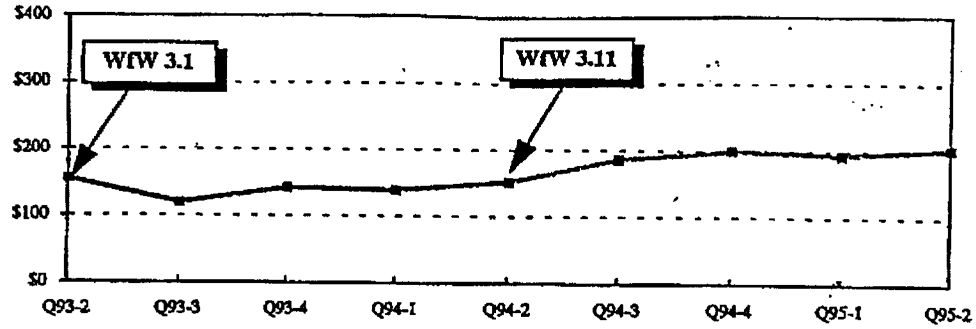
- *Q95-2 shipments of MS-DOS new users rose 53% over Q94-2 to 8.5 million licenses.*

Competition

- *IBM released beta veriosn of PC-DOS 7.0 in late October.* The product has been refined to target the portable computing market with File Update, a utility for file synchronization between two systems. IBM will also ship Stacker 4.02 compression software as part of PC-DOS 7.0, which ends IBM's use of its SuperStor compression technology. IBM has also included Rexx for DOS, a cross-application scripting language, currently available on OS/2, AIX, and MVS. Notably absent from the beta was the promised Workplace Shell for DOS. IBM plans to release PC-DOS 7.0 in the first quarter of 1995 with a list price of $127.
- *Apple introduced a new DOS compatibility card at Comdex which is orderable as part of the Power Macintosh 6100 or as a stand alone product.* The new card uses Intel's 66-Mhz 486 DX2 chip and can either share the Macintosh RAM or support up to 32 MB of RAM on the compatibility card. The card also includes 16-bit Soundblaster support and software enabling NetWare and TCP/IP connectivity. The Power Macintosh 6100 DOS Compatible system sells for $2,999. The user installable card is available for $699.
- *Insignia Solutions shipped a beta of SoftWindows version 2.0.* The PC-emulation software product has a planned release date of April, 1995. The new version will enable Power Macintosh models to run Windows in enhanced mode with 486 emulation and speed. Retail cost will be $499 with an upgrade price of $130.

WINDOWS

Net Revenue Stream & Key Product Releases (in millions)



Highlights

- *Windows for Workgroups 3.11 won PC/Computing's Most Valuable Product (MVP) award for operating systems.*
- *The second Windows 95 beta was shipped to over 48,000 beta testers in early November.* The Windows 95 Preview Program, the final Windows 95 beta, is scheduled to be sold to 400,000 customers worldwide this March for $30 per copy.
- *Windows 3.x life-to-date user shipments exceeded 75 million at the end of Q95-2.*
- *MS and the People's Republic of China's Ministry of Electronics Industry signed a Memorandum of Understanding to develop and deliver a Chinese version of Windows 95.*

Competition

- *OS/2 Warp appears to be doing better than expected and IBM states it has sold 800,000 units worldwide through its retail channels.* IBM is marketing the product aggressively, particularly in Europe, and brand awareness of OS/2 hit an all-time high among US PC users in November. According to PCWatch, however, Warp has not measurably increased OS/2 market share among US PC users. Among OEMs, Dell Computer, Toshiba America, CompuAdd Computer Corp. and German manufacturer Vobis have or will make OS/2 available on their PCs.
- *The announced January ship date for IBM's Full Pack Version of OS/2 is dependent on beta test results.*
- *IBM has stated it does not plan to create a joint operating system with Apple or make clones of Apple's Macintosh machines.*
- *Power Computing Corp. and Radius Inc. announced the first clones of Apple Computer Inc.'s Macintosh.* Power Computing Corp., a company partly owned by Olivetti, will start selling Macintosh clones in March by mail and plans to make them available by mid-1995 to other computer makers under their own brand names. Radius will clone the technology in workstations aimed at the high-end market.
- *IBM announced plans to start selling its PowerPC computers this spring with the new version of OS/2 and Windows NT.* The PowerPC line was originally scheduled to be available last year. *IBM shipped the first beta release of its OS/2 for PowerPC to about 150 testers,* and plans to release Beta 2 in March. Beta 2 will include full networking capabilities and support for multimedia, pen and speech.
- *Apple computer announced the Power Macintosh 8100/110.* Based on a 110mhz RISC-Based PowerPC 601 chip, the new computer is Apple's most powerful. As with all Power Macintosh models, the Power Macintosh 8100/110 can run DOS and Windows applications when used with Insignia Solutions' SoftWindows program.

CONSUMER

Results of Operations ($ in millions)

	Q95-2			FYTD95		
	Actual	Plan	Variance	Actual	Plan	Variance
Net revenue	$195.4	$231.3	($35.9)	$307.1	$366.7	($59.6)
Cost of revenue	64.2	66.1	1.9	103.5	109.1	5.6
Gross profit	131.2	165.2	(34.0)	203.6	257.6	(54.0)
People	16.2	18.4	2.1	30.9	36.3	5.3
Infrastructure	3.6	4.0	0.4	7.0	7.9	1.0
Marketing	19.1	20.3	1.2	32.6	35.3	2.7
Broad Reach	0.0	0.0	(0.0)	0.0	0.0	(0.0)
Bad debt & taxes	2.6	2.5	(0.0)	4.4	4.6	0.2
Product development	13.6	21.9	8.0	23.5	40.3	16.8
Other	0.1	0.0	(0.0)	0.1	0.1	(0.0)
Shared resources	2.7	3.2	0.5	5.1	6.4	1.4
Product support services	5.1	5.4	0.3	8.9	10.3	1.4
Operating expenses	63.0	75.8	12.7	112.5	141.3	28.8
Operating margin	$68.2	$89.4	($21.3)	$91.1	$116.4	($25.3)
% Net revenue						
Cost of revenue	33 %	29 %	(4) %	34 %	30 %	(4) %
Operating margin	35	39	(4)	30	32	(2)
Operating expense mix						
All product development	53 %	58 %		55 %	60 %	
Marketing	30	27		29	25	
PSS	8	7		8	7	
Other expenses	9	8		9	8	
Total costs	100 %	100 %		100 %	100 %	

Cost Driver Analysis

- *Gross revenue from finished good and OEM channels was $221 million during Q95-2, 43% higher than the year-ago quarter.* Aggregate sell-in of software titles grew 36%, while Input Device sales increased 57% over the year-ago quarter.
- *Net revenue of $195 million was 84% of plan,* principally due to delays in shipping Utopia (Bob), Flight Simulator 5.1, and slower than planned NAFG channel sell-in.
- *Returns reserves for the North America finished goods channel at quarter-end were $22 million.* These reserves were built up during the quarter to cover anticipated Q95-3 returns of unsold holiday inventory.
- *Input Devices business unit sales were $81 million, 35% over plan.* Strong sell-in of Natural Keyboard and Mouse sales, particularly through OEM, led to the favorable sales variance.
- *Cost of revenue was 33% of net revenue compared to plan of 29%.* This higher cost of revenue is due to a higher mix of Input Device products than plan. Actual mix for input devices was 37% of gross revenue versus plan of 25%. In addition, royalty payments exceeded plan due to above plan unit sales of royalty bearing Works.
- *Operating expenses were lower than plan* due to a 15% positive variance in headcount, and delays in third party development spending. Headcount increased by 71 during the quarter, but the division is still 131 heads below year end plan. Product development expenses include $2 million for amortization of intellectual property assets as a result of the Nextbase acquisition.
- *Marketing expense in aggregate was 6% below plan,* but as a percentage of net revenue was 10% compared to plan of 9%.

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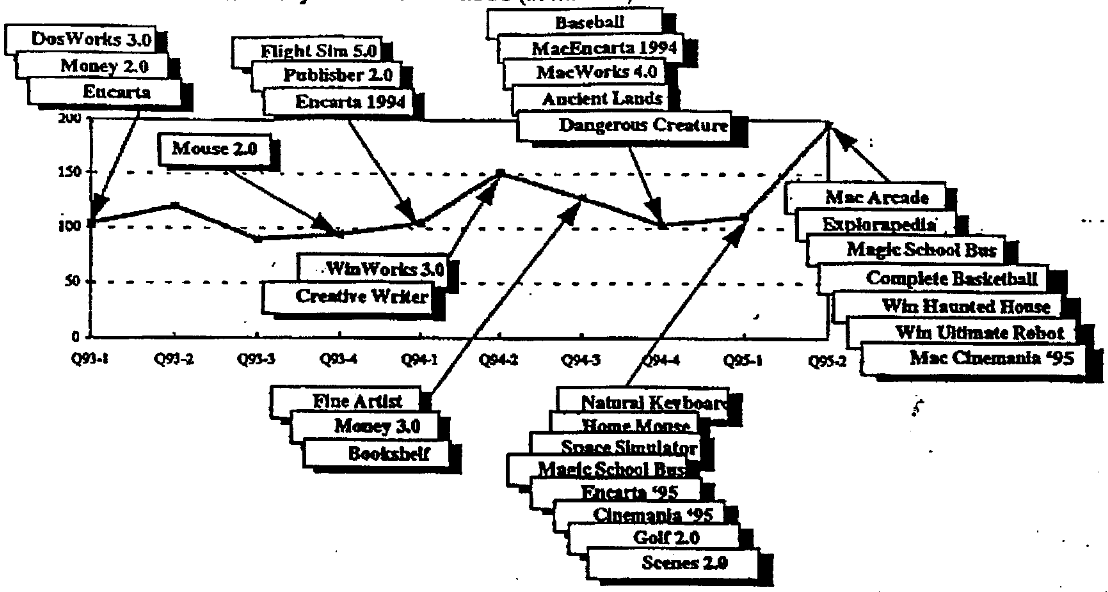
Net Revenue Stream & Key Product Releases (in millions)



Highlights

- *33 titles (which includes different languages and operating environments) shipped during Q95-2.* An additional 42 titles are expected to be released during Q95-3.
- *MS Natural Keyboard unit shipments totaled 157,000 during Q95-2 versus plan of 31,000.* In an effort to meet demand, manufacturing capacity is being increased to 140,000 units per month.
- *Nextbase Ltd intellectual property assets were purchased for $24 million in late October.* New versions of products based on the acquired mapping and route planning code will be released with MS packaging during Q95-3. These products will be part of the Reference business unit.
- *$19 million was spent on holiday marketing efforts,* including COMDEX, the cross-country ExplorasauraBus, the Composer Series tour, and the Complete NBA Basketball kickoff. Most notable among many product awards were Parent Choice awards for Bookshelf, Encarta, and Creative Writer.
- *The Utopia (Bob) beta 2 was released in early December.* Bob was announced at CES in Las Vegas in early January, and is set for release to manufacturing in late January.
- *The Business Development Unit was created,* combining the groups responsible for intellectual properties, localization, and business management. A second significant organizational change was the Kids Programming group moving from Advanced Technology into the Consumer division.

Competition

- *Viacom's Nickelodeon Director's Lab and Edmark's Imagination Express are soon to be released.* These products are direct competitors to MS Socrates, a 3D movie-maker targeted at the kids market, which is scheduled to release to manufacturing early next fall.
- *Capital Cities/ABC and Electronic Arts announced a joint venture* to develop software and video games based on ABC's children and news TV shows.
- *Electronic Arts has released US Navy Fighters to favorable reviews.* The MS offering in this category is Sniper, a McDonnell Douglas F-18 simulator scheduled to release to manufacturing next fall.
- *EasyPhoto by Storm Technology is scheduled to debut at Demo '95* and ship during the same timeframe as Windows '95. It will be bundled with a personal scanner for $199.

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DEVELOPER

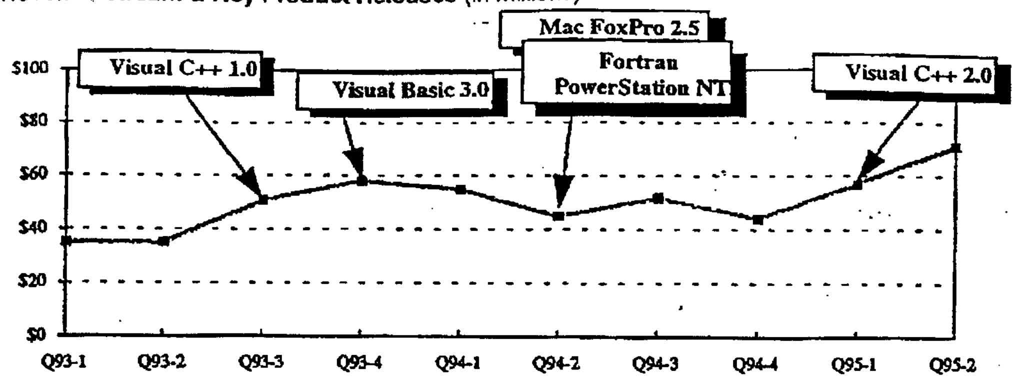
Results of Operations ($ in millions)

	Q95-2 Actual	Q95-2 Plan	Q95-2 Variance	FYTD95 Actual	FYTD95 Plan	FYTD95 Variance
Net revenue	$71.3	$58.0	$13.3	$128.5	$104.6	$23.9
Cost of revenue	14.7	17.5	2.8	29.8	32.9	3.1
Gross profit	56.6	40.5	16.1	98.7	71.7	27.1
People	20.3	19.6	(0.7)	39.1	38.3	(0.8)
Infrastructure	4.9	5.0	0.1	9.8	10.5	0.7
Marketing	13.3	11.7	(1.6)	18.7	23.0	4.3
Broad Reach	0.0	0.0	0.0	0.0	0.0	0.0
Bad debt & taxes	0.4	0.7	0.3	0.6	1.2	0.6
Product development	3.0	5.5	2.4	5.5	10.9	5.4
Other	0.4	(0.1)	(0.5)	(0.4)	(0.2)	0.1
Shared resources	(4.7)	(3.6)	1.0	(9.3)	(7.2)	2.1
Product support services	12.8	14.5	1.7	25.4	28.8	3.4
Operating expenses	50.4	53.2	2.8	89.5	105.4	15.9
Operating margin	$6.3	($12.7)	$19.0	$9.2	($33.7)	$42.9
% Net revenue						
Cost of revenue	21 %	30 %	10 %	23 %	31 %	8 %
Operating margin	9	(22)	31	7	(32)	39
Operating expense mix						
All product development	56 %	57 %		61 %	57 %	
Marketing	26	22		21	22	
PSS	25	27		28	27	
Other expenses	(8)	(6)		(10)	(6)	
Total costs	100 %	100 %		100 %	100 %	

Cost Driver Analysis

- *Net revenue was $13 million above plan for the quarter.* The VC++ Product Unit had net revenue of $23 million versus $16 million plan. The Kits Product Unit, where the Access Developers Toolkit makes up the majority of revenue, was $8 million over plan for the quarter. The Fox Product Unit was under plan for the quarter by $1 million with $11 million in net revenue.
- *Cost of revenue as a percent of net revenue was well below plan at 21% for the quarter.* While material costs for the quarter approximated plan at 10% of net revenues versus a plan of 11%, the variance was due to lower than planned manufacturing costs and allocations.
- *Total operating expenses for the quarter were 5% below plan, primarily due to less than planned product development and product support costs.*
- *Total marketing was 14% above plan. Domestic product and channel marketing were both underspent during the quarter, while internatiol spending was over plan.* Though marketing expenditures are $4.3 million under plan year-to-date they are expected to approach plan by fiscal year end. The delay in the Visual Basic 4.0 launch also contributed to lower than planned spending during the first half of FY95.
- *Product development was below plan by $2.5 million for the quarter. Ramping up with qualified third parties has been slower than plananed.*

Net Revenue Stream & Key Product Releases (in millions)



Highlights

- Developer Division net revenue was 23% above plan at $71 million, with all channels exceeding plan.
- *Independent Software Developers (ISV's) are making strong commitments to Windows 95.* To date, the Developer Relations Group has obtained commitment from ISV's to ship 43 leading applications incorporating the Windows 95 logo within 90 days after Windows 95 ships.
- *In December 1994 the MSDN OffRamp was created.* This is an area on the Internet which will make available a broad array of technical and strategic information and news for developers of Windows based software. It will also be a key forum for marketing MSDN memberships.
- *Visual C++ 2.0 Development System and Tools were 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. In addition, during Q95-2 versions for the Macintosh and Digital Alpha were released.
- *Visual Basic 4.0 has been delayed. Originally scheduled for a Q95-2 release, it is now tied to the Windows 95 schedule. Revenues from this release are not expected until FY96.*
- *FoxPro 3.0 is scheduled for release to manufacturing on March 15, 1995.*
- *MS acquired One Tree Software, the developer of SourceSafe, in November, 1994.* 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 Visual C++, Visual Basic and FoxPro users, and it is expected that SourceSafe will be incorporated into these products during 1995.. Eventually, SourceSafe's version control and configuration management infrastructure will be evolved into MS Repository being jointly developed with Texas Instruments, which will enhance team development through improvement in the re-use of components and integration between MS and third party tools.

Competition

- *Borland announced the resignation of Philippe Kahn, chairman, president and CEO, in January.*
- *Sybase announced Director approval of a merger between Powersoft Corp. and Sybase Inc. in November, 1994.* It is expected that PowerBuilder's success in the development tool market will give Sybase a potentially strong combination of server technology and tools.

