

Donna Poreda

From: Brad Silverberg
To: johnlu
Subject: FW: Systems Revenue Goals and sources
Date: Tuesday, June 15, 1993 2:07PM

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From: Joachim Kempin
To: bradsl; steveb
Cc: billg; bradc; jeffr; joachimk; jonro; paulma; richt
Subject: RE: Systems Revenue Goals and sources
Date: Tuesday, June 15, 1993 12:42PM

STEVE, I like Your revenue stream memo at the same time I do not believe it takes the competitive landscape into enough consideration and probably underestimates the \$ we can get from OEMs. (meaning You sound like anything under a 100 M\$ per year does not interest You too much?) Competitive situation I see developing this fall:

IBM will push PC DOS 8.0 with a new GUI as the new DOS standard. NOVELL will try to establish UNIX on the DT and cater at the same time to current WIN and DOS users with Personal Netware and DR DOS 7.0. Fearing the first two products less, let's focus on Personal Netware a WINDOWS add on from NOVELL and DR DOS 7.0. They will position this duo as the best solution for DT integrated into the NOVELL 4.0 environment. The new realtime kernel of their DOS 7.0 is supposed to deliver what we are planning for Chicago when operating in a networked environment (32-bit, preemptive MT etc.). It is unclear how much WIN API cloning will be included in that product and how much of a MAC GUI they will design in. In any case such a product could be a possible threat to our MS-DOS revenue stream and if they succeed in convincing their corporate customers that Personal Netware is a must for getting great Netware 4.0 services today and in the future the revenue stream of WfW might fade away over night- assuming that we can't produce a major product uplift. The revenue streams You are talking about in Your proposal are implementable in the Chicago timeframe, but how do we respond to the scenario I see developing in the fall? I have not spend sufficient time on this but I see two possible ways to act:

1. hang tight and accelerate Chicago (do only small version changes on WfW and WIN 3.1 in the meantime to show that we have been listening to our customers and continue to stay up to date)
2. Rescue WfW and sell it as Chicago "junior" (this means we have a Chicago packaging strategy and put the pieces for the "rescue release" together so that there is no confusion)

I believe we can execute both strategies successfully and I would make the decision based on when we will ship Chicago and less on revenue streams assuming we can work out Chicago revenue streams. Yes, we can sit tight and fight it out by actively persuading people why our Chicago strategy makes more sense than NOVELL's- if we get the right product shipped by April. In case Chicago slips into sep/oct which April releases tend to do, I recommend we execute version 2. In any case I will try to persuade as many OEMs as I can to ship WfW instead of WIN 3.1 as the best version of WINDOWS assuming we can easily install/deinstall the peer component and have good story how our product packaging will look like in the chicago time frame and how the transition will work for them.

From: Brad Silverberg
To: Steve Ballmer
Cc: Bill Gates; Brad Chase; Jeff Raikes; Joachim Kempin; Jonathan Roberts; Paul Maritz; Richard Tong

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Plaintiffs' Exhibit

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Comes v. Microsoft

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Subject: RE: Systems Revenue Goals and sources
Date: Monday, June 14, 1993 9:34AM

we are meeting with you friday to discuss.

a few points to note:

- having "offshoot" versions of windows (ie, wfw) is a mistake. they don't advance our platform. they don't serve strategic goals, they are confusing to customers, they don't sell well. as we move forward we should have three categories of products:

1) base oem products. this is your stream 1. we shouldn't give oem's everything we have for the reasons you point out. of course they can license the additional parts. this is a follow-on to the successful "ms-dos + enhanced tools" model though i expect base chicago to be a lot richer. the base os is our primary api carrier. api's we consider part of the windows platform should be in the base.

2) upgrade to the rich full version of the os. this is primarily the base + cool utilities. there may be various sku's in this category which we can decide on: upgrade from dos (ie, chicago full packaged product), upgrade from previous versions of windows, and upgrade from the base oem product. my own view is that we should have fewer sku's rather than more.

