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Microsoft Memo

TO: Ted Hannum
FROM: Debbie Flynn
RE: Commodore Trip Report
Date: November 20, 1990
CC: Richard Fade, Joachim Kempin

Date of Meeting: November 20, 1990

Attendees:

Commodore: Mehdi Ali, President
Tony Ricci, Director of Finance

Microsoft: Joachim Kempin
Richard Fade
Debbie Flynn

OBJECTIVES

- 1) Agree on a DOS price.
- 2) Prevent Commodore from making a DRI DOS decision.
- 3) Agree on a Windows price.
- 4) Make a decision on a Works price.
- 5) Agree on what to do with the rights to Amiga Basic.
- 6) Agree on the terms and conditions of these issues to enable us to move forward on putting a license together.

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Executive Note: Ted is the audience for this report, so it goes into a pretty detailed discussion of what happened in our meeting. For your purpose, I will summarize the agreed upon details of the deal.

Need current status of DOS, WORKS when according to MS

closing out all previous contracts

THE DEAL: This will be an umbrella license covering DOS, Works and Windows. The term of the agreement will be from October 1, 1990 to June 30, 1993, which includes a 9 month promotional period and a 2 year follow up period. Fifteen months into the follow up period, CBM will have the right to come back and renegotiate their royalty prices with us, but the other components of the contract will stay the same. Within the promotional period the royalty pricing will be as follows:

	8086	80286	80386SX	80386	80486
DOS \$	4.50	6.50	9.00	13.00	16.00
Works \$	16.00	16.00	—	—	—
Windows \$	—	16.00	22.00	22.00	22.00
\$/processor:	21.50	23.50	31.00	35.00	38.00

These royalty prices are for both US and localized versions of product. The minimum commitment for both the promotional and follow up period will be \$625,000 per quarter (\$2.5M annually: based on the 40K units of Works and the 20K units of Windows they were willing to commit and the DOS mins that we negotiated), giving us a total revenue package of approximately \$7M. In the follow up period, CBM will have two choices on how they want to continue the license. They can sign up

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for a per processor agreement with the same royalties, or a per copy agreement with a \$5 increase on the Works and Windows royalties. We will also put language in the contract that will allow them to make a higher unit commitment than the 60K units and negotiate the \$5 increase. With 100% per country per processor penetration, CBM would have the option of shipping either Works or Windows on their 286 machines and would ship Windows with all 386SX and higher machines. We also agreed to give them a \$.50 royalty price on every machine bundled with Amiga Basic and a \$2 royalty for every stand alone package they sold. CBM will pay us a \$100,000 min commit for this product on a yearly basis. The terms and conditions for this agreement will go into effect at the end of the contract period (June 30, 1991).

RESULTS

Our strategy was to get all of the issues on the table at once so that we could try and put some kind of package together without appearing to "lie" the products. Mehdi's first comments were very encouraging. He indicated that he was getting a lot of interest from his country managers about the availability of Windows. Mehdi went through a brief rundown about what they wanted and their concerns for each of the four issues: Windows, Works, DOS and Basic. Throughout the meeting both Mehdi and Tony were very upfront, honest and projected a real desire to work with Microsoft to the mutual benefit of both companies. I was very surprised by this, as I had heard horror stories from Jeff Scherb about how emotional and anti-Microsoft Mehdi was.

We moved on to develop the specifics of each issue. They were exactly the same as what Tony had shared with us in West Chester, but he added some background and we also got some input from Mehdi.

Windows: They see a real opportunity for this product with their new high end machines which they will be officially introducing January 10. As Tony had previously mentioned, there was little financial incentive for his country managers to ship above their minimum commitment. A lower royalty price would reduce their COGS and therefore drive more Windows volume. This was the direct feedback Tony and Mehdi were getting from the country managers. They are not sure just how much business they can drive yet because they do not have the product. Therefore, they are unwilling at this time to trade a 100% penetration of all countries for a lower price. They need time to gather information on just what percentage of the market they could penetrate in the shipment of Windows. After said period of time, they would be in a much better position to commit to some kind of penetration rate. If things go very well, they would consider bundling 100% of their 386SX and higher machines with Windows. However they will only commit to 20,000 units per annum at this time. Tony again brought up the idea of a sliding scale.