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ADVANCED TECHNOLOGY

Results of Operations ($ in millions)

	Q95-2			FYTD95		
	Actual	Plan	Variance	Actual	Plan	Variance
Net revenue	$8.0	$9.8	($1.8)	$15.8	$17.4	($1.6)
Cost of revenue	7.0	5.0	(2.0)	10.3	9.3	(1.0)
Gross profit	1.0	4.8	(3.8)	5.6	8.1	(2.6)
People	22.5	23.6	1.1	40.7	45.3	4.7
Infrastructure	4.4	5.7	1.3	8.3	10.3	2.1
Marketing	2.0	3.4	1.4	3.7	6.5	2.8
Broad Reach	0.0	0.0	0.0	0.0	0.0	0.0
Bad debt & taxes	0.0	0.0	(0.0)	0.0	0.0	(0.0)
Product development	2.9	7.2	4.2	4.5	12.6	8.1
Other	(0.2)	0.1	0.3	6.3	0.3	(6.0)
Shared resources	(3.0)	(3.7)	(0.7)	(5.8)	(7.2)	(1.3)
Product support services	0.1	0.0	(0.1)	0.1	0.0	(0.1)
Operating expenses	28.8	36.3	7.5	57.7	67.9	10.2
Operating margin	($27.8)	($31.5)	$3.7	($52.2)	($59.8)	$7.6
% Net revenue						
Cost of revenue	87 %	51 %	(36) %	65 %	53 %	(12) %
Operating margin	(349)	(322)	(27)	(329)	(344)	14
Operating expense mix						
All product development	104 %	101 %		93 %	101 %	
Marketing	7	9		6	10	
PSS	0	0		0	0	
Other expenses	(11)	(10)		1	(10)	
Total costs	100 %	100 %		100 %	100 %	

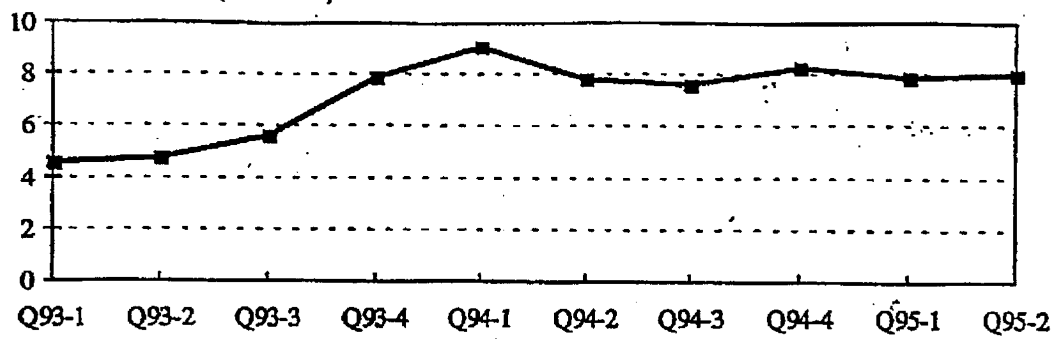
Advanced Technology includes Advanced Consumer Technology (Softimage and ITV), MS On line, and Other Advanced Technology (APD, BMA, research and division management).

Cost Driver Analysis

- *Cost of revenue is above plan as a result of the timing versus plan of payments to DEC for the management and startup of the Microsoft Network data center.* Cost of revenue for Softimage are below plan as a result of a mix shift away from certain hardware options and royalty bearing products.
- *People expenses were under plan due slower than planned hiring rates.* The Advanced Consumer Technology group (ACT) ended the quarter 35 people below its hiring plan and Microsoft On-line Services (MOS) 62 people below plan. Overall, AT was 143 people below plan.
- *The favorable infrastructure expense variances were the result of lower than plan headcount coupled with lower than plan building and grounds distributions.*
- *ACT marketing spend for FYTD was $3.4 million versus a budget of $4.5 million, while MOS, BMA and Advanced Product Development (APD) have not yet incurred any material marketing expenses.* The overall marketing spend is expected to meet budgeted levels for the year.
- *Product development costs approximated plan for MOS for the quarter, but were below plan in all other areas of AT.* Underspending in other AT groups was consistent with Q95-1, and related principally to third party contractors and significant outsourced product development.
- *The FYTD variance in other expenses was due to the unplanned $6 million acquisition of Altamira.*

ADVANCED CONSUMER TECHNOLOGY

Net Revenue Stream (in millions)



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

Highlights

Authoring Tools Highlights:

- *Microsoft announced a new version of Softimage 3D version 3.0 for the Silicon Graphics platform.* The new release offers a full-featured, flexible and integrated 3D modeling, animation and rendering solution.
- *Microsoft announced a new version of Softimage Toonz Version 3.5 for the Silicon Graphics platform.* Softimage Toonz is the leading cel-animation software for traditional cel-animators who create animation for film, video, interactive games and news media.
- *Microsoft announced a price reduction for Softimage 3-D, Toonz, and Eddie image editing software.* These price reductions are an integral part of Microsoft's strategy to make high-end media creation tools available to broader audiences in response to demand for content with high production value for interactive, film and video markets.
- *Sega selected Softimage 3D as the official 3D development tool for their new Saturn game platform.* Sega-Saturn is an advanced 32-bit game system released in Japan in 1994 and due to be released in the U.S. in late 1995.
- *Fox Television chose Softimage Toonz software for their new production development center in Arizona.* The contract is estimated at $7 million.
- *Daniel Langlois, Founder and Director of Softimage Research and Development was named "Canadian Entrepreneur Of The Year".* The country wide program is sponsored by Ernst and Young.

Authoring Tools Competition/Industry Highlights:

- *Adobe announced a new version of Adobe Premiere Version 4.0 for Windows.* The version upgrade incorporates new features for video, film and multimedia professionals who create digital movies in the Microsoft Video for Windows format.
- *Autodesk announced a new version of Cyberspace Developer Kit Version 2.0 for Windows NT.* The new version is a toolset for 3-D visualization and simulation.
- *Avid Technology recently announced the planned acquisitions of Digidesign Inc., BASYS Automation Systems and Softech Systems.* Digidesign a maker of digital audio technology is to be acquired in a stock swap valued at $205 million. BASYS Automation Systems, a unit of Digital Equipment, and privately held Softech Systems will be acquired in separate deals estimated for a total of $5 million.

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ITV Highlights:

- *At the ACT Summit was held in November, Microsoft unveiled its end-to-end software solution for interactive broadband networks to the top 35 network operators worldwide.* Commitments were made by systems integrators, hardware manufacturers, telecommunications, consumer electronics and personal computer companies to provide worldwide service, support, testing and products for the Microsoft broadband-network solution.
- *MicrosSoft announced five system integrators participating in predeployment (alpha) testing to include Alcatel, Andersen Consulting, Lockheed Missiles and Space Co., NTT Data Communications Systems Corp. and Olivetti.* Network operators partnering with Microsoft include Nippon Telegraph and Telephone, Rogers Cablesystems Limited, SBC Communications, Deutsche Telekom, Telstra Corp. of Australia and US West Communications Inc.
- *ACT unveiled its Insight Program and Pre-release (beta) Test Partners at the Western Cable Show in December.* Insight is a program which provides technical information, training, prerelease "beta" software, and technical design reviews. Participants will receive on-site access to the Microsoft and TCI test in the Seattle area as well. Insight Program members include Belgacom, British Telecom, Cox Cable, France Telecom, GTE Corp., Hong Kong Telecom, Korean Telecom, Pacific Telesis Video Services, Sprint and Viacom Deutsche Telekom, Nippon Telegraph & Telephone Corp., Rogers Cablesystems Ltd., SBC Communications, Telstra Corp. of Australia, and US WEST Communications Inc.

ITV Competition/Industry Highlights:

- *Oracle released their Oracle Media Objects beta tool kit for interactive broadband networks content development which is estimated to provide a 12-18 month advantage on interactive application development.*
- *Scientific Atlanta announced a new subsidiary, PowerTV, which will develop a competing software for interactive television set top boxes.*
- *Digital Equipment Corporation announced their second generation media server, a new "Video Services On-line Protection" system and the opening of Digital's first interactive video development studio.*

MICROSOFT ONLINE SERVICES GROUP (MICROSOFT NETWORK)

OVERVIEW

Mission

The mission of the Microsoft Network (MSN) is to connect the personal computer user to Microsoft and a wide variety of online information and communication services in an easy and empowering way. The online service will allow us to communicate to our customers, disseminate information at a low cost, and develop new distribution mechanisms through this unique channel. By owning and developing our own online service we can create tight technology and business linkages with applications and our other system businesses. This will become a worldwide and very competitive market. We will have to work with new customers and partners, including phone companies and information providers. This is Microsoft's first full-service business and will require a customer service approach and orientation different than our traditional business.

The MSN client application will ship as an integral and dependant component of Windows 95. The primary marketing goal is to acquire and retain a large number of subscribers. To that end, MSN will attempt to build a vibrant electronic community on top of a set of basic communications and information services. The basic services will include email, BBS and Internet newsgroup access, chatting, and a baseline offering of news, sports, financial market and weather information. Additionally, MSN members will be offered access to an array of extended services such as branded information, entertainment, and shopping provided by both Microsoft and our partners. Many of these extended services will be built with a new development system - code named Blackbird and available in FY96 - which is an advanced publishing system for developing rich multimedia titles for the MSN online environment.

MSN services will be targeted at end-users at home, small businesses, and large organizations. Initially, MSN will target specific segments for which we will be able to deliver a rich, valuable, and credible offering. The current planned target segments are: 1) the Microsoft devoted customer (i.e., someone that loves Microsoft products and always wants to know the latest); 2) the PC information and support seeker, 3) the small office/ home office customer, 4) families with children in elementary and/or junior high school, and 5) the hobbyist. MSN will compete directly in the online services business against players such as CompuServe, Prodigy, America Online and AT&T Interchange.

Because of MSN's wide availability, we expect that large and medium organizations will want to use MSN as a communications tool for their own organizations (e.g., communicating with sales force). A separate project has been initiated within the MOS group to provide more comprehensive, back-end, LAN connection services targeted at large organizations.

Objectives and Strategy

The Microsoft Online Services (MOS) group was organized in June, 1993. Its two part objective is:

- *Develop and operate a Microsoft branded online service.*
- *Develop the systems software platform for online services.*

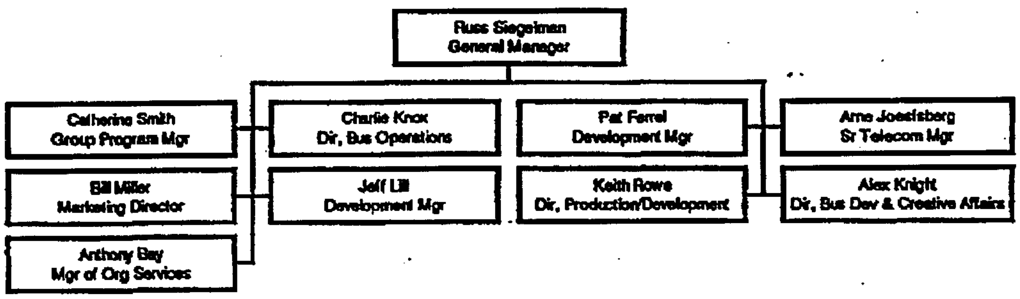
The rationale for pursuing these business strategies is:

- *The online consumer market is growing rapidly and is expected to be a two billion dollar market within five years.* Microsoft wants to participate in this business. More than 40% of Windows customers have modems, but less than 4% of US households subscribe to online services.
- *Online services are synergistic with many existing Microsoft programs and customer services such as PSS, MSIN, Solution Providers, MSDN, etc.* By developing and owning our own online service we can reap the greatest synergy with these customer programs.
- *Microsoft products, particularly in the Consumer segment, will require online capabilities.* By having its own service, Microsoft can get the tightest technology and business linkage between an online service and its applications.
- *Microsoft needs to make Windows a great platform for online services.* If we don't, someone else will and we will lose control of a key API.

- *Two key aspects of online services are the server platform that manage the information and the tools for creating the online content.* There is a growing system platform business around online information. Microsoft wants to leverage its systems and operating system products and create a new information publishing/tools business.
- *The subscriber base, partner relationships, service business experience, online marketing and transaction experience will serve as a strong foundation for our entry into the interactive TV and wallet PC businesses.*

Organization

MSN is led by General Manager Russ Siegelman, who joined Microsoft in 1989. Catherine Smith is the group program manager, Pat Ferrel and Jeff Lill are the development managers, and Anthony Bay is responsible for organization services. Bill Miller is the marketing director. Charlie Knox is responsible for the business operations and Arne Joesfsberg is the senior telecom manager. Siegelman also manages the broadband media group which includes Alex Knight for business development and creative affairs and Keith Rowe who manages MSN and ITV content development.



Finance support is provided primarily through the Controller's group. This support includes planning, measuring, and analysing financial information for the business, as well as responsibility for internal control and compliance with Microsoft's Accounting Policies.

BUSINESS MODEL

Product Definition

MSN Basic

MSN will provide basic features to all members of the service. The basic service will include the following:

- *Communication applications* - email, bulletin boards and chat.
- *Internet* - email and newsgroup access
- *Information* - news, sports, stock and weather; product and product support information; and special interest group (SIG) information. At launch we will have Microsoft Encarta and Bookshelf available on line.
- *File download libraries* - shareware, graphics and wave files, applets, product support (drivers etc.), article archives, and Microsoft KnowledgeBase.
- *Microsoft information and support* - In addition to other hardware and software vendors, MSN will also provide an extensive Microsoft area. Through this area, Microsoft groups (including PSS, product groups, Inside Sales, etc.) will provide customer service, product info, and technical support. In addition, fee-based technical support will also be provided by PSS.

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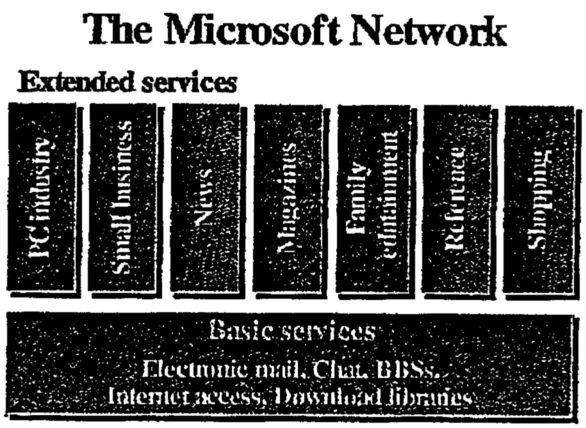
Access to MSN, including these basic services, will be available at a low monthly subscription price for the first x hours per month with a separate charge for additional hours.

MSN Extended Services and Products

In addition to the basic services, Microsoft branded and independently branded extended services and products will be made available to users. Some will only be available for an additional charge - subscriptions, transaction fees, cover charges and additional time based fees - while some will be at no additional charge since they will depend upon advertising or shopping transactions for revenue. The combination of MSN basic and extended services provide users a veritable online mall. Below are some examples of potential extended services.



Marvel Extended services from Microsoft and 3rd parties. May be additional subscription price, transaction fees and/or funded by advertising.

Microsoft will also bundle certain extended services. For example, the Consumer Division is working on plans to extend the CD-ROM based products targeted at personal finance, travel, reference and entertainment to include online capabilities. These might be packaged together on MSN as the "Microsoft Home Service."

Additionally, we are aggressively recruiting partners who will use our publishing tools to deliver branded extended services in MSN.

MSN will provide a browsing tool (user interface) that will allow customers to find, view and execute the various MSN basic and extended applications. This will allow us to present a user friendly common directory that provides access to different applications that are marketed and priced differently.

Access

Customers will access MSN via dial-up modem to a local phone number. MOS has contracted for network access service from telco carriers worldwide (In U.S.: AT&T and Sprint; Canada: Unitel and Sprint; Internationally: Sprint and British Telecom). Access speeds will range from 2400 bps to 14.4K bps (28.8K bps implementation is awaiting agreement on a common standard). Services will be optimized for 9600 bps and above. Access via the Internet, ISDN, and cable modems is planned for future implementation.

Being a standard feature of Win95, MSN will be launched simultaneously around the world and will be available in over 40 countries through local access dialing. The client application will be localized in over 20 languages. MSN will provide access to a variety of both international and local content so that users and Information Providers alike will benefit from having access to a global marketplace and local services. Microsoft is actively recruiting Information Providers in the key European countries. MSN will be priced in several different currencies and customer service will be available in local languages through local telephone calls.

A joint venture between Microsoft and Australia Telecom has been formed. The joint venture is an independent company with ownership divided evenly between Microsoft and Telecom and will be in operation by MSN launch. The mission is to provide Australians with online communication and content with local technical support and customer service at the lowest possible cost. It will serve as a trial for other ventures we may plan.

Formation of Microsoft Online Services Partnership

TCI Technology Ventures, the technology business group of Tele-Communications, Inc., and Microsoft have formed Microsoft Online Services Partnership (MOSP) to own and operate MSN under terms of a joint venture agreement. TCI invested $125 million in the partnership and acquired a 20% interest in MOSP. The main benefit to Microsoft is that we get a highly motivated partner with over 11 million cable subscribers. TCI is motivated to make sure that MSN targeted to personal computers will be successful using TCI's cable system.

The initial agreement with TCI was signed on September 12, 1994. Microsoft and TCI expect this agreement to be superseded by a more definitive agreement before July 1, 1995, which will include a 3 year business plan containing budgets, capital requirements, projected cash flows, marketing strategies and operational structures, as well as a description of assets, businesses, and rights contributed by Microsoft as part of its initial capital contribution.