3) add-on. they are pure utilities or other features that make life nicer or faster for a windows user but which we feel we can market separately and (get a separate revenue stream) from those in (2). the line between add-on and upgrade is not always clear. for instance, had we been selling Workgroups for Windows rather than Windows for Workgroups, then we'd have the Workgroup (or peer networking) add-on for windows. this is in fact how it's being sold and how's it's most successful. that it's been positioned and measured as some special kind of windows has hurt it. for another example, if we had sold snowball as a "turbo addon pack", then it too would be an add-on. the debate a month ago of option A (win 3.2) vs option B (addon pack) is precisely this upgrade vs add-on split. thinking ahead to chicago, we could postulate a Mobile add-on which includes remote network access and other goodies targeted at the mobile user; another might be an "ms-dos companion" add-on. this latter is a set of power tools for chicago, in a sense turning things upside down and viewing ms-dos as an add-on to chicago rather than the other way around.

- we really must make the snowball decision this week.

- if we don't do snowball as 3.2 (or 3.1 +) then we should either kill it altogether or scale it back very dramatically. if there is little revenue upside to it and the company is not going to get behind it, then the team should focus fully on chicago. this will have some repercussions though for oem's and beta testers who have been told about snowball. it will be a huge amount of work, though, to get snowball out and if it is not going to be important then i want to use the effort to make chicago better. what i see as wfw 3.11 would be a true .01 release: no-net install plus some of the admin functions to control peer networking. no vfat, no 32-bit disk drivers, no ras; nothing that requires a lot of test or in depth effort.

From: Steve Ballmer
To: bradsl
Cc: billg; bradc; jeffr; joachimk; jonro; paulma; richt
Subject: Systems Revenue Goals and sources
Date: Thursday, June 10, 1993 2:24AM

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Here are my thoughts on where the systems business goes longer term as a business and how I see us getting there though Chicago and Snowball what do others think?? I referred to this yesterday to Richt and Jonro as their \$2 Billion a year quota but it is food for thought thx

<< File Attachment: SNOWBALL.DOC >>

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I want to give my thoughts on how I would like to see the Systems business shape up from a revenue basis and use that as a foundation for a discussion of Snowball strategy and Chicago packaging. My basic thesis is that the Systems business should over time have four revenue streams. I ignore here for the moment Windows NT because I see it mostly in specialty applications or on servers for the time being. It does though fit into the general model I think quite well.

The four revenue streams can best be characterized as follows:

1. Per system royalties that come primarily from hardware system vendors selling PC's and paying us in ways similar to the ways people pay us today— royalty licensing, MED, and SVED options. My hope is that we can in the Chicago time frame get OEM's to pay us an average of \$40/ system through these programs. Compaq will be certainly less. IBM is a wild card and MED SVED and lower volume shippers are higher royalties. The market will be 30MM machines per year. Between CUP and machines licensed for other systems I hope we can get 90% of those licensed. that would mean 27MM * \$40 = \$1.08Billion. This revenue stream is the natural successor of the old MS-DOS royalty stream of the 80's.

2. The second revenue stream will come from a high volume systems retail offering. I use the word retail here to mean primarily offered on a packaged basis per copy although some of our OEM's may sell it. (Some OEM's may even license it per system but that will be the exception not the rule). I view this revenue stream as the successor to the Windows retail revenue stream of the late 80's and early 90's. In its prime Windows was selling 400M copies a month at a distri price of \$75 in the US. The product that we sell to capture this revenue stream should be those parts of what we think of as Chicago plus fonts, daily views, sound software, video software and the like that we do not need to bundle in the OEM royalty product. We must cleverly decide what to put in each bag of bits to make these two revenue streams a reality. Post Chicago, I am sure pieces of this product will move from this revenue stream product into the revenue stream 1 product and we will need to renew this product with more code. This product probably differs from the original Windows product in that it more likely delivers end user value to the owner or the revenue stream 1 product than it delivers new APF's not contained in that product. This product is important strategically as well as revenue wise since it lets us keep an important retail systems product in the market to drive forward things OEM's do not want to pay for or call attention to or otherwise make available. It is also a way to make more money on those Compaq machines for which we have a fixed royalty for a number of years to come. I think Billg highlighted the importance at one time of a retail systems product earlier in the snowball discussion but I did not really understand him then.

