

Date: September 27, 1993  
To: Paul Maritz  
From: David Brooks  
Rich Freedman  
Subject: Windows Enhancement Business Opportunity

This memo summarizes the baseline MS-DOS and Windows businesses, and lays out what we have to accomplish to generate an incremental revenue stream of \$500 million from Windows Enhancements.

Summary

In FY93, the personal systems business generated revenues of \$1.2 billion and BOI of \$520 million. (Windows NT, Systems Marketing and Jimall's group are not included in these numbers - they reduce the BOI for PSG to \$355 million.) Revenue will decline to about \$1.0 billion in FY94 because of the lack of any major upgrade opportunities, and will increase to about \$1.5 billion in FY95. The increase from FY94 to FY95 is a one-time hit attributable mainly to upgrading the Windows installed base to Chicago.

In contrast to the upgrade business aimed at the installed base of Win 3.1 users, the "Windows Enhancement" product will be targeted at purchasers of new PCs. Rich's memo addresses the features that will be included in the base Chicago OEM product and the features included in the Enhancement. We will need to sell the Enhancement to 25+% of the purchasers of new hardware to generate revenues in the \$500 million range (assumes SRP of \$149, 46% discount and revenue to MSFT of \$80). Incremental profit from this product is estimated at about \$45 per unit, and at 25% penetration would add about \$325 million in incremental profits.

Discussion

The table on the next page summarizes units and revenue streams for the personal systems business. Revenue will decline in FY94 compared with FY93 but will increase sharply in FY95 due to upgrading the Windows 3.1 installed base to Chicago. We estimate 7.5 million users (15% of the installed base) will buy this product in FY95 and generate more than \$500 million in revenue (assumes USSRP of \$100 and a 30% discount).

Our model assumes MS-DOS 7.0 will be available on a stand-