As part of the agreement, MS will enter into a management contract with MOSP under which MS will manage and operate the business in consideration for MOSP reimbursing MS for the burdened cost of personnel and all other costs of running MSN.

TCI has agreed to offer MSN on its cable systems that are suitably equipped and to cooperate with MS in the planning, marketing, promotion, development and support of MSN. Furthermore, TCI has agreed not to conduct, engage or invest in any competing narrowband PC on-line service and to provide MOSP with "MFN" (Most Favored Nation) pricing for cable carriage.

Other Strategic Relationships

Microsoft purchased 8% of UUNet for $3.9 million and received a warrant to purchase an additional 11% (see *Treasury* section). UUNet will build a network to carry MSN, Internet on MSN, and other Microsoft network needs. Microsoft will reimburse UUNet for 100% of the cost of building and operating this network. The estimated cost is $50 million over the next 5 years.

Customer service and technical support has been outsourced to MCI, Decisions Group, Merit Communications, and Corporate Software. The contract with DEC for the data center located in Bellevue, WA, is for five years. DEC's main responsibilities are for the management of the facility, data center operations, WAN monitoring and fault reporting, a help desk, and hardware and software maintenance.

Microsoft has telecommunication contracts with AT&T, BT plc, and Sprint. These contracts provide us worldwide coverage with 9600 bps POPs. NABANCO has been contracted with for credit card services, and Dun and Bradstreet will handle the corporate billing.

We will also have contractual relationships with the Content Providers. It is estimated we will enter into at least 1000 of these relationships within 12 months of MSN's launch.

Market and Business Model

MSN will ship with Windows 95. Since MSN is an online service which can be updated and enhanced online, the typical version 1.0 to version 2.0, 12-24 month product cycle is not applicable to MSN as it is with other Microsoft products. Although we may have major releases from time to time, many new features and capabilities can be added incrementally.

The following pro-forma financial plan highlights were developed by the MOS operations group prior to entering into the joint venture agreement with TCI. Terms of that agreement are expected to have significant financial implications yet to be determined and are not reflected below.

	FY96	FY97	FY98
Gross revenue	$ 153,453	$ 487,526	$ 876,516
Cost of revenue	$ 169,615	$ 413,582	$ 722,999
Operating expenses	$ 38,308	$ 79,539	$ 121,779
Contribution Margin	($ 54,470)	($ 5,595)	$ 31,738
Capital investment	$ 24,503	$ 24,264	$ 37,253
End of period subscribers	1,300	2,200	3,700

All amounts in thousands

Author: Bruce Biemann (BBier)

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The key assumptions used by the MOS Operations Group in creating the business model are as follows:

- *Win95 installed base will grow from 14 million at the end of FY 96 to 46 million at the end of FY98.*
- *40% of Win95 users have 2400 bps modems or faster.*
- *50% of the above users will try MSN during launch, approximately 31% thereafter.*
- *Churn rate is much better than the industry average due to MSN's customer retention programs.*
- *Basic service fee will be $4.95 per month for three hours of usage.*
- *Usage above three hours will cost users $2.95 per hour.*
- *Additional revenue will be generated from Premium Services.*
- *US telecom costs will be 94 cents per hour.*
- *7% of revenue will go to Information Providers.*
- *Corporate allocations and inter-company transfers are not fully considered.*

COMPETITION

Currently, there are three major on-line providers, including CompuServe, America Online, and Prodigy.

CompuServe

- *Strengths*: CIS has an extremely loyal customer base and the largest membership (2,400,000 members) of the big three. Years of experience in online business and premium pricing have contributed to it being the only truly profitable major online service. CompuServe is most known for its leadership in breadth and depth of content, and it boasts actively used forums on just about any subject. CIS has been successful in recruiting ISVs and OEMs to have customer support forums making it the most popular service among PC users seeking technical support. Threaded bulletin boards make BBSs easy to use. This is the only service of the top three that has any international presence. It is popular with both Mac and PC customers and is owned by H&R Block.
- *Weaknesses*: Premium pricing makes service expensive. Service uses inconsistent formats, and primitive ASCII is used throughout the service. Generally difficult to find content. CIS charges per message fees for email past a certain allotment (about 70 per month) and nearly all but the most basic services cost extra (i.e., hourly connect charge applies) on top of monthly rate. Service uses puzzling system of user ID numbers. Although WinCIM interface has dramatically improved usability beyond previous DOS client and terminal mode access methods, ease of use still needs improving. A new UI is supposedly in development that will "catch up" with AOL. Management appears to be conservative and complacent, and marketing is not aggressive.
- *Dangers*: CompuServe could be energized by Microsoft's entry. A price cut of 50% has been announced that will be effective the first week in February.

America Online

- *Strengths*: Fastest growing of the big three. Relatively easy to use interface. Allows multiple (up to six) users/usernames per master account. AOL has recently signed some big brand name partners (e.g., MTV, Morningstar) and has garnered excellent PR. Recent acquisition of Redgate Communications gives AOL some skills and credibility they did not have before (e.g., electronic commerce). The service is adding around 75,000 users per month. Of the three big US consumer services, AOL has been the most aggressive in adding Internet connectivity such as Gopher and WAIS. Its all inclusive price of $9.95 for 5 hours per month with no per email charge is perceived as being a good deal. Additional hours were recently reduced from $3.50 to $2.95. Chat areas on AOL are very popular and appear to be in use nearly all the time. Searching for files has been made easier because of a consolidated master download library. AOL is popular with both Mac and PC customers. AOL does strong joint marketing with Information Providers (IP's). They've been successful in creating a virtual community atmosphere.

- *Weaknesses*: Rapid growth is straining system capacity and degrading performance. Most content lacks depth. Virtually all IP content is presented in ACSII and therefore unappealing. AOL is less attractive to partners because all inclusive pricing does not present a profitable business model. There is not always a lot of message traffic in special interest forums.
- *Dangers*: AOL could be sold to a company with more resources. New MUI (Multimedia User Interface), now shipping, could advance its UI and presentation significantly.

Prodigy

- *Strengths*: Prodigy has an easy to use interface. Service is targeted at home users who may fear a traditional Windows application. Service has name recognition and a large installed base of 1,100,000 households. Prodigy boasts a high capacity distributed system architecture. Recently, Prodigy has done some interesting co-marketing (e.g., with CBS and its Winter Olympics coverage). Sears and IBM are strong financial backers of the service. Overall there is a decent breadth of information offerings. Prodigy has recently moved into the Internet area with AstraNet, an Internet accessible service that carries some of the Prodigy content, but uses standard Internet protocols and technology.
- *Weaknesses*: Though easy to use, interface is ugly. Some features like BBSs, off-line mail, and Internet mail require either the Windows client or a special add-on. Overall communications features are very weak and difficult to use. Prodigy uses very primitive graphics in its UI making it slow at 2400 baud. Intrusive advertising takes up precious Window space and has not been well received by customers. Its primitive qualities make Prodigy appropriate for mostly entry-level PC users. Service has not been profitable (although it has reported first operating profits recently).
- *Dangers*: Sears and IBM could decide to engage in a price war with the other online services. IBM might also decide to purchase Sear's interest in Prodigy.

AT&T and Ziff Interchange

- *Strengths*: AT&T provides an inexpensive and extensive network to this service now in beta testing. Interchange uses a new user interface and allows multi-tasking. The Ziff partnership will provide significant content advantages at launch and Ziff has almost a decade of experience in the online service business. The combined marketing expertise of AT&T and Ziff and established customer base will provide for a quick entry in the market.
- *Weaknesses*: Untested product. High degree of uncertainty exists with the staff in Cambridge due to recent acquisition by AT&T. Infrastructure to support the new online service is untested. This includes the VAX farm in Medford, MA, the customer support system, the NaBanco and CheckFree relationships, etc.
- *Dangers*: AT&T provides unlimited resources and uses its network for an economic advantage.

Pricing

The overall MSN pricing philosophy is to move away from the current industry model of time-based connect pricing towards a value-based model. This is based on the fact that consumers' perception of value is based on the information retrieved vs. time spent accessing information. Because of inherent industry costs, it is currently not pragmatic to eliminate all connect time charges. But in line with this philosophy, our goal has been to price MSN's connect time charges low. Access to MSN's basic services will cost a monthly subscription ($4.95) which includes three hours of connect time. Additional connect time will be billed at $2.95 per hour. A benefit of this pricing model is the low monthly cost aids in both trial and retention. Compared to CompuServe and Prodigy, MSN's pricing is significantly less expensive. Compared to America Online, MSN's cost is competitive for heavy users, but significantly cheaper for light (< 3 hours) users (see chart below). Once the initial launch phase is over, a one month free trial period will be the standard offer. This means that a person joining MSN for the first time will have his first monthly charge of $4.95 waived, and he will get 3 hours of free access to the basic MSN services. International pricing will be in local currency and will be similar to U.S. pricing plus network surcharges of approximately $4.50 per hour in Western Europe and $7.50 in the rest of the world.

Members will derive value from MSN by using the extended services. These extended services will have additional fees on top of the normal monthly and hourly charges. These services may be charged per transaction, a cover charge basis (entry fee), a monthly subscription, or as additional connect charges.

	MS Network	America Online	CompuServe	Prodigy
Monthly Charge	$4.95	$9.95	$9.95	$9.95
Includes	3 hours of connect time	5 hours of connect time to entire service	Unlimited connect to very basic offering (no BBS) All other services charged at hourly rate	Unlimited connect to very basic offering (no BBS) 2 hours of timed services
Additional hourly charge	$2.95 (considering $2.45)	$2.95	$4.80 (14.4kbs)	$2.95

Customer Support

Customer Service and Technical Support will be a differentiating factor between the MSN and other competing services. The standards set by the big three on-line services today are very low. Customers are encouraged to ask for support on-line with telephone support very limited resulting in many disgruntled customers. We intend to set very high standards of customer support and alleviate burdening existing groups. We have partnered with outsource companies. The key area's and geographic coverage can be summarized as follows:

	Customer Service	Technical Support
North & South America	MCI - Tampa, FL	Corporate Software - Dallas, TX
England, Scandinavia, Far East, Rest of World	Decisions Group - London	Corporate Software - Amsterdam
Rest of Europe	Merit Communications - Brussels	Corporate Software - Amsterdam

- *MCI's Business Markets group will provide customer service for the Microsoft Network members in North and South America.* MCI's primary responsibility will be to support in-bound customer service calls and MSN messages while ensuring excellent customer satisfaction. Co-located in Pinellas Park, Florida with MCI's Proof Positive Call Center the Microsoft Service Professionals will be trained, managed, measured and motivated for Microsoft by MCI. The call center will initially staff approximately 125 Microsoft Service Professionals offering 7 x 24 coverage. The call center has capacity to grow to 600 MSPs. Much emphasis is being given to using technology to lower cost and speed delivery of service. An example of this is the Enhanced Voice Services system being used to deliver automated support such as access numbers, notification of problems with the data network and top ten tips. Customer service will be provided via a toll-free number to as many countries as possible.
- *Decisions Group will provide customer service for members in England, Scandinavia, the Far East, and other English speaking and minority languages from their facility in London, England.* They will also provide Technical Support for certain small volume languages. The Decisions Group, one of the UK's top three agencies, does primarily outbound telemarketing and has been a vendor of Microsoft Ltd in the past.
- *Merit Communications is a sister company of Decisions Group and is located outside Brussels, Belgium. Merit will be providing customer service to the rest of Europe and is managed by the Decisions Group.* Between the two companies, they will provide service to 33 different countries in 18 languages starting with 65 MSPs between the two sites. Given the time zones covered, they will effectively have a 7 x 24 operation although there will be some limitations in service depending upon language. Toll free customer support is being provided in most countries as available.

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- *Corporate Software will provide technical support from two locations, Dallas, Texas and Leiden, Netherlands.* Corporate Software already provides technical support for many Microsoft applications including support to Microsoft Ltd from their Dallas facility. Their European facility is located in the Netherlands to enhance their ability to recruit multi-lingual individuals with excellent computer skills. They will use their existing tools to track customer incidents and provide feedback to our development group. Initially, they will have approximately 30 support people in Dallas and 15 in Leiden.
- *All of the service professionals will be running Win'95, MSN, Microsoft Exchange, Microsoft Office, MS Infobase and a custom application for servicing MSN customer accounts.* They will be connected to Microsoft's data center over a frame relay connection.

Customer Billing and Financial Interface

Pricing of the Microsoft Network will be done in 19 different currencies, an innovative first in on-line services. We will offer two billing options, credit cards for most consumers and direct billing for Corporate Accounts. We are contracting with NABANCO, the largest credit card processor in the world to provide authorization and collection of credit cards. In a first outside of the airline industry, they will be able to provide the local currency processing we require. Corporate Account billing and collection is being outsourced to Dun and Bradstreet and will be managed out of the US and London.

The revenue from the Microsoft Network will be interfaced into the MS Sales reporting system and the financial accounting systems here in Redmond. International allocation of revenue and costs will be done centrally, with no resource impact expected on subsidiary operations.

Customer Retention Programs

A major issue in the industry is customer turnover (or "churn"). We expect to build customer appreciation and retention programs potentially similar to airline or phone company programs. We believe that low pricing is also a tool to limit customer turnover. Our retention plans are still under development but examples of the current thinking are shown below:

- *MSN Content.* Our content will be the core retention "lever". By recruiting and having great sysops, we hope to create successful (interesting, engaging, exciting) forums around the areas they manage. Effective packaging and delivery of value-added, relevant information, communication and services will be a key component to ongoing retention strategies. The development of highly personalized applets (stock portfolios, favorite places and shortcuts) is intended to create an online service environment that has high personal switching costs. Delivering profile driven "customized" content (e.g. personal newsletter) will allow us to differentiate our on-line service by creating *"market segments of one."*
- *Customer Segmentation.* Identify and score "high lifetime value" MSN segments based on frequency and "recency" of activity, subscription, extended and transaction based revenue.
- *Tiered Benefits and Rewards.* Create a retention model that addresses all levels of customer loyalty and value. Structure loyalty programs so that rewards are clearly allocated on the basis of customer value. PR and marketing communications should emphasize the distinct benefits of being a loyal MSN customer.
- *Branded Retention Program.* MSN will have "first mover" advantage by creating an aggressive retention program in the OLS industry. We will set precedent for industry followers by creating "branded" programs that address the needs of primary Marvel audiences: small business and consumer.
- *Loyalty/Rewards System.* Retention programs will promote benefits that are relevant to the audience, add value to the user experience or lifestyle, and reward frequency of usage. Retention programs will incent lower value segments to migrate to higher value segments.

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Revenue Growth Opportunities

Because the monthly subscription fees will be low, it will be necessary to develop subsidy services such as advertising, classifieds, and sales commissions to enhance revenue. The basic MSN business model assumes that subscription fees only cover operational costs, so additional revenue sources will be critical for profitability.

We think there is a strong potential for classified advertising, direct marketing and transaction/services commission revenue. Classifieds are a large business in print that should translate to online. Shopping is a possible proposition over narrow band communication lines, and commissions generated by getting a percentage of online consulting fees (tax advice for small businesses, for example) can be a good business. No one in the industry has discovered the formula yet to capture these sources and experimentation will be necessary.

Commitments and Risks

The following are significant challenges and risks related to the online industry that should be considered:

- *Rapid technological change.* The online service industry is characterized by rapid technological change and uncertainty as to new products, competitors, interfaces, partnerships, etc.
- *Long-term investment cycle.* Developing, marketing, and maintaining a new online information service is expensive, and the investment involves a long pay-back cycle. Established online services have a reliable cash flow and new services (along with the old) may clone many MSN innovations without the cost burden of our long-term investment.
- *Pricing.* Future prices MSN is able to obtain for its service may decrease from historical levels, depending upon market and other cost factors. With a competitive market and low customer switching cost there is a strong likelihood that there will be a pricing war. It is possible that MSN will never make money in the narrow-band market, but will only be able to make money by transitioning our customer base into the broad-band.
- *Assumed growth.* The only way for the consumer online market to be profitable is for demand to grow strongly. There is also the risk of too rapid growth for MSN. The data center, customer service, and other operating systems may not be able to handle the demand.
- *Unknown competition.* Competition will be vigorous, but will it be sane? Will AOL, CompuServe, Prodigy, AT&T, and Microsoft target different markets or will they compete for the same customers? The direction and role of Internet is unknown. It has several shortcomings for deploying a commercial service, but if these problems are addressed, the Internet would suddenly become a strong competitor.
- *Win95 and EMS.* MSN is dependent on a timely and successful launch of Win95 and EMS. MSN needs to be distributed widely via Win95 so it gets into both the retail and OEM products.
- *Reliance on outsourced vendors.* MSN will require the coordination and high quality work of several outsourced vendors: network vendors, billing vendors, customer service vendors, etc. This will be a worldwide operation with complex deployment plans.
- *Partners.* MSN is commited to a number of partners. The broadband strategy and other corporate goals may conflict with certain individual partners.
- *Blackbird.* MSN needs a strong tools strategy. Great publishing is needed to make it easy for content developers to put their content on MSN.
- *Service business.* This is Microsoft's first "service" business. MSN needs to become a strong service provider: little downtime of the service, great customer service, managing the customer experience back through our vendors (network), etc.
- *Model assumptions.* Our assumptions may be too aggressive or too conservative. There is also the risk that we have not fully considered a key driver in our assumptions about the online service business.
- *Unknown business risks.* Complex tax and legal issues, accounting standards, and operational risks may have been overlooked. This is a new business for Microsoft.