This product should outsell as a metric the most popular Windows or DOS utility packages combined.
5-6MM units/year *\$75 = \$400-500MM

3. Revenue stream 3 is the upgrade product to the revenue stream 1 product. I think we need a \$99 price point for the first Chicago upgrade since it is transition product until we can get revenue stream 4 in place and because I think whatever is in Chicago product 1 will be exciting enough to command the \$99 street price. This product is the heir apparent to the MS-DOS upgrade revenue stream. We must try to AVERAGE at least 3 million units a year of this product with surges obviously on product introductions. We have upside to continuously increase the units through clever annuity offerings and other ideas. This stream needs to get us at least then \$80 (decreasing probably for later releases to 40) * 3MM (increasing to 6MM) = \$250MM a year.

4. The fourth revenue stream is the upgrade to revenue stream 2. It is a \$40 retail offering with lower units than revenue stream 3 product. Say 1-2 million units a year. This makes it a \$100 MM a year business.

If we could package all our systems bits into two offerings with two upgrade like this and do the units and prices I show our base systems business not including servers could be a 1.8-1.9 billion a year business or more. I write this because it is very very important that we focus on how to increase profits

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out of the systems business while maintaining high volumes and low prices. We have often talked about the opportunity to "raise the price of Windows(Chicago) over time. This is my view of where we are driving. I do not think we can get much higher per system royalties in the near term than I show so we really need all the revenue elements to make this happen and we need exciting products with good unit volumes. The Chicago packaging plan must enable us to move these revenue stream forward.

Today I think our product line maps to these revenue streams as follows

1. MS-DOS 6 and Windows 3.1
2. Windows for Workgroups add on
3. MS-DOS 6 upgrade and the Windows 3.1 upgrade(not clear whether to think of that here or below
4. Nothing or the win 3.1 upgrade

The snowball plan should not eliminate any of these revenue streams short term. I know people think that WFW is a low volume hard to sell option as the revenue stream 2 option but that is what we have until Chicago. I do agree there will be better names and packaging options for stream 2 in the future. (Given that stream 2 content will evolve I think the name of that product in the Chicago timeframe should not describe its content!! WFW obviously is a version of windows and describes its content making it less than a perfect choice for stream 2. However, I do not want to do anything in the snowball time frame that is different than what we want to do for Chicago OR looks like a strategy change from where we are today unless it represents a huge revenue opportunity.

There are as I understand it today two proposals for Snowball and the Windows guys make be working on others.

Proposal 1:

Revenue Stream 1: Take all the bits in Snowball plus fonts and perhaps some others and get \$2 plus more or so form OEM's per system than the \$30 or so we get today

Revenue Stream 2; get rid of it no product in this stream

Revenue Stream 3: Continues as MS-DOS 6 and now the upgrade to revenue stream 1 product as a hot \$49 street price intro. offer product

Revenue Stream 4: None

This proposal says that there is very low value in WFW in general and in the snowball upgrade specifically so lets throw all the bits we have into a few buckets and try to get all we can. I find this strategy bad for three reasons. It eliminates concepts that we want to and need to reinstate for Chicago but we may lose momentum in our people's focus on the Systems retail business (non upgrade). Second, this strategy will look like a big change to the market since we will kill wfw and we will do a new Windows release before Chicago which the market is not expecting. Customers will complain about two upgrades in a short time especially since many people will not see this new "win 3.2" release as major. Third, no one argues that this new win 3.2 release is exciting enough to generate huge revenue in the 6-9 months between Snowball and Chicago. We might sell as many as 10MM OEM units in the period and capture the incremental \$2 (and I think we could do an OEM add on pack with off the shelf bits and get some of that 10MM *\$2) plus we might sell 500M or so upgrade for the \$40 or another \$20 MM. Of course all wfw revenue would disappear so the net incremental in my judgment might be \$20MM not small potatoes but not big enough to take the hit in the market and distract our people in the fall when we need to really focus on Office and building NT momentum at the server.

The second proposal which is mine says we should do snowball as a small wfw release to show commitment, make it easier to sell and make technical progress on where we need to go any way. This

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plan changes nothing and will likely not increase sales of wfw much in this timeframe. I could certainly accept Brad scaling back the snowball content in this scenario.

This is not definitive thinking on this entire topic but I do think having a common view of the long term revenue framework is important. Thoughts??

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