Works: We briefly touched on the logistical problems Microsoft had on delivering the disks and CRC. It was very apparent that this was a dead horse, but Mehdi did not let the opportunity pass to let us know that our failure to deliver on our stated dates had caused quite a few complaints on his end. But both he and Tony agreed that it was past history and they were interested in moving forward. As he had mentioned to us a few weeks ago, his thinking on Works was very similar to Windows. To be able to compete with the brand name PC's, CBM is trying to add value with software without adding any additional costs to the consumer (although the country managers do mark up the cost). Tony reiterated his request for a \$15 price. He indicated that he would be willing to commit to 40,000 units annually. Again, they were unwilling to commit to 100% penetration of European countries.

DOS: Because a significant portion of Commodore's business is at the XT and AT level where the

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market is very price sensitive, they are looking for ways to reduce costs. DRI came in and quoted them very aggressively which caught their attention. However, they see such a large PC opportunity in Europe on their new machines that they are unwilling to give DRI the business at the high end (where the market would be more sensitive to whose DOS is in the box). Tony still thinks MS DOS is worth a 30% premium and they prefer to stay with MS across the board. However, DRI came back with a quote that was very attractive: \$2-XT, \$3-AT and \$4-SX. These prices made them even more sensitive to the royalties that they were paying MS. A price of \$8 across the board would end the negotiations with DRI immediately. Richard went into his value and fair pricing spiel to help build our case for asking a higher price.

Basic: In a meeting with their local country managers two weeks ago in Frankfurt, all countries except one voted to unbundle Amiga Basic from the machines to help reduce the COGS. They still wanted to have the ability to have a Basic offering, but did not want to tie the cost into the machine. They much preferred a packaged product as an additional sale. Mehdi really wanted a flat buyout because he sees their volume decreasing drastically with the unbundling, but still wants to be able to have an offering (at a substantially reduced cost). They offered us \$50,000 for the rights to the product.

THE OFFER: Joachim, Richard and I adjourned to another room to strategize on what kind of offer we were going to make them. We wanted an umbrella contract covering DOS, Works and Windows for a two year term that was per processor in all countries. Joachim came up with the idea of having 100% bundling consist of either Works or Windows on the 286 machines and the 386SX and higher machines would be 100% Windows. We decided to offer them a promotional period to give them time to make a per processor decision, which would be based on their ability to determine what penetration percentage their market could bear. We threw numbers around for a royalty and came up with some aggressive numbers, actually even better than what they asked for because we really wanted to make it attractive for them to give us a 100% per processor license. We would offer DOS royalties of \$5.50-8086, \$7.50-286, \$9-386SX, \$13-386 and \$16-486 (Mehdi had already agreed to pay our price at the high end). We would give them \$16 for Works and \$16-286 and \$22-386SX+ for Windows. The minimum commitment for the promotional period would be half of the numbers they said they would be willing to commit to for Works (20K) and Windows (10K) as well as an arbitrary \$1M for DOS, giving them a total min commit of \$1.5M. After the promotional time period they could choose to continue the deal with the same royalty and an annual min commit at the same rate for two additional years, provided they would agree to a per processor deal in all countries. If they could not commit to a per processor deal at the end of 6 months, they would still be committed for two years and the same number of units, but their royalty price would go up \$5. This whole offer was designed to reduce their risk by putting all of their min commits in one pool and have them recoupable across all products.

On Basic we decided that we wanted at least \$500,000 in revenue and we would take that in a buyout, but would prefer to see it in royalty revenue. We would offer them a \$5 per copy royalty for all packages sold separately, and we would like to see an annual \$100,000 minimum commitment.