MS ONLINE SERVICES

Highlights

- *TCI and Microsoft announced plans to form a partnership to develop and operate Microsoft Network (MSN).* TCI paid $125 million for a 20% interest in the new entity. The goal of this relationship is to eventually provide Microsoft access to TCI's broadband network and the cable company's 11 million subscribers.
- *Microsoft is planning to purchase 8% of UUNet for $3.9 million, including a warrant to purchase an additional 11%.* An agreement with UUNet will provide high speed access to the Internet for MSN and other Microsoft network needs. Microsoft will reimburse UUNet for 100% of the cost of building and operating this network, expected to total $50 million over 5 years.
- *German Telekom and Microsoft are forming a strategic partnership.* The goal of the cooperation is to build a Windows based platform which can offer services on existing infrastructure, especially the ISDN network, and on future Telekom networks. This partnership will provide inroads to the single largest market in Europe.

Competition/Industry Highlights

- *AT&T has announced plans to buy Ziff's Interchange Online Network for approximately $50 million.* The telecommunications giant earlier this year launched PersonalLink, an online service that plans to make heavy use of so-called intelligent agents that fetch a variety of information for online customers. AT&T also recently acquired the 80% stake it didn't already own in ImagiNation Network, a video-game network. It isn't immediately clear how AT&T might mesh these two efforts with the Interchange approach.
- *Comcast, one of the nations' top four cable operators, unveiled an ambitious plan to deliver online services over its vast cable network.* Comcast will join a growing crowd of online ventures seeking to exploit the huge capacity of coaxial cable which can carry data 50 times faster than telephone lines. Rivals Continental Cablevision, Cox Enterprises, and Cablevision Systems also have announced plans to provide access to the Internet and such online services as America Online and Prodigy.
- *America Online announced plans to acquire Advanced Network for $20 million in cash and $15 million in stock.* Advanced Network Services provides Internet access to over 150 corporate customers, and AOL is expected to use Advanced Network Services to provide America Online subscribers with high-speed links to the Internet.
- *Prodigy, America Online, and CompuServe have all slashed their prices in the last month.* Increasing competition in the online service arena should lead to increased price pressure for all providers.

OTHER AT DIVISIONS (APD, BMA, RESEARCH, MGMT)

Highlights

- *Microsoft and Visa signed a letter of intent to jointly provide a standard method for executing electronic bankcard transactions across global public and private networks.*
- *Microsoft and Visa also agreed to jointly develop software based on RSA Data Security's data-encryption technology that will allow PC users with credit cards to shop electronically.*

Competition/Industry Highlights

- *CNN and Intel announced CNN at Work, a $12.50 per month subscription service that delivers live Headline News or CNN broadcasts over PC networks to businesses.*
- *The Sega Channel was successfully tested and will roll out nationwide at a subscription price of $12 - $15 per month.*
- *Paul Allen acquired a significant stake in C/Net, a TV programming service about computers and technology.* He will control two of five seats on the company's board.
- *Interactive Network and NTN Communications are testing interactive gaming in California.* For a monthly fee of $9.95 subscribers can wager points on horse races and table games. Interactive Network also announced a newly formed subsidiary, RealTime Gaming Systems, to market TV gambling.
- *On Demand Services is also testing a home wagering system.* Subscribers can electronically place bets and monitor the tote board.
- *Sun Microsystems, LSI Logic and David Sarnoff Research announced plans to develop real-time MPEG-2 video encoding systems at half the price of conventional systems.*
- *Pacific Bell's Data Communications Group is testing Media Park SM, a "virtual" production studio.* This studio allows instant access to film and photo libraries, video and audio production facilities, data conversion services, image rendering and compression functions, digital production tools and talent data bases over Pacific Bell's business communications superhighway.

Worldwide Operations

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WORLDWIDE OPERATIONS

Highlights

- *North America completed the planning phase of Project Genesis during the quarter.* This project was undertaken to provide better customer service through improved operating procedures and implementation of supply chain management techniques. The project team analyzed the organization structure, inventory management procedures, sku management, manufacturing capacity utilization, distribution strategies and supplier relationships. The implementation phase of proposed changes will commence in Q95-3.
- *North American Operations successfully supported the increased demand in consumer products during the holiday season.* A distributed manufacturing arrangement was implemented to supply east coast customers from KAO Inc. in Plymouth, Massachusetts.
- *The remaining European subsidiaries for Central Europe were converted to the EOC Central Ordering System at the end of October 1994.* This successfully completes the conversion for all of Europe to the EOC Central Ordering System. All remaining European warehouses were transitioned to EOC during the quarter.
- *EOC completed a survey of 35 European distributors in seven countries to measure the current level of customer service in logistics (i.e. matching sales orders verus demand; on-time delivery; focal points for customer communications) and to identify actions needed to address their concerns.* The findings indicate that MS is under-performing in terms of service compared to competitors. There are considerable efforts underway to respond to these findings.
- *Latin America Operations established a distributed manufacturing site in Mexico, which produces full packaged product for distributors in Mexico and supports fulfillment activities for local end users.* This distributed manufacturing site reduced lead time from twenty to nine days for customers in Mexico. A distributed manufacturing site in Brazil is on schedule to be operational in Q95-3.
- *Far East Operations presented current findings from Project Akebono to Far East management.* This is a project to study efficiencies and determine leverage for manufacturing and distribution in our growing Far East business. Further operational analysis is needed to substantiate the business case for activities that should be changed from the current business model. A joint venture arrangement for manufacturing and localization of products in China is under development.
- *Operational support for new sales programs, and vendor fulfillment capabilities of these programs, continues to be a major business challenge.* The Select operations and sales team is addressing unplanned costs and ITG's ability to deliver certain system enhancements on time for Select 3.0.
- *Progress on MS Product, a system to establish management control for product content, SKU creation and SKU pricing, is progressing well.* Delivery of phase I functionality is scheduled for Q95-4.

COST OF REVENUE SUMMARY

FYTD95 Finished Goods

FYTD cost of revenue was 17% of net revenue for worldwide finished goods compared to plan of 20%, and was lower than plan across all regions. This reduction is primarily the result of higher than planned volumes, lower material costs, and a significant shift to Select and other license programs. On a worldwide basis FPP license mix, excluding hardware, is 50% versus a plan of 67%.

- *North America was favorably impacted by revenue in excess of plan, combined with lower than plan spending in aggregate.*
- *Europe and ICON continued to be favorably impacted by a dramatic shift in sales to licensed product compared to plan.* FPP license mix exceeded plan by 24% in Europe, and 29% in ICON.
- *Far East benefited from exceptionally strong revenue driven by higher prices compared to budget, combined with a favorable shift to licensed products.* The actual weighted average revenue per license for FPP was $196 versus a budget of $128, while licensed product mix exceeded plan by 17%.

Product Costs

- *Product costs consist of all costs incurred to manufacture and assemble finished goods.*
- *Total product costs were $9 million below plan (2% favorable to plan as a percent of finished goods revenue) due principally to reduced cost of disks, manuals, and manufacturing spend across all regions.*

Processing Costs

- *Processing consists of costs related to program management, planning and order transaction processing. These costs are incurred by the Operations Management and Planning group in Redmond, OSC's, and local processing in subsidiaries.*
- *Processing costs were 1.5% of net FG revenue compared to plan of 1.8%.* 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 $31 million which approximated plan.* Significant expenses included provisions for inventory obsolescence of $12 million and returns scrap of $11 million.

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 of 1.4% of net FG revenue, were below plan by $1.4 million.* All regions were favorable to plan except for Far East and ICON. ICON's unfavorable variance was primarily due to air freight costs to Australia in support of sales promotions.

Royalties

- *Royalty costs include payments to third parties for the use of their intellectual property.* MS currently has approximately 180 software royalty agreements. Nearly all agreements require royalties be paid on a fixed per unit basis or a fixed percentage of revenue.
- *Royalties totaled $31 million or 1.5% of net FG revenue on a plan of $30 million.* The unfavorable variance was due primarily to sales volumes in excess of plan for products that carry royalties.

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COST OF REVENUE SUMMARY

($ IN MILLIONS, LICENSES IN THOUSANDS)

	North America				Europe			
	Actual		Plan		Actual		Plan	
Net revenue	$ 954.5	100.0%	$ 875.0	100.0%	$ 710.4	100.0%	$ 662.3	100.0%
Cost of revenue								
Product Cost	118.3	12.4%	123.3	14.1%	64.0	9.0%	69.8	10.5%
Processing	15.3	1.6%	15.7	1.8%	12.2	1.7%	12.8	1.9%
Inventory adjustments	20.8	2.2%	21.6	2.5%	6.6	0.9%	5.2	0.8%
Freight & distribution	10.3	1.1%	13.3	1.5%	8.3	1.2%	8.3	1.3%
Royalties	18.6	2.0%	18.6	2.1%	6.4	0.9%	7.6	1.1%
Miscellaneous costs	(0.7)	(0.1%)	-	0.0%	-	0.0%	-	0.0%
Total cost of revenue	182.5	19.1%	192.5	22.0%	97.5	13.7%	103.7	15.7%
Gross margin	772.0	80.9%	682.5	78.0%	612.9	86.3%	558.6	84.3%
Revenue Mix								
FPP	$ 727.1	76.2%	$ 681.8	77.9%	$ 413.9	58.3%	$ 464.9	70.2%
Select	86.6	9.1%	69.0	7.9%	123.7	17.4%	65.7	9.9%
Other license	128.0	13.4%	88.6	10.1%	138.3	19.5%	120.4	18.2%
Maintenance	41.0	4.3%	13.7	1.6%	22.2	3.1%	14.5	2.2%
Hardware	61.0	6.4%	50.3	5.7%	16.3	2.3%	18.3	2.8%
Revenue adj & other	(89.2)	(9.3%)	(28.3)	(3.2%)	(4.0)	(0.6%)	(21.5)	(3.3%)
Total net revenue	$ 954.5	100.0%	$ 875.0	100.0%	$ 710.4	100.0%	$ 662.3	100.0%
License Mix								
FPP	6,457	50.0%	6,415	62.0%	2,465	46.7%	3,523	70.4%
Select	752	5.8%	597	5.8%	819	15.5%	332	6.6%
Other license	1,559	12.1%	1,189	11.5%	916	17.4%	543	10.9%
Maintenance	795	6.2%	279	2.7%	491	9.3%	143	2.9%
Hardware	1,166	9.0%	881	8.5%	356	6.7%	461	9.2%
Other	2,186	16.9%	989	9.6%	232	4.4%		0.0%
	12,915	100.0%	10,350	100.0%	5,278	100.0%	5,003	100.0%

	ICON				Far East			
	Actual		Plan		Actual		Plan	
Net revenue	$ 192.7	100.0%	$ 159.2	100.0%	$ 203.9	100.0%	$ 136.0	100.0%
Cost of revenue								
Product Cost	25.1	13.0%	26.9	16.9%	27.2	13.3%	23.5	17.3%
Processing	1.0	0.5%	1.3	0.8%	2.9	1.4%	2.9	2.1%
Inventory adjustments	2.3	1.2%	3.1	2.0%	1.5	0.7%	0.7	0.5%
Freight & distribution	4.5	2.3%	3.3	2.1%	4.8	2.4%	4.4	3.2%
Royalties	2.4	1.3%	2.0	1.3%	3.2	1.6%	1.8	1.3%
Miscellaneous costs	-	0.0%	-	0.0%	(0.1)	(0.1%)	-	0.0%
Total cost of revenue	35.3	18.3%	36.7	23.1%	39.5	19.4%	33.3	24.5%
Gross margin	157.5	81.7%	122.5	76.9%	164.4	80.6%	102.7	75.5%
Revenue Mix								
FPP	$ 115.9	60.1%	$ 119.6	75.1%	$ 171.4	84.1%	$ 117.7	86.6%
Select	16.4	8.5%	8.8	5.5%	5.6	2.7%	4.3	3.2%
Other license	49.6	25.7%	28.2	17.7%	24.9	12.2%	13.4	9.9%
Maintenance	9.7	5.1%	1.6	1.0%	0.8	0.4%	-	0.0%
Hardware	5.1	2.7%	5.2	3.3%	2.4	1.2%	2.5	1.8%
Revenue adj & other	(4.1)	(2.1%)	(4.1)	(2.6%)	(1.3)	(0.6%)	(1.9)	(1.4%)
Total net revenue	$ 192.7	100.0%	$ 159.2	100.0%	$ 203.9	100.0%	$ 136.0	100.0%
License Mix								
FPP	1,036.3	47.5%	1,282.7	76.5%	852	66.1%	903	83.0%
Select	141.5	6.5%	48.2	2.9%	42	3.2%	35	3.2%
Other license	530.2	24.3%	168.0	10.0%	284	22.0%	91	8.3%
Maintenance	122.8	5.6%	30.0	1.8%	21	1.7%		0.0%
Hardware	163.5	7.5%	142.7	8.5%	49	3.8%	60	5.5%
Other	188.6	8.6%	-	0.0%	42	3.3%		0.0%
	2,182.9	100.0%	1,676.5	100.0%	1,289.9	100.0%	1,088.1	100.0%

	Finished Goods			
	Actual		Plan	
Net revenue	$ 2,061.5	100.0%	$ 1,832.5	100.0%
Cost of revenue				
Product Cost	234.6	11.4%	243.6	13.3%
Processing	31.4	1.5%	32.8	1.8%
Inventory adjustments	31.1	1.5%	30.6	1.7%
Freight & distribution	28.0	1.4%	29.4	1.6%
Royalties	30.6	1.5%	30.0	1.6%
Miscellaneous costs	(0.9)	(0.0%)	-	0.0%
Total cost of revenue	354.8	17.2%	366.2	20.0%
Gross margin	1706.7	82.8%	1466.3	80.0%
Revenue Mix				
FPP	$ 1,428.3	69.3%	$ 1,384.1	75.5%
Select	232.3	11.3%	147.8	8.1%
Other license	340.9	16.5%	250.6	13.7%
Maintenance	73.8	3.6%	29.7	1.6%
Hardware	84.8	4.1%	76.2	4.2%
Revenue adj & other	(98.5)	(4.8%)	(55.8)	(3.0%)
Total net revenue	$ 2,061.5	100.0%	$ 1,832.5	100.0%
License Mix				
FPP	10,810.3	49.9%	12,129.3	66.9%
Select	1,754.0	8.1%	1,012.1	5.6%
Other license	3,289.3	15.2%	1,990.6	11.0%
Maintenance	1,430.1	6.6%	452.0	2.5%
Hardware	1,734.1	8.0%	1,544.3	8.5%
Other	2,648.7	12.2%	989.3	5.5%
	21,666.4	100.0%	18,117.5	100.0%

Inventories by Location (in millions)

	Q94-3	Q94-4	Q95-1	Q95-2
Canyon Park	$71	$72	$73	$84
Ireland	16	14	19	17
Puerto Rico	1	1	1	1
Subsidiary warehouses				
Japan	8	7	7	6
Others	35	8	8	9
	$131	$102	$108	$117

- *Consolidated inventories increased 8.3% for the quarter*
- *North America inventories increased by 15% over Q95-1 due primarily to lower than forecasted sell-in for the month of December for Desktop Applications and Consumer products.* Additionally, North America experienced an unusually high level of returns from distributors late in December.

Accounts Receivable by Region - Finished Goods (in thousand)

Description	North America	Europe	Far East	Latin America	Apac	Aime	Total
Current	$165,513	$189,707	$65,995	$43,143	$33,513	$15,778	$513,650
1 - 30 Past	31,448	88,872	3,872	8,045	1,093	1,145	134,475
31 - 60 Past	2,103	20,580	574	1,890	1,360	301	26,808
Over 60 Past	3,322	34,812	1,336	4,283	641	423	44,816
Total	$202,386	$333,970	$71,778	$57,361	$36,607	$17,647	$719,749
DSO	31	63	58	112	85	78	51

- *Total Q95-2 accounts receivable for the finished goods channel increased 31% over Q95-1 primarily due to the strong sales during the holiday season.*
- *Worldwide retail DSO improved from 54 days to 51 days from Q95-1 to Q95-2.*
- *Total worldwide A/R in the over 60 days column increased from 4.4% to 6% from Q95-1 to Q95-2 due to slippage in Europe, ICON and the Far East*

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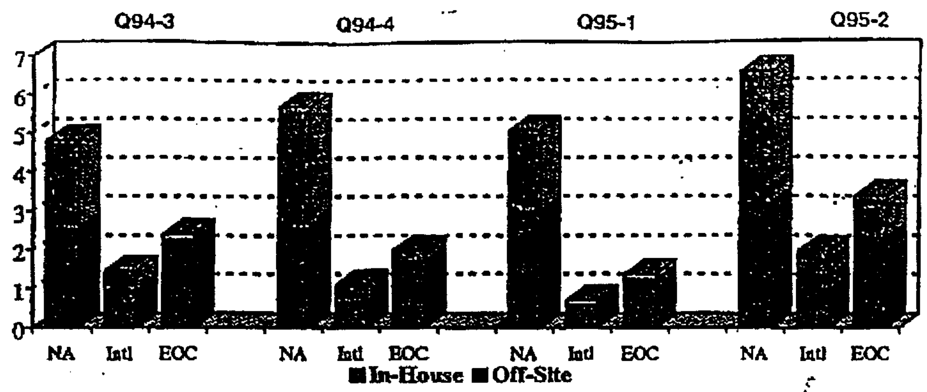
Production Comparison (units in millions)



North America

- *North America produced 6.6 million units during Q95-2. North American production increased 30% over Q95-1 levels.* The largest volume products were Consumer Division products (Games 1.1 million units, Family Reference 417,040 units, Lifestyles 282,107 units), Office (787,043 units), MS-DOS (560,973 units) and Windows (474,883 units).
- *In Q95-2, North America outsourced 51% of its production against a plan of 55%, and 41% during Q95-1.* This increase over Q95-1 was driven by the increased demand of the holiday season.

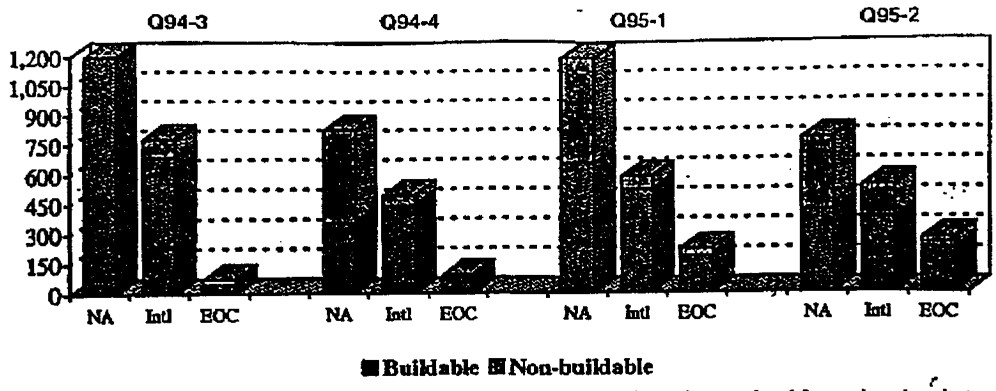
International

- *International OSC's (Latin America, APAC, AIME, Far East) produced 2 million units during Q95-2 which included 700,000 units of turnkey manufacturing performed in the Far East.*
- *During Q95-2, the international OSC's outsourced 23% of its production.*

European Operations Center (EOC)

- *The European Operations Center produced 3.4 million units during Q95-2.* EOC production increased 147% over Q95-1 levels. Full packaged product orders increased from a weekly average of 110,000 in September to 250,000 in November.
- *EOC outsourced 31% of its production compared to 10% in Q95-1.* The increase in outsourcing occurred to establish outside vendors in anticipation for the Win95 and Office95 launches.

Backlog Comparison (units in thousands)



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

North America

- *North America's total Q95-2 backlog of 780,820 units represents a decrease of 35% from the Q95-1 backlog.*
- *Buildable backlog totaled 416,000 units of which 83,000 were on credit hold.* The remaining 333,000 units of buildable backlog represents 6.5 day's production (50,500 units/day).

International

- *Canyon Park International's total Q95-2 backlog of 538,911 units represents a decrease of 8% from the Q95-1 backlog.*
- *Buildable backlog totaled 374,000 units of which 71,000 were on credit hold and approximately 109,000 to be sourced from turnkey production in the Far East.* The remaining 194,000 units of buildable backlog represents 9.7 day's production (20,000 units/day).

European Operations Center

- *EOC's total Q95-1 backlog of 275,000 units represents an increase of 24% over the Q95-1 backlog.*
- *Buildable backlog totaled 218,000 units of which 128,000 (58%) had a ship date due prior to December 30.* The 128,000 shippable backlog represents 2.5 day's production (50,000 units/day).

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Cost Centers

HEADCOUNT

	Q95-1	Q95-2			FY95
	Actual	Actual	Plan	Variance	Plan
USFG End User	590	537	630	93	625
USFG Org	754	825	858	33	858
USFG - Other	129	118	150	32	179
Canada	263	259	278	19	280
Total North America FG	1,736	1,739	1,916	177	1,942
US PSS	1,899	1,990	2,013	23	2,082
MCS	304	334	348	14	393
Europe FG	2,345	2,409	2,680	271	2,736
ICON FG	634	661	725	64	742
Far East FG	388	449	520	71	594
OEM	205	207	235	28	237
Other AT	143	157	189	32	210
Other Channel	3	5	6	1	6
Press	29	33	37	4	37
CHANNELS	7,686	7,984	8,669	685	8,979
Business Systems	993	1,000	1,147	147	1,206
Consumer	601	672	788	116	813
Desktop Applications	1,018	1,042	1,044	2	1,106
Developer	775	802	859	57	893
Personal Systems	690	681	733	52	783
International/Other WPG	335	358	478	120	630
Total WPG	4,412	4,555	5,049	494	5,431
Advanced Consumer Tech	360	462	497	35	574
Advanced Technology - Other	154	160	206	46	220
Microsoft On-Line	114	149	211	62	233
Total AT	628	771	914	143	1,027
TOTAL PRODUCT GROUPS & AT	5,040	5,326	5,963	637	6,458
OPERATIONS	1,567	1,654	1,750	96	1,774
CORPORATE	1,312	1,415	1,544	129	1,561
MICROSOFT	15,605	16,379	17,926	[illegible]	18,772

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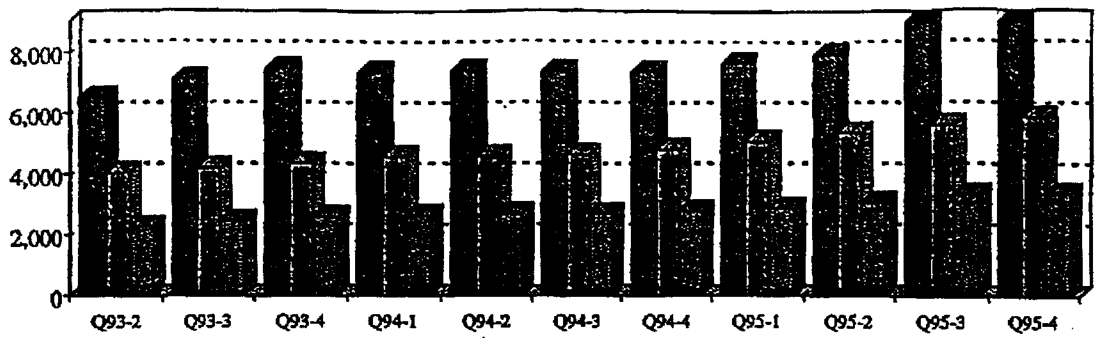
Headcount Trend



The above graph uses actual headcount from Q93-2 through Q95-2 and budgeted headcount for Q95-3 and Q95-4.

Worldwide Headcount by Location

- *The following chart shows the distribution of total Microsoft employees by location.* Approximately 57% (9,353) of total employees (16,379) are employed in the Puget Sound Area.

	Q93-2	Q94-2	Q95-2
Corporate campus	39 %	40 %	44 %
Subsidiaries	32	33	30
Field locations	13	13	13
Other Puget Sound	10	9	8
Canyon Park	6	5	5
Total	100 %	100 %	100 %

Profile of Employees

Domestic Statistics

Description	Q93-2 Employees	Q93-2 Mix	Q94-2 Employees	Q94-2 Mix	Q95-2 Employees	Q95-2 Mix
Sex:						
Female	3,353	38 %	3,540	36 %	3,734	33 %
Male	5,440	62	6,296	64	7,495	67
Ethnicity:						
White	7,629	87 %	8,420	86 %	9,387	84 %
Asian/Pacific Islander	666	8	834	8	1034	9
African American	224	3	262	3	310	3
Hispanic	206	2	231	2	261	2
American Indian/Alaska Native	42	0	51	1	52	1
Other	26	0	38	0	185	1
Age:						
Under 20	72	1 %	38	0 %	40	0 %
20 - 29	3,476	39	3,511	36	3,506	31
30 - 39	3,950	45	4,699	48	5,587	50
40 and Over	1,295	15	1,588	16	2,096	19
Average Age:	31.7		32.3		33.[illegible]	

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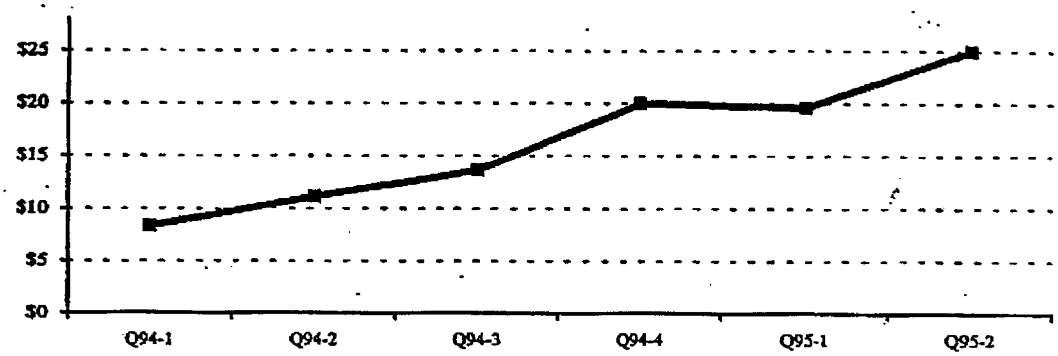
Worldwide Employee Statistics

Average tenure in years	Q93-2	Q94-2	Q95-2
Domestic	2.6	3.1	3.3
Subsidiaries	1.8	2.4	2.9
Worldwide average	2.4	2.8	3.2

Domestic Temporary Employee Expense (in millions)



- *The use of temporary employees increased by $5.4 million from Q95-1 to Q95-2*, from $19.6 to $25.0 million. Of this total, AT accounted for $1.0 million, other product groups $14.1 million, operations and corporate $5.2 million, and channel $4.7 million.
- *Of the $5.4 million increase, product groups accounted for $3.4 million, operations and corporate increased $1.3 million, AT increased $0.4 million, and the channels increased by $0.3 million.* The product group increase included a $1.0 million increase in Consumer and a $0.8 million increase in Personal Systems. The operations and corporate increase included $1.0 million in ITG.

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INFORMATION TECHNOLOGY
(IN MILLIONS)

	Q95-2			FYTD95		
	Actual	Plan	Variance	Actual	Plan	Variance
People	$17.7	$23.9	$6.2	$32.2	$46.9	$14.7
Infrastructure	2.6	3.4	$0.8	5.1	6.6	$1.5
Other expenses	(0.2)	(0.7)	($0.5)	(0.4)	(1.1)	($0.7)
Controllable expense	$20.1	$26.6	$6.5	$36.9	$52.4	$15.5

- *Q95-2 people and infrastructure expenses were significantly below plan, primarily as a result of the quarter delay in approving ITG's fiscal plan and the cancellation of the SAP project.* Significant favorable variances include outsourcing $2.6 million QTD, and $4.9 million FYTD, consulting fees $1.1 million QTD, and $3.7 million FYTD, and payroll $1.2 million QTD and $2.5 million FYTD. It is anticipated that Q95-3 expenses will approximate plan.
- *Other expenses primarily reflect the charge-back of MOS-related ITG activity to the AT group.* Since the release of MSN is linked to the Windows 95 release, both expenses and charge-backs have been behind plan.

Q95-2 Significant Development Projects
(IN THOUSANDS)

- *Beginning in FY95, ITG development projects are accounted for using an average cost methodology.* Both actual and plan costs were calculated using this method. Project costs for major applications are as follows:

	FYTD95	FY95 Plan	Variance	Beta Date
MS Product	$1,034	$3,000	$1,966	Jun-95
Manugistics	302	2,709	2,406	Jun-95
MS Manager	1,683	2,400	717	Jun-95
ARAD	451	1,300	849	Jun-95
MS Plan	336	1,000	664	Apr-95
EMS Rollout (Integration)	219	913	694	N/A
People	668	820	152	May-95
Mariposa (PSS Phone System)	1,180	593	(587)	Oct-94
MSTS	546	546	-	Sep-94
MS Channel	46	440	394	Dec-95
CMS 1.1	406	362	(44)	Oct-94
MS Sales v1.0 (WW Revenue)	363	280	(83)	Oct-94
Fast Track v1.0 (Market Share)	534	204	(330)	Nov-94
SAME	188	183	(5)	Jan-95

- *Mariposa, CMS 1.1, MS Sales and Fast Track 1.0 costs exceeded plan due principally to additional testing required before release.* For example, Mariposa required an additional month of testing, adding approximately 70% more hours than planned to complete the project. The goal of the additional testing was to minimize disruption and possible downtime to PSS. ITG was successful in accomplishing this goal.

FACILITIES

($ IN MILLIONS, SQUARE FEET IN THOUSANDS)

Worldwide Facility Distribution & Spending

Location	Facilities Distribution Square Feet	Mix	FY95YTD Actual	FY95 Plan	Variances	
Corporate Campus	2,436	41%	$59.1	$154.3	$95.2	62%
Other Domestic	1,593	27%	3.6	8.2	4.6	56%
International	1,927	32%	7.3	17.7	10.4	59%
	5,956	100%	$70.0	$180.2	$110.2	61%

- *The size of the worldwide portfolio (in square feet) increased 2% over Q95-1.* Buildings under construction (including Building 26 and the Redmond West campus) and other space committed or planned will add 1.1 million square feet over the next 15 months.

Key Terms for Significant Leases

Location	Square Feet	Annual Amt.	Total Commit.	Expires
Tokyo - existing	94.5	$7,182	$37,278	2/28/00
Tokyo - Chofu	121.3	$5,626	$31,748	2/28/00
Canyon Park Commons	95.3	$1,358	$6,229	7/31/99
Bellevue Place - PSS	105.9	$2,474	$4,123	8/31/96
Lincoln Plaza - PSS	146.6	$2,838	$3,074	1/31/96
Sammammish Pk Place	102.6	$1,749	$2,915	8/31/96

- *MSKK has re-negotiated its existing Tokyo site lease in connection with the expansion into Chofu.* Upon expiration of the current lease, MSKK will be moving R&D and technical groups to lower cost office space in Chofu. The current Tokyo lease expires 2/95, but has been re-negotiated at lower rates to house sales/marketing staff through 2000.
- *Current year leasing activity included space for ITG at Sammamish Park Place and Operations at CP Commons.* Lease costs at Sammamish Park Place are $17 per square foot and $15 per square foot at CP Commons.
- *Leases at Bellevue-area PSS sites will be expiring within the next fiscal year.* Current lease costs (including operating expenses) are approximately $22 per square foot.

Construction and Acquisitions

- *Construction began on the new Redmond West campus in October.* Despite a two-week delay in obtaining the building permit and heavy rainfall during the quarter, the occupancy date of August 1995 remains unchanged. Total cost of Redmond West campus is forecasted at $135 million, including land. FY95 spending is budgeted for $78 million, of which $14 million has been incurred to date.
- *Building 26 is expected to be completed as scheduled* by early Q95-4. The building will house the Business Systems Division, and should be completed within the revised development budget of $40 million.
- *MS purchased Cascade Place for approximately $11 million late in Q95-2.* Cascade Place, a 97,000 square foot building near the campus, will be occupied by MS in early 1996. In the meantime, MS will realize rental income from the current tenants, and occupy space as it becomes available.
- *Ireland WPG expansion is currently on schedule.* Approximately 80,000 square feet of office is being constructed to accommodate localization, at a total cost of $19 million for the building and land.

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Treasury

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CASH & SHORT-TERM SECURITIES

Cash and Investment Portfolio Balances (in millions)

	Sept. 30, 1994		Dec. 31, 1994	
U.S. $ investment portfolio	$ 3,593	95%	$ 3,651	95%
Foreign currency investments	81	2	165	4
Operating bank accounts	102	3	23	1
Worldwide cash and investments	$ 3,776	100%	$ 3,839	100%

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

	Sept. 30, 1994			Dec. 31, 1994		
Security type	Cost	%	Pre-Tax Yield	Cost	%	Pre-Tax Yield
Municipal bonds	$ 1,496	42%	5.8%	$ 1,501	43%	6.1%
Treasury securities	434	12	4.7	698	19	5.5
Floating rate notes	356	10	5.5	356	11	5.9
Commercial paper	537	15	5.0	326	9	6.0
Certificate and time deposits	213	6	5.7	302	5	6.4
Corporate bonds	198	5	5.7	233	7	7.0
Money market preferred	259	7	5.1	156	4	6.5
Other	100	3	5.5	79	2	8.3
U.S. $ investment portfolio	$ 3,593	100%	5.4	$ 3,651	100%	6.1
Yield Comparison:						
90 day T-Bill			4.3			5.7

- *Cash balances increased $63 million during Q95-2.* Cash earned from operations was offset by the repurchase of 5.3 million shares of MS stock for $335 million.
- *The portfolio yield increased 1.2%,* paralleling significant increases in short-term interest rates, ending the quarter at over 6%.
- *99% of the portfolio is held in investment grade securities, 74% in the AA and AAA rated categories.*
- *Many public and private portfolios have reported significant losses this year as a result of highly leveraged investments, the most recent example being Orange County.* The MS portfolio has no exposure to Orange County, and does not hold leveraged investments.