We presented our offer with the umbrella package first, making the points that this was a package deal and that there were interdependencies. After the presentation, we gave them some time to consider our proposal. They had some sticking points and offered a counter proposal. The royalty for the low end was too high. They only wanted to pay \$4.50 and \$6.50. They absolutely did not want a 2-year additional term because of the fluidity and downward price trend of the processor market. They wanted to be able to come back in a year and renegotiate the price. They wanted to know what the minimum commitment was going to be for Works on the XT. We gave them the XT

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machines as a buffer to hit their minimum commitment. They wanted the promotional period to go from October 1 to June 1 because of the January introduction of their machines. They also wanted to adjust their min commit units to 30K for Works and only 10K for Windows during the promo period because they have Works and do not have Windows. They thought that the mins for DOS were too high. We agreed that instead of a \$3M annual min commit for all three products that we would reduce it to \$2.5M. They also thought they might be able to do better than the per copy units, but not quite up to 100% per country bundling. We agreed that we would put language in the contract that would give them a third choice. If they could make a higher commitment in terms of units then we would negotiate the \$5 uplift. We spent a long time working through the royalty price for XTs and ATs and the actual length of the agreement. We finally agreed to give them the royalty price that they had requested and accept a 15 month term after the promotional period, while the remaining terms and conditions would be in effect for an additional 9 months.

Basic: They pushed us hard for a buyout. We offered a \$5 per copy royalty for packaged product on 20,000 units for the next year, but they kept pressing for the buyout. We told them that we were so far apart on the price that we hesitated to even bring up what we wanted. They asked for the price again and we gave them the \$500,000 figure. Joachim told them that it could either be that, or he wanted at least that much in royalty revenue in the next year. They wanted to know what we could do on the per system royalty. Joachim offered them a \$.50 royalty for each machine that they bundled and a \$2 per package royalty. We agreed that they would go with the old royalty structure for now and that the new agreement would last a year from the end of the current license. Mehdi thinks that they may see a continued demand for a bundled product in Germany, but the UK definitely wants to unbundle. Tony is going to send me a list of the countries and what they plan to do with the bundling of Amiga Basic.

Joachim covered the NDA issue where Jeff had passed on our DOS letter to DRI. We also asked them to be very discreet when talking to DRI about why CBM had made the decision to go with Microsoft.

Other Items of Interest from the Meeting:

- *There may be some additional opportunity for MS in a palmtop machine. They are deciding right now whether to go with the Intel 8088 chip or the Motorola 6502 chip. They are interested in a very aggressive DOS price from us if they go with the Intel chip.
- *They have an exclusive laptop distribution agreement with Sanyo in Europe. Their new 386SX laptop is also from Sanyo and will be announced in the next few weeks.
- *They anticipate not renewing any of their contracts for US distribution of PC products. They feel there is no loyalty with that channel of distribution (mostly catalog showroom outlets like Sears, Best, Service Merchandise).
- *There is no longer a head of European operations, they have a very flat organizational chart and the country managers work through Tony or Mehdi for decision making and counsel. Tony runs the finance and pricing.
- *Germany is 1/3 of their business and they visit there at least a month out of every year.
- *They are seeing a boom in the Commodore 64 market and think that the reunification of Germany may be playing a part.

ACTION ITEMS:

- 1) Clarify their DOS agreement with Sanyo.
- 2) Write a letter to Tony Ricci confirming everything agreed to in the meeting.
- 3) Write up a new contract that includes DOS, Works and Windows.
- 4) Call Tony next week and get a list of open issues that we can get together on once a week to get

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an update.

5) Need to be fully briefed by Tony on what the decision criteria is going to be for choosing which chip for their palmtop and find out what I can do to make them go with Intel.

6) Write an amendment for the Amiga Basic contract with the new royalties and minimum commitments.

7) Develop a relationship with Gail Wallington to open up possible multimedia opportunities on Commodore PC's.

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