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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	$98	11 %	$76	$13	$3	$6
Merisel	97	11	75	14	2	6
Computer 2000	59	7	38	11	4	6
Olivetti	22	3	9	9	1	3
Tech Pacific	16	2	15	1	0	0
Corporate Software	16	2	10	4	3	(1)
GT Interactive Sftw.	15	2	15	0	0	0
Egghead Software	13	1	12	0	0	1
Software Japan	10	1	10	0	0	0
Acer	10	1	9	1	0	0
Total ten largest	356	41	269	53	13	21
Other	512	59	327	112	24	49
Total Q95-2	$868	100	$596	$165	$37	$70
Total Q95-1	$660	100	$491	$103	$20	$46
Total Q94-4	$643		$480	$91	$22	$50
Aging mix of top ten	100%		75	15	4	6

- *The top 3 customers represent 29% of total accounts receivable at the end of Q95-2, versus 33% at the end of Q95-1*
- *The top 10 customers represent 41% of total accounts receivable at the end of Q95-2, versus 47% at the end of Q95-1.*

Worldwide Accounts Receivable (in millions)

	DSO Q94-3	Q94-4	Q95-1	Q95-2	Total A/R Q94-3	Q94-4	Q95-1	Q95-2	Aging Summary Current	1-30	31-60	60+
Retail												
USFG	44	31	37	28	$197	$185	$200	$165	$140	$21	$1	$3
International	53	59	72	73	333	343	358	555	374.2	114	26	41
					530	528	558	720	514	135	27	44
OEM	33	30	24	27	127	98	81	113	68	22	6	17
Other	84	NM	NM	NM	18	17	21	35	14	8	4	9
Total accts receivable	46	42	47	47	675	643	660	868	$596	$165	$37	$70
Aging percentages									69%	19%	4%	8%
GAAP adjustments					115	146	202	332				
Sales returns reserve					(99)	(143)	(172)	(419)				
Customer deposits/deferred revenue					(43)	(43)	(35)	(44)				
Reseller rebates					(19)	(36)	(24)	(31)				
Allowance for doubtful accounts					(107)	(92)	(104)	(115)				
Accounts receivable-net					$522	$475	$527	$591				

Allowance for doubtful accounts represent about 13% of total accounts receivables

- *Total A/R increased over $200 million to $868 million at the end of Q95-2, from $660 million at Q95-1.*
- *Total A/R in USFG is down by $35 million, offset by increases in International ($208 million) and OEM ($32 million).*
- *While total DSO remained steady at 47 days during Q95-2, USFG improved to 28 days from 37, while OEM slowed to 27 days from 24.*
- *To insure sufficient supply of Microsoft products from Merisel to CompUSA, MS provided a [illegible] million guaranty to ITT in event of payment default by CompUSA.* - In addition, MS provided a [illegible] million guaranty to ITT for purchases by Ballard Computer, secured by an unlimited personal guaranty from Ballard Computer's Chairman and principal stockholder.

Author: Norm Chapman (NormC)

AUTHOR: JEAN-FRANCOIS HEITZ (JEANF)

OTHER ASSETS
(IN MILLIONS)

	Cost			Market Value (if public)		
	Sep. 30, 1994	Dec. 31, 1994	Change	Sep. 30, 1994	Dec. 31, 1994	Change
Financial assets						
Stac Electronics	$ 40	$ 40	$ –	$ –	$ –	$ –
Mtel	30	30	–	–	39 (a)	39
Santa Cruz Operation	20	20	–	37	40	3
Dorling Kindersley	19	19	–	59	65	6
MicroUnity	15	15	–	–	–	–
Metricom	6	6	–	3	3	–
Academic Systems	4	4	–	–	–	–
On Australia (Telecom JV)	–	3	3		–	–
Monotype	3	3	–	–	–	–
Natural Language Inc.	3	3	–	–	–	–
Citrix Systems	2	2	–	–	–	–
ASCII NT	1	1	–	–	–	–
	143	146	3	$ 99	147	$ 48
Valuation allowance	(65)	(68)	(3)			
	78	78	–			
MOSP Joint Venture	–	125	125			
Intellectual property rights						
Consumer Software, Inc.	13	13	–			
Nextbase	–	25	25			
Other	55	57	2			
	68	95	27			
Accumulated amortization	(46)	(50)	(4)			
	22	45	23			
Miscellaneous	47	40	(7)			
	$ 147	$ 288	$ 141			

- *Financial assets include equity and equity-related investments.* An investment in On Australia (Telecom JV) was added during Q95-2. 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.
- *MS entered into a joint venture agreement with TCI to form the Microsoft Online Services Partnership (MOSP).* As described in the feature section, this joint venture will own and operate the Microsoft Network (MSN). Under terms of the agreement, TCI contributed common stock worth $125 million for a 20% interest in the venture, while MS retains an 80% interest in exchange for contribution of certain assets and rights.
- *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. The increase of $27 million during the quarter is essentially due to the acquisition of Nextbase ($25 million).
- *Miscellaneous assets include other long-term assets, primarily lease and other deposits and patent rights.*
- *Excludes warrants with an estimated current market value in excess of $5 million.*

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INVESTMENTS
(IN MILLIONS)

Stac Electronics, Inc.

	Year Ended Sep. 30, 1993	Year Ended Sep. 30, 1994	Change $	Change %
Net revenue	$ 37.0	$ 31.3	$ (5.7)	(15) %
Cost of revenue	7.3	5.0	(2.3)	(32)
Gross profit	29.7	26.3	(3.4)	(11)
Controllable expenses	29.3	26.4	(2.9)	(10)
Net income	$ 0.4	$ (0.1)	$ (0.5)	(125)

- *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.
- *On October 31, 1994, Stac acquired privately-held Ocean Isle Software for $20 million in cash.* Ocean Isle develops and markets both modem and LAN versions of a software product called ReachOut - a remote control and file transfer product that allows users to access their data remotely. The market for this product is estimated at almost $100 million, and IDC expects it to increase 30% annually for the next three years.
- *Sales of Stac's core software product, Stacker, remain sluggish.* The ReachOut purchase is a first step in Stac's strategy to grow through acquisitions.
- *Stac's common stock currently trades at $5.375, and has traded between $5.00 and $6.00 for the last nine months.* The preferred stock is convertible at $9.00 per share.

Mtel Corporation

- *In mid-December, Mtel, the 80% owner of Destineer, and the other Destineer shareholders, including MS, announced an agreement in principle to merge the Destineer subsidiary into Mtel at a conversion price equal to $17.10 per Mtel share.* This agreement is expected to close in the coming quarter. Mtel will continue to develop the Destineer two-way network.
- *As a part of the agreement, Mtel completed a $265 million high-yield senior notes issue, of which MS purchased $25 million.* Given the marketability of these bonds, they are included in the portfolio section rather than as a financial asset.
- *MS is assisting in the development of an optimized network for the Pegasus client and will receive: (i) royalty-free access to the Destineer Network Operations Center (NOC) to ensure compatibility with the Pegasus NOC; (ii) a 2% royalty on all revenues generated by Pegasus clients on Destineer; and (iii) marketing "ownership" of Pegasus's Destineer customers.* Destineer's network is expected to be operational by July 1995.

Santa Cruz Operation, Inc.

	First Quarter Ended Dec. 31, 1993	(Estimate) Fiscal Year Ended Dec. 31, 1994	Change $	Change %
Net revenue	$ 41.6	$ 48.3	$ 6.7	16 %
Cost of revenue	11.3	13.0	1.7	15
Gross profit	30.3	35.3	5.0	17
Controllable expenses	28.8	45.1	16.3	57
Net income	$ 1.5	$ (9.8)	$ (11.3)	NS

- *SCO's net loss in this quarter is due to its acquisition of Visionware on December 3, 1994.* Visionware, based in the UK, brings to SCO its Windows/UNIX integration technology and expertise in its X Server and SQL products. These are key elements in SCO's "Windows friendly" strategy. The purchase price was $14.75 million (about 90% cash and 10% SCO stock).
- *Without Visionware, SCO sales, cost of revenue and net income is estimated to have been: $47.0 million, $12.7 million and $3.6 million (US business slightly below budget), respectively.* EPS would have been $0.11, down 6 cents compared to the previous quarter. The impact of Visionware was to increase sales and operating income $1.7 million and $0.8 million, respectively. However, the acquisition included a one-time charge of $13.2 million.
- *SCO's stock currently trades at $9.50, after having reached a 12 month high of $11.50 in November, 1994.*

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. The company has not yet released its results for the six months ending December 31, 1994.
- *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.*
- *This fall DK Multimedia introduced 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.* These titles have experienced good success in the U.K., but only moderate sales in the U.S.

MicroUnity Systems Engineering, Inc.

- *MicroUnity's fab is completed and generating output. The company's major focus is to develop a clearer product/marketing strategy.*
- *MicroUnity remains in the development phase.* The ACT group is working closely with MU to insure compatibility with MS's broadband efforts. In addition, MS is working on licensing MicroUnity our C++ compiler so that they can host development work.
- *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)

- *There is no significantly different or new information from the previous quarter's update.*
- *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 Mtel/Destineer, that will complement MS's Pulsar and local wireless data strategy.*

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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)

- *There is no significantly different or new information from the previous quarter's update.*
- *In August 1994, MS invested $4 million in Academic Systems, along with TCI., 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.
- *This round of financing raised $12 million for Academic Systems to support its development and marketing needs.* Further, the company is installing the full Introductory Algebra course on six college campuses this Fall.

"On Australia" Telecom JV

- *In mid November 1994, MS signed a Joint Venture agreement with Australian Telecom. Pursuant to this agreement, MS contributed AUD $4.5 million (approximately US $3 million) to "On Australia", the joint venture company.* This company will be the delivery vehicle for the Microsoft Online Services Partnership in Australia.
- *On Australia is owned approximately 50% by MS and the rest by Australian Telecom.* For the software license provided to the JV, MS will get a recurring revenue stream of 8% to 11% of the gross end user bill. In addition, MS's partnership with Australian Telecom, a company with one of the most advanced infrastructures in the world, experience in billing services and content and wide reach across Australia, is synergistic and will provide for rapid growth.

Monotype Typography Limited

	Quarter Ended Sep. 30, 1994	Quarter Ended Dec. 31, 1994	Change $	Change %
Net revenue	$ 2.0	$ 2.1	$ 0.1	5 %
Cost of revenue	0.6	0.6	0.0	0
Gross profit	1.4	1.5	0.1	7
Controllable expenses	1.2	1.2	0.0	0
Net income	$ 0.2	$ 0.3	$ 0.1	50

- *While revenue was marginally higher, costs were essentially flat this quarter versus the prior quarter.* This resulted in a profit margin improvement of approximately 4 points versus the prior quarter. The Company's profitability is largely attributable to headcount reductions in late 1993 and a continuing focus on cost containment. This has resulted in fifteen consecutive profitable months.
- *Revenue for the twelve months ended December 31, 1994 was $7.8 million, with approximately 55% or $4.3 million generated by overseas operations.* During this period, the company generated a $0.9 million profit versus a $0.6 million loss in the corresponding twelve months period the previous year.
- *The company returned to a positive net equity position in November, 1994 thus erasing losses and write-offs of $1.4 million.* Though the company continues to have positive cash flow, its overall liquidity remains tight. However, due to fiscal controls, the company is on target to achieve its operating budget for fiscal 1995.
- *MS's $2.8 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.

Author: Jean-Francois Heitz (JeanF)

Natural Language Incorporated

	Quarter Ended Dec. 31, 1993	Quarter Ended Dec. 31, 1994	Change $	Change %
Net revenue	$ 0.4	$ 0.2	$ (0.2)	(50) %
Cost of revenue	0.1	0.0	(0.1)	(100)
Gross profit	0.3	0.2	(0.1)	(33)
Controllable expenses	0.9	0.3	(0.6)	(67)
Net income	$ (0.6)	$ (0.1)	$ 0.5	(84)

- *MS is in the final stages of acquiring the assets of NLI.* The consideration is as follows: (i) $1.25 million; (ii) up to $250,000 in expenses related to winding down the company; (iii) an additional $1.25 million if we incorporate the technology in a database product within 5 years; and (iv) $500,000 if we incorporate the technology in any non-database products.
- *Offers have been extended to all seven of NLI's technical employees, six of whom have accepted their offers to date.*
- *As reported last quarter, NLI's headcount is down to the core staff of eight and the company is conserving cash as it readies itself for sale.* As a result the business has shrunken substantially year over year.

Citrix Systems, Inc.

	Year Ended Dec. 31, 1993	Year Ended Dec. 31, 1994	Change $	Change %
Net revenue	$ 5.0	$ 10.1	$ 5.1	102 %
Cost of revenue	0.9	2.1	1.2	133
Gross profit	4.1	8.0	3.9	95
Controllable expenses	6.8	7.6	0.8	12
Net income	$ (2.7)	$ 0.4	$ 3.1	NM

- *Citrix had excellent sales of $3.0 million in the fourth quarter driven by the continued success of WinView 2.3 and the introduction of its TCP/IP-capable product.* Margins increased due to a successful price increase for the WinView 2.3 product. Profitability in the fourth quarter also improved due to the reversal of certain reserves.
- *The company has begun major marketing expansions into Europe and with OEM customers.* In addition, Citrix is preparing for the introduction of its NT-based product later this year.
- *For the year, Citrix made its twin goals of exceeding $10 million of sales and being profitable.* The company has begun conversations with investment bankers regarding a possible IPO later this year.

ASCII Network Technology, Inc.

- *There is no significantly different or new information from the previous quarter's update.*
- *In late May 1994, 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, NTT Data Corp., CSK Corp. and IBJ Ltd. Fifty percent of the investment took place in early June 1994, and the balance was funded in Q95-1.
- *ASCII NT's mission is to 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.* To help accomplish this mission, the company had employed 25 persons by October 1994 and plans to increase its work force to 40 employees by March 1995.
- *ASCII NT's strategy is to focus on Windows NT.* This is underscored by its inclination to sell by early 1995 its marketing rights to Informix back to the company. Further, the company's major longer term goals are to become profitable in two years, achieve cumulative positive retained earnings in four years and go public in 2000.

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Investments Subsequent to December 31, 1994

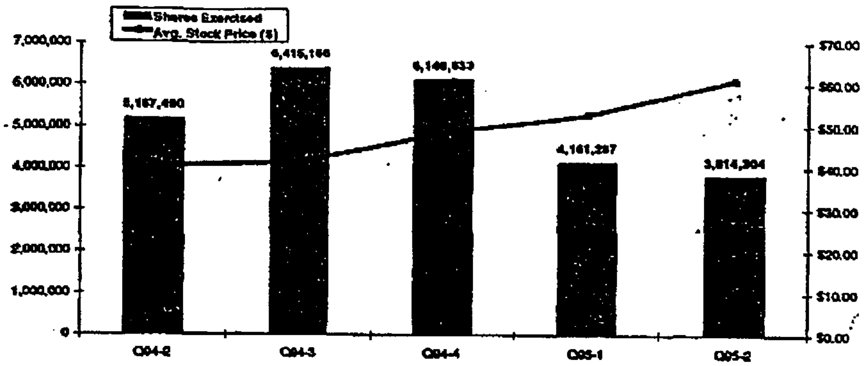
UUNET Technologies, Inc.

	Quarter Ended Sep. 30, 1993	Quarter Ended Sep. 30, 1994	Change $	Change %
Net revenue	$ 1.9	$ 3.2	$ 1.3	68 %
Cost of revenue	0.8	2.9	2.1	263
Gross profit	1.1	0.3	(0.8)	(73)
Controllable expenses	1.4	1.6	0.2	14
Net income	$ (0.3)	$ (1.3)	$ (1.0)	333

- *UUNET is a leading Internet access provider with calendar 1994 revenues of $12.4 million (4th quarter revenue was $4.1 million) and 130 employees.* The company is based in Falls Church, VA and was founded in 1987.
- *In addition to MS and UUNET founder (Rick Adams), other major investors include Accel Partners, Menlo Ventures, New Enterprise Associates and Mitch Kapor.* The company closed an $8.5 million venture round in September at a valuation of $49 million.
- *UUNET's business plan calls for it to reach profitability in the 3rd calendar quarter of 1995 and the company plans to go public in the same time frame.*
- *MS signed, December 8, 1994, a binding Memorandum of Understanding, under which MS will invest in UUNET, enter a Network Agreement and enter a Loan Agreement.*
- *MS will purchase 8% of the company for $3.9 million and receive warrants to purchase an additional 11% for $12.5 million (both percentages calculated on pre-money basis).*
- *Under the Network Agreement, UUNET will build a dedicated TCP/IP network which will carry Internet and other local dial-up traffic for Marvel and for other MS services.* MS will pay 100% of the cost of this network for 5 years (minimum $56 million, depending on volume) and will make a loan to UUNET covering the first 2 years' capital equipment requirements (maximum of $25 million).
- *In lieu of taking a mark-up on the cost of the network, UUNET will be entitled to 15% of network capacity at peak hours and 40% during off-peak hours.* At volume, the per hour cost to MS is estimated to be approximately one-third of that available from providers such as AT&T and Sprint.

STOCK MATTERS

Stock Administration



- *In Q95-2, the number of shares exercised under the stock option program decreased 26.5% while the number of option exercises increased by 12.9% from the same period the previous year.* In FY93 August review, stock option eligibility guidelines were broadened to include non exempt employees in addition to expanding the stock class 6 into classes 6,7, and 8. The affect was a significant increase (76%) in the number of grants relative to the number of shares included in the grant.
- *The cumulative outstanding options as of 12/31/94 are 122,612,216 at an average price of $27.56. The range of option prices is from $.0011 to $62.25 per share.* Authorized but unissued options total 216,449,924 at December 31, 1994.
- *During Q95-2, 921 stock option grants totaling 2,303,083 shares were processed for new hires.*
- *The final approved August 1994 international review option models were received and processed in Q95-2 for Belgium, Canada, England, Italy, Japan, Netherlands and Puerto Rico.* A total of 676,395 shares were granted to 829 international employees.
- *Under the ESPP program, a total of 417,918 shares were issued to 7,926 domestic employees at a purchase price of $42.71 in Q95-2.* International numbers will be available next quarter.

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	3,959,655	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
Q95-2	5,320,000	334	62.81
LTD	43,210,905	$1,562	36.15

- *During Q95-2, MS sold 4 million put warrants on MS stock, with strike prices ranging from $57.59 to $59.04 and maturities of 12-18 months.* MS received a cash premium of $16 million on the sale of these puts, bringing total program cash proceeds to $26 million.
- *Approximately 1.6 million puts expired in Q95-2, leaving an outstanding total of 6.4 million puts.*
- *This program has effectively reduced the LTD stock buyback cost per share by $0.60 (from $36.15 to $35.55).* A liability of $297 million was recorded as an offset to retained earnings to recognize the amount that would be required to purchase all 6.4 million shares at their respective put strike prices.

Industry Watch

COMPETITOR HIGHLIGHTS

Novell

- *Revenues for the fiscal year ended in October grew 9% to $2 billion.* Net income was $207 million.
- *Released UnixWare 2, its next generation of the UNIX System V application platform.* UNIX systems product revenues grew $83 million year over year (excluding the $81 million license fee from Sun).
- *Released NetWare 4.1, although compatible versions of Novell's NetWare Loadable Modules are still under development.* NetWare sales increased only 11% year over year to $1 billion.
- *Released Perfect Office 3.0, its desktop application suite that has ties to NetWare 4.1.* Total annual applications revenues declined 17% to $591 million.
- *Sold its Utah manufacturing plant to R.R. Donnelley.*
- *Ray Noorda retired from the Board of Directors in November.*

Lotus

- *Desktop applications revenues have been weak, declining 17% in the September quarter (from the comparable quarter).* During the first three quarters of calendar 1994, SmartSuite represented 44% of Windows desktop revenue.
- *During the September quarter, desktop applications represented 67% of revenues and communications products and services comprised 33% of revenues.* Analysts estimate that Notes and communications business will account for 50% of Lotus revenue by the end of 1995.
- *Notes revenues for calendar 1994 were estimated at $200 million.* Lotus has shipped server versions of Notes for: Windows, NT, NetWare, HP/UX, SCO UNIX 3.2, and IBM AIX. Sun, HP, and SCO will bundle Notes with their server products.
- *Lotus's stock price was bolstered by rumors of a takeover by Oracle.* Lotus's cap value exceeds $2 billion.

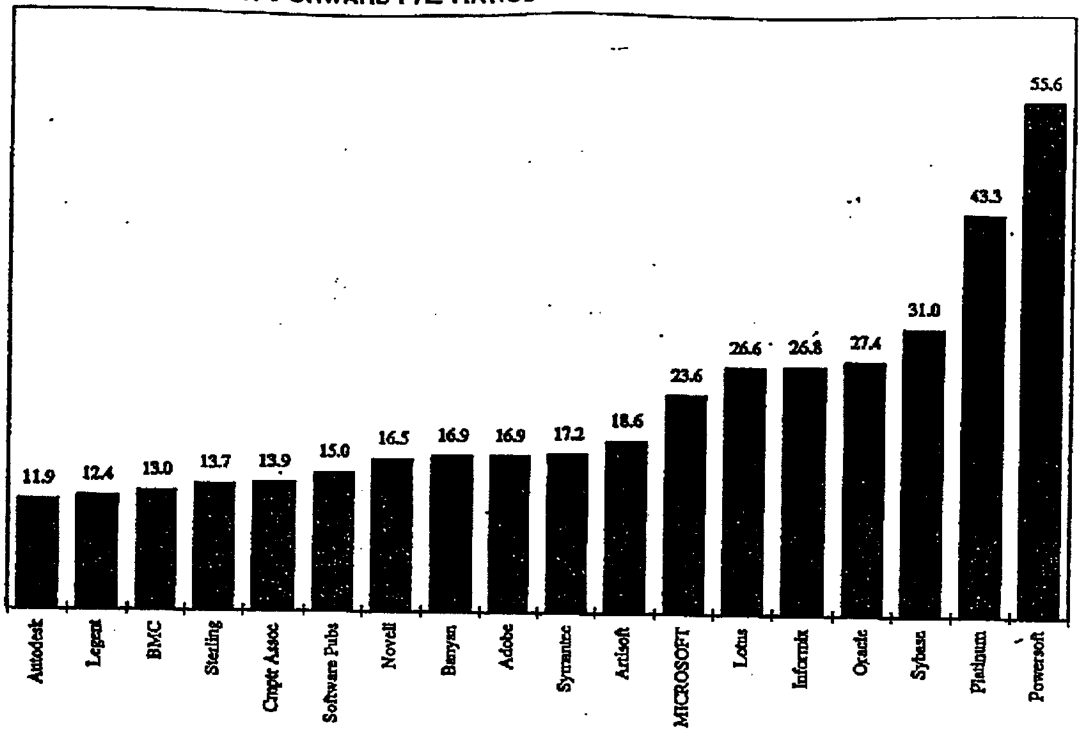
Oracle

- *BellSouth announced that it replaced Oracle with Sybase as the provider of interactive video software for its Atlanta interactive TV trial.*
- *In the November quarter, revenues increased 48% over the comparable quarter.* Database server license sales rose 67%.
- *Licenses represent 55% of revenues while services make up 45%.*
- *Announced its intention to distribute a new low-end database product over the Internet.*
- *A new version of Oracle tools called CDE 2.0 will be launched soon.* This new generation of its client server development tool set will include lower-priced Windows tools which should fuel continued strong revenue growth.
- *Stockholders approved an increase in common shares to 800 million from 400 million.*
- *Market rumors have Oracle, Matsushita, and Phillips acquiring Apple, with Oracle ending up with Apple's software assets.* Apple's cap value exceeds $5 billion.

Others

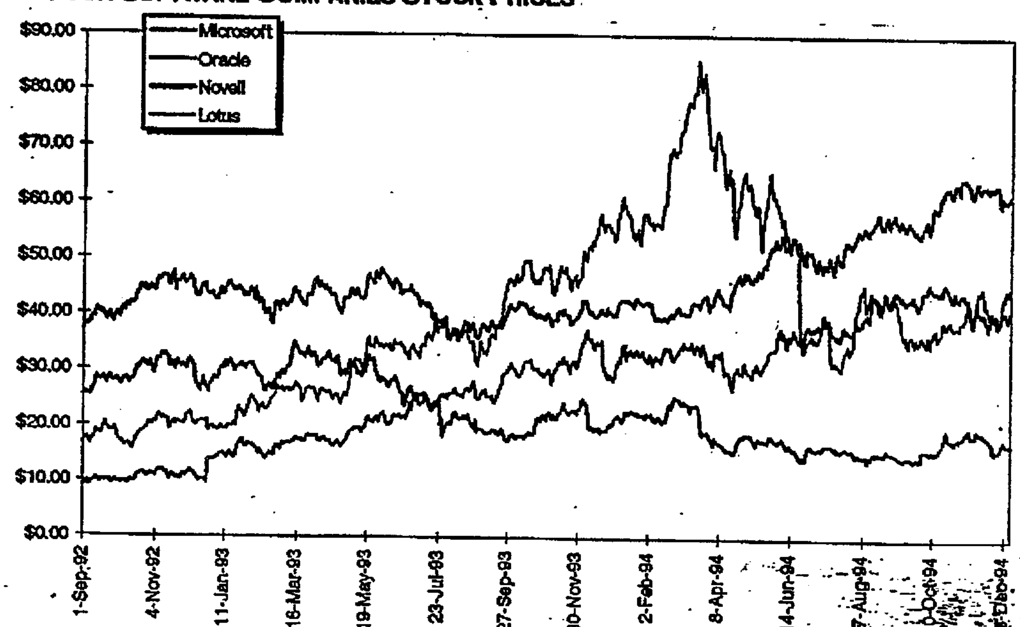
- *Borland's cap value is down to $200 million.* In 1991, Borland acquired Ashton-Tate for $437 million
- *Philippe Kahn resigned as CEO of Borland.* He was PC Magazine's Man of the Year in 1991.
- *Sybase and Powersoft agreed to merge.* Pro forma combined sales for the year ended September 30, 1994 were $730 million.

SOFTWARE INDUSTRY FORWARD P/E RATIOS



Forward P/E ratios are calculated based upon December 31, 1994 stock prices and analysts's consensus estimates for the next four quarters.

TOP FOUR SOFTWARE COMPANIES STOCK PRICES



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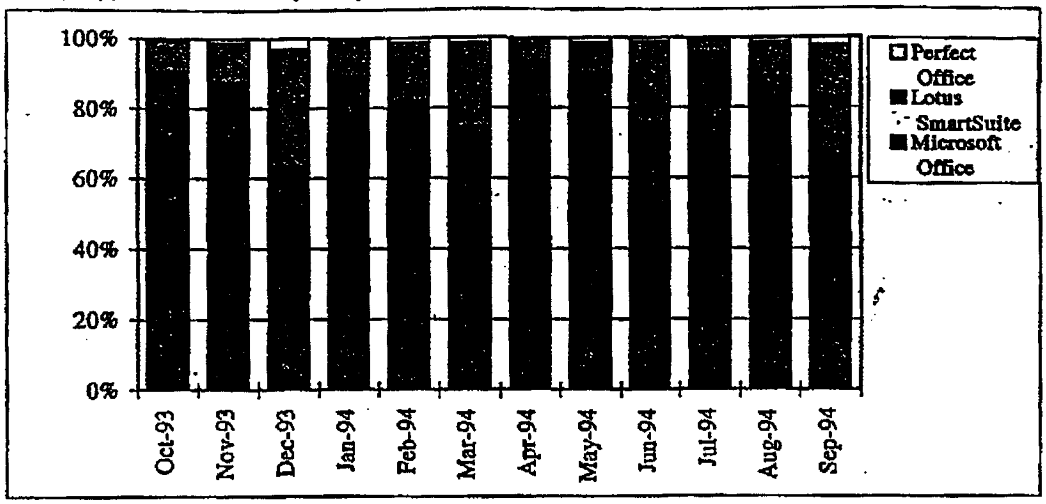
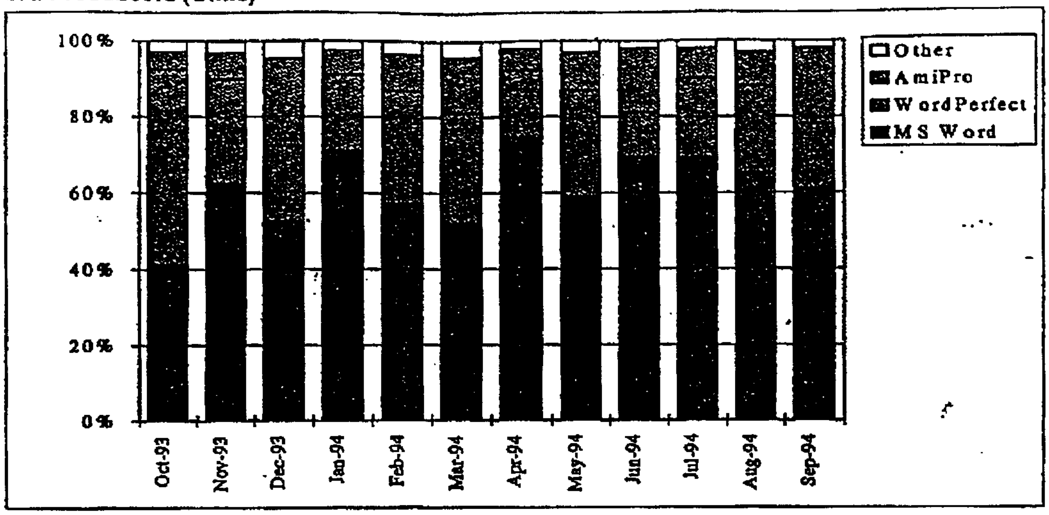
WORLDWIDE MARKET SHARE

Desktop Application Suites (Units)



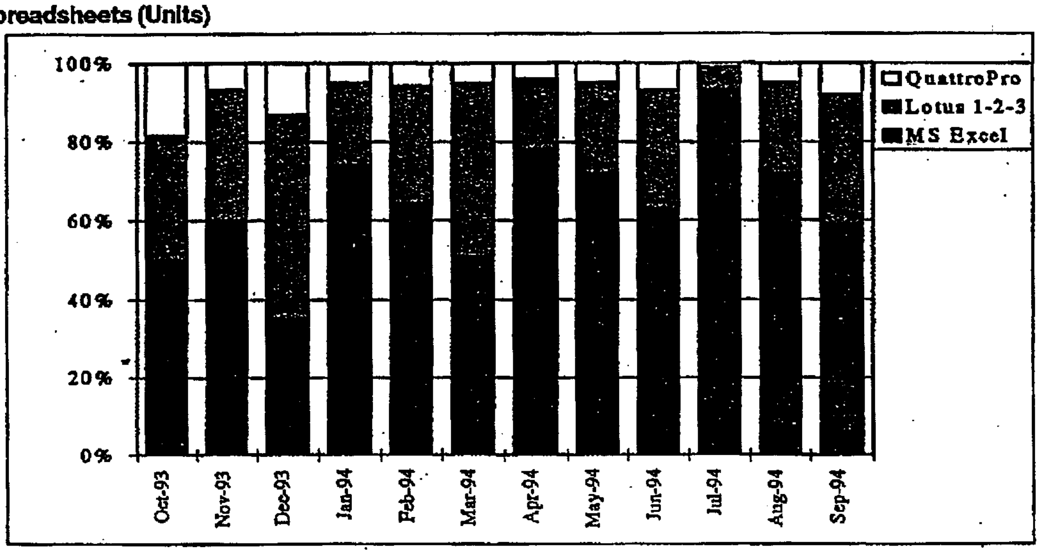
Information presented is for the Windows environment on a worldwide basis.
Market share is calculated by Microsoft Office marketing personnel and is based on SPA, IDC, and DataQuest information.

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.

TOP FOUR SOFTWARE COMPANIES
(IN MILLIONS)

Most recent quarter	Microsoft 12/31/94		Novell (a) 10/31/94		Lotus 9/30/94		Oracle 11/30/94	
Net revenue	$ 1,482	100.0%	$ 486	100.0%	$ 235	100.0%	$ 670	100.0%
Cost of revenue	222	15.0	112	23.0	42	17.9	187	27.9
Gross profit	1,260	85.0	374	77.0	193	82.1	483	72.1
Research and development	199	13.4	90	18.5	42	17.9	57	8.5
Sales and marketing	479	32.3	164	33.8	124	52.6	245	36.6
General and administrative	62	4.2	38	7.8	18	7.7	43	6.4
Non-recurring charge	–	–	61 (b)	12.6	77	32.8 (e)	–	–
Total operating expenses	740	49.9	353	72.7	261	111.0	345	51.5
Operating income	520	35.1	21	4.3	(68)	(28.9)	138	20.6
Nonoperating income	37	2.5	10	2.1	3	1.3	2	0.3
Income before income taxes	557	37.6	31	6.4	(65)	(27.6)	140	20.9
Provision (benefit) for income taxes	184	12.4	11	2.3	1	0.5	46	6.9
Net income	$ 373	25.2%	$ 20	4.1%	$ (66)	(28.1)%	$ 94	14.0%
Average shares outstanding	625		369		48		296	
EPS	$ 0.60		$ 0.06		$ (1.39)		$ 0.32	

Trailing twelve months	Microsoft		Novell (a)		Lotus		Oracle	
Net revenue	$ 5,266	100.0%	$ 1,998 (c)	100.0%	$ 985	100.0%	$ 2,378	100.0%
Cost of revenue	827	15.7	467	23.4	183	18.6	627	26.4
Gross profit	4,439	84.3	1,531	76.6	802	81.4	1,751	73.6
Research and development	703	13.3	347	17.4	145	14.7	217	9.1
Sales and marketing	1,609	30.6	562	28.1	489	49.7	881	37.0
General and administrative	202	3.8	162	8.1	69	7.0	154	6.5
Nonrecurring charge	–	–	190 (d)	9.5	77	7.8	–	–
Total operating expenses	2,514	47.7	1,261	63.1	780	79.2	1,252	52.6
Operating income	1,925	36.6	270	13.5	22	2.2	499	21.0
Nonoperating income	25	0.5	27	1.4	7	0.7	8	0.3
Income before income taxes	1,950	37.1	297	14.9	29	2.9	507	21.3
Provision (benefit) for income taxes	643	12.3	90	4.5	35	3.5	168	7.0
Net income	$ 1,307	24.8%	$ 207	10.4%	$ (6)	(0.6)%	$ 339	14.3%
Average shares outstanding	618		369		48		296	
EPS	$ 2.11		$ 0.56		$ (0.12)		$ 1.15	

(a) Novell results include WordPerfect operations for all periods presented.
(b) Novell nonrecurring charges in the October quarter include restructuring costs and expenses related to the WordPerfect merger.
(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) Novell trailing twelve month results include a charge of $114 million related to the purchase of Quattro Pro from Borland.
(e) Lotus September quarter results include a European restructuring charge of $9 million and a $68 million write-off of purchased R&D in connection with the acquisitions of SoftSwitch and Edge Research.

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TOP FOUR SOFTWARE COMPANIES (CONTINUED)
(IN MILLIONS)

Balance sheets	Microsoft 12/31/94		Novell 10/31/94		Lotus 9/30/94		Oracle 11/30/94	
Current assets:								
Cash and short-term investments	$ 3,839	64%	$ 862	44%	$ 389	45%	$ 329	19%
Accounts receivable - net	591	10	391	20	194	22	539	31
Inventories	117	2	–	–	19	2	–	–
Other	149	3	200	10	25	3	169	9
Total current assets	4,696	79	1,453	74	627	72	1,037	59
Property, plant and equipment - net	977	16	395	20	133	15	442	25
Capitalized software	–	–	–	–	98	11	100	6
Other assets	288	5	115	6	16	2	165	10
	$ 5,961	100%	$ 1,963	100%	$ 874	100%	$ 1,744	100%
Current liabilities	$ 1,096	18%	$ 463	24%	$ 238	27%	$ 722	41%
Long-term liabilities	–	–	14	1	104	12	123	7
Other liabilities	125	2	–	–	–	–	–	–
Put warrants	297	5	–	–	–	–	38	2
Stockholders' equity	4,443	75	1,486	75	532	61	861	50
	$ 5,961	100%	$ 1,963	100%	$ 874	100%	$ 1,744	100%

Other data	Microsoft	Novell	Lotus	Oracle
Closing stock price (Dec. 31, 1994)	$61.13	$17.13	$41.00	$44.13
Common shares outstanding	625	369	48	296
Market value	$38,206	$6,321	$1,968	$13,062
Price/revenue ratio	7.3x	3.2x	2.0x	5.5x
Price/earnings ratio - trailing twelve	28.8x	30.6x	n/m	38.4x
Price/earnings ratio - future 4 quarters	23.6x	16.5x	26.6x	27.4x
Headcount (most recent disclosure)	16,379	9,463	4,738	12,500
Net revenue/employee	$321,509	$211,138	$207,894	$190,240
Book value per share	$7.11	$4.03	$11.08	$2.91
Price/book value ratio	8.6x	4.3x	3.7x	15.2x
Growth statistics (over comparable quarter):				
Revenue	31%	(5%)	(2%)	48%
Research and development	33%	11%	29%	25%
Sales and marketing	42%	16%	8%	47%
General and administrative	48%	(15%)	1%	36%
Net income	29%	(80%) (a)	(463%) (b)	51%

(a) Novell October quarter results included $61 million of nonrecurring charges. Absent the charges, net income would have been $81 million, a decrease of 21% from the comparable quarter of the prior year.
(b) Lotus September quarter results included $77 million of nonrecurring 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)

Income statement	Adobe 11/25/94	Artisoft 9/30/94	Autodesk 10/31/94	BMC 9/30/94	Banyan 9/30/94
Most recent quarter					
Net revenue	$165	$30	$108	$80	$39
Net income (loss)	(48) (a)	2	16	24	4
EPS	(0.79)	0.11	0.32	0.96	0.22
Trailing twelve months					
Net revenue	$598	$117	$427	$314	$142
Net income (loss)	6	12	64	64	4
EPS	0.10	0.83	2.08	2.50	0.20
Net income (loss) as a % of net revenues	1%	10%	15%	21%	3%
Balance sheet					
Cash	$400	$16	$218	$58	$50
Other current assets	132	54	112	83	33
Other assets	94	23	96	291	30
	$626	$93	$426	$432	$113
Liabilities	$169	$18	$100	$163	$42
Equity	457	75	326	269	71
	$626	$93	$426	$432	$113
Other data					
Closing stock price (Dec.31, 1994)	$29.75	$7.81	$39.63	$56.88	$17.88
Common shares outstanding (in millions)	61	15	50	25	18
Market value (in millions)	$1,815	$117	$1,982	$1,422	$322
Price/revenue ratio	19.8x	1.0x	4.6x	4.5x	2.3x
Price/earnings ratio - trailing twelve	311.6x	9.4x	19.1x	22.7x	91.0x
Price/earnings ratio - future 4 qtrs.	16.9x	18.6x	11.9x	13.0x	16.9x
Headcount (most recent disclosure)	2,000	426	1,788	987	692
Net revenue/employee	$299,050	$274,491	$238,903	$317,629	$204,962
Book value per share	$7.49	$5.00	$6.52	$10.76	$3.94
Price/book value ratio	4.0x	1.6x	6.1x	5.3x	4.5x
Growth statistics (over comparable quarter):					
Revenue	15%	47%	10%	18%	20%
Research and development	26%	57%	12%	20%	43%
Sales and marketing	14%	39%	14%	14%	32%
General and administrative	4%	(27%)	15%	n/a	10%
Net income	(325%) (a)	(47%)	6%	20%	14%

(a) Adobe's net loss included costs of $72 million in connection with its merger with Aldus and $12 million purchased R&D. Absent these charges, net income would have been $30 million, an increase of 50% over the comparable quarter of the prior year.

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SOFTWARE COMPANY METRICS (CONTINUED)
(IN MILLIONS)

Income statement	Borland 9/30/94	Computer Assoc. 9/30/94	Informix 9/30/94	Intuit 10/31/94	Legent 9/30/94	Platinum 9/30/94
Most recent quarter						
Net revenue	$81	$623	$117	$68	$148	$15
Net income (loss)	0	130	17	(54) (a)	14	0
EPS	0.01	0.78	0.25	(2.73)	0.40	0.00
Trailing twelve months						
Net revenue	$313	$2,308	$420	$253	$502	$57
Net income (loss)	(14)	328	60	(222)	54	(56)
EPS	(0.49)	1.95	0.90	(12.49) (b)	1.53	(4.50)
Net income (loss) as a % of net revenues	(4%)	14%	14%	(88%)	11%	(99%) (d)
Balance sheet						
Cash	$111	$277	$161	$34	$123	$19
Other current assets	63	704	133	91	277	17
Other assets	177	1,972	82	142	312	23
	$351	$2,953	$376	$267	$712	$59
Liabilities	$148	$1,744	$140	$98	$280	$44
Equity	203	1,209	236	169	432	15
	$351	$2,953	$376	$267	$712	$59
Other data						
Closing stock price (Dec. 31, 1994)	$6.13	$48.50	$32.13	$66.75	$28.75	$13.00
Common shares outstanding (in millions)	29	168	67	20	36	13
Market value (in millions)	$178	$8,148	$2,153	$1,335	$1,035	$169
Price/revenue ratio	0.6x	3.5x	5.1x	5.3x	2.1x	3.0x
Price/earnings ratio - trailing twelve	n/m	24.9x	35.8x	n/m	18.8x	n/m
Price/earnings ratio - future 4 qrts.	n/m	13.9x	26.8x	65.4x	12.4x	43.3x
Headcount (most recent disclosure)	1,650	6,900	1,718	1,300	2,700	485
Net revenue/employee	$189,773	$334,506	$244,501	$194,757 (c)	$185,827	$117,068
Book value per share	$7.00	$7.20	$3.52	$8.45	$12.00	$1.15
Price/book value ratio	0.9x	6.7x	9.1x	7.9x	2.4x	11.3x
Growth statistics (over comparable quarter):						
Revenue	(24%)	21%	30%	93%	20%	28%
Research and development	25%	5%	42%	202%	(3%)	17%
Sales and marketing	(18%)	9%	31%	108%	16%	(33%)
General and administrative	n/a	n/a	(5%)	231%	n/a	(15%)
Net income	(88%)	49%	14%	n/m	5%	(101%)

(a) Intuit's quarterly results included a purchased R&D write off of $44 million in connection with the Parsons acquisition.
(b) Intuit trailing twelve month results also 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.
(d) Platinum restated its financial results during 1994. The company recorded a $17 million charge to settle a securities lawsuit, a restructuring charge of $7 million, and legal costs of $3 million in connection with the litigation.

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SOFTWARE COMPANY METRICS (CONTINUED)
(IN MILLIONS)

Income statement	Powersoft 9/30/94	Software Publishing 9/30/94	Sterling 9/30/94	Sybase 9/30/94	Symantec 9/30/94
Most recent quarter					
Net revenue	$34	$14	$132	$183	$79
Net income (loss)	3	4	19	19	8
EPS	0.28	(0.32)	0.74	0.36	0.22
Trailing twelve months					
Net revenue	$112	$62	$470	$617	$313
Net income (loss)	12	(5) (a)	58	65	3 (b)
EPS	1.03	(0.40)	2.98	1.20	0.08
Net income (loss) as a % of net revenues	11%	(8%)	12%	10%	1%
Balance sheet					
Cash	$37	$48	$144	$199	$60
Other current assets	31	15	153	157	85
Other assets	21	5	192	143	40
	$89	$68	$489	$499	$185
Liabilities	$25	$38	$313	$197	$106
Equity	64	30	176	302	79
	$89	$68	$489	$499	$185
Other data					
Closing stock price (Dec. 31, 1994)	$82.25	$4.50	$36.75	$52.00	$17.50
Common shares outstanding (in millions)	12	12	21	55	37
Market value (in millions)	$987	$54	$772	$2,860	$648
Price/revenue ratio	8.8x	0.9x	1.6x	4.6x	2.1x
Price/earnings ratio - trailing twelve	80.0x	n/m	12.3x	43.3x	224.5x
Price/earnings ratio - future 4 qrts.	55.6x	15.0x	13.7x	31.0x	17.2x
Headcount (most recent disclosure)	292	230	3,000	2,528	1,204
Net revenue/employee	$382,099	$267,439	$156,798	$244,182	$259,749
Book value per share	$5.33	$2.50	$8.38	$5.49	$2.14
Price/book value ratio	15.4x	1.8x	4.4x	9.5x	8.2x
Growth statistics (over comparable quarter):					
Revenue	171%	(2%)	19%	63%	36%
Research and development	159%	(57%)	34%	56%	40%
Sales and marketing	181%	(52%)	21%	54%	20%
General and administrative	145%	(72%)	n/a	39%	18%
Net income	50%	112%	139%	76%	230%

(a) Software Publishing trailing twelve month results included restructuring costs of $26 million related to workforce reductions and leases.
(b) Symantec trailing twelve month results included acquisition and restructuring costs of $31 million.

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HARDWARE COMPANY METRICS
(IN MILLIONS)

	Apple	Compaq	DEC	Dell	Gateway
Income statement	9/30/94	9/30/94	9/30/94	10/31/94	9/30/94
Most recent quarter					
Net revenue	$2,493	$2,838	$3,122	$885	$644
Net income (loss)	115	229	(195)	39	28
EPS	0.95	0.75	(1.44)	0.93	0.35
Trailing twelve months					
Net revenue	$9,189	$9,817	$13,558	$3,186	$2,423
Net income (loss)	310	847	(2,199) (a)	98	102
EPS	2.61	3.18	(15.86)	2.42	1.34
Net income (loss) as a % of net revenues	3%	9%	(16%)	3%	4%
Balance sheet					
Cash	$1,258	$392	$881	$400	$115
Other current assets	3,218	4,572	5,535	874	391
Other assets	827	967	3,550	116	101
	$5,303	$5,931	$9,966	$1,390	$607
Liabilities	$2,920	$2,584	$6,820	$808	$271
Equity	2,383	3,347	3,146	582	336
	$5,303	$5,931	$9,966	$1,390	$607
Other data					
Closing stock price (Dec. 31, 1994)	$39.00	$39.50	$33.25	$41.00	$21.63
Common shares outstanding (in millions)	120	269	142	41	78
Market value (in millions)	$4,680	$10,626	$4,722	$1,681	$1,696
Price/revenue ratio	0.5x	1.1x	0.3x	0.5x	0.7x
Price/earnings ratio - trailing twelve	14.9x	12.4x	n/m	17.0x	16.2x
Price/earnings ratio - future 4 qtrs.	10.8x	10.7x	54.5x	10.4x	12.1x
Headcount (most recent disclosure)	14,592	10,541	73,800	7,500	3,836
Net revenue/employee	$629,711	$931,316	$183,717	$424,750	$631,578
Book value per share	$19.86	$12.44	$22.15	$14.20	$4.29
Price/book value ratio	2.0x	3.2x	1.5x	2.9x	5.0x
Growth statistics (over comparable quarter):					
Revenue	16%	63%	4%	17%	61%
Research and development	(13%)	24%	(9%)	32%	n/a
Sales and marketing	(9%)	48%	(4%)	0%	92%
General and administrative	n/a	n/a	n/a	n/a	n/a
Net income	4,204%	114%	(135%)	276%	17%

(a) DEC trailing twelve month net loss includes a restructuring charge of $1.2 billion.

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HARDWARE COMPANY METRICS (CONTINUED)
(IN MILLIONS)

Income statement	Hewlett Packard 10/31/94	IBM 9/30/94	Intel 12/31/94	Silicon Graphics 9/30/94	Sun 10/2/94
Most recent quarter					
Net revenue	$7,002	$15,431	$3,228	$427	$1,273
Net income (loss)	476	710	372 (a)	42	38
EPS	1.83	1.18	0.86	0.27	0.40
Trailing twelve months					
Net revenue	$24,991	$63,551	$11,521	$1,607	$5,003
Net income (loss)	1,599	2,111	2,304	157	218
EPS	6.14	3.62	5.28	1.01	2.07
Net income (loss) as a % of net revenues	6%	3%	20%	10%	4%
Balance sheet					
Cash	$2,478	$10,804	$2,410	$477	$783
Other current assets	10,031	29,346	3,757	644	1,456
Other assets	7,058	38,918	7,649	476	571
	$19,567	$79,068	$13,816	$1,597	$2,810
Liabilities	$9,641	$56,605	$3,805	$624	$1,120
Put warrants	0	0	744	0	0
Equity	9,926	22,463	9,267	973	1,690
	$19,567	$79,068	$13,816	$1,597	$2,810
Other data					
Closing stock price (Dec. 31, 1994)	$99.88	$73.50	$63.88	$31.16	$35.50
Common shares outstanding (in millions)	260	586	433	157	96
Market value (in millions)	$25,969	$43,071	$27,660	$4,892	$3,408
Price/revenue ratio	1.0x	0.7x	2.4x	3.0x	0.7x
Price/earnings ratio - trailing twelve	16.3x	20.3x	12.1x	30.9x	17.1x
Price/earnings ratio - future 4 qtrs.	13.8x	12.6x	10.0x	23.6x	12.3x
Headcount (most recent disclosure)	96,200	235,000	29,500	4,357	13,300
Net revenue/employee	$259,782	$270,430	$390,542	$368,913	$376,154
Book value per share	$38.18	$38.33	$21.40	$6.20	$17.60
Price/book value ratio	2.6x	1.9x	3.0x	5.0x	2.0x
Growth statistics (over comparable quarter):					
Revenue	23%	5%	35%	42%	33%
Research and development	12%	(23%)	9%	36%	11%
Sales and marketing	8%	(9%)	21%	37%	26%
General and administrative	n/a	n/a	n/a	n/a	n/a
Net income	60%	1,114%	(37%)	63%	131%

(a) Intel's December quarter included a pretax charge of $475 million to cover replacement and other costs associated with a divide problem in the floating point unit of the Pentium chip.

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KEY RELATIONSHIPS
(IN MILLIONS)

Income statement	Egghead 9/30/94	Merisel 9/31/94	RR Donnelley 9/30/94
Most recent quarter			
Net revenue	$194	$1,231	$1,243
Net income (loss)	(1)	3	80
EPS	(0.06)	0.09	0.52
Trailing twelve months			
Net revenue	$792	$4,544	$4,741
Net income (loss)	(1) (a)	26	260
EPS	(0.08)	0.85	1.69
Net income (loss) as a % of net revenues	(0%)	1%	5%
Balance sheet			
Cash	$29	$0	$21
Other current assets	217	886	1,277
Other assets	22	174	2,814
	$268	$1,060	$4,112
Liabilities	$126	$818	$2,167
Equity	142	242	1,945
	$268	$1,060	$4,112
Other data			
Closing stock price (Dec. 31, 1994)	$11.75	$8.00	$29.50
Common shares outstanding (in millions)	17	30	154
Market value (in millions)	$200	$240	$4,543
Price/revenue ratio	0.3x	0.1x	1.0x
Price/earnings ratio - trailing twelve	n/m	9.4x	17.5x
Price/earnings ratio - future 4 qtrs.	65.3x	8.8x	15.2x
Headcount (most recent disclosure)	2,500	2,502	34,000
Net revenue/employee	$316,648	$1,816,231	$139,435
Book value per share	$8.35	$8.07	$12.63
Price/book value ratio	1.4x	1.0x	2.3x
Growth statistics (over comparable quarter):			
Revenue	24%	68%	11%
Sales, general, and administrative	18%	49%	12%
Net income	(313%)	(54%) (b)	15%

(a) Egghead has closed 16 stores in the past year: total stores now number 179.
(b) Merisel's interest expense in the September quarter increased to $7 million from $4 million last year.

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CONSUMER SOFTWARE COMPANIES
(IN MILLIONS)

Income statement	Broderbund 11/30/94	Electronic Arts 9/30/94	Davidson & Assoc. 9/30/94	Sierra On-Line 9/30/94
Most recent quarter				
Net revenue	$53	$86	$22	$19
Net income (loss)	12	7	3	(1)
EPS	0.57	0.14	0.20	(0.08)
Trailing twelve months				
Net revenue	$132	$417	$70	$68
Net income (loss)	16	48	4	(8)
EPS	1.30	0.96	0.26	(1.01)
Net income (loss) as a % of net revenues	12%	11%	6%	(11%)
Balance sheet				
Cash	$92	$126	$18	$66
Other current assets	27	121	23	24
Other assets	8	46	10	19
	$127	$293	$51	$109
Liabilities	$34	$100	$9	$63
Equity	93	193	42	46
	$127	$293	$51	$109
Other data				
Closing stock price (Dec. 31, 1994)	$46.75	$19.25	$32.50	$34.25
Common shares outstanding (in millions)	20	50	17	8
Market value (in millions)	$935	$963	$553	$274
Price/revenue ratio	7.1x	2.3x	7.9x	4.0x
Price/earnings ratio - trailing twelve	36.0x	20.1x	127.4x	n/m
Price/earnings ratio - future 4 qtrs.	29.0x	19.3x	47.8x	51.9x
Headcount (most recent disclosure)	460	1,077	327	540
Net revenue/employee	$287,104	$387,399	$213,865	$126,159
Book value per share	$4.65	$3.86	$2.47	$5.75
Price/book value ratio	10.1x	5.0x	13.2x	6.0x
Growth statistics (over comparable quarter):				
Revenue	62%	5%	33%	32%
Research and development	18%	11%	165%	51%
Sales and marketing	20%	16%	4%	13%
General and administrative	48%	35%	n/a	n/a
Net income	86%	(16%)	41%	73%

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Supplemental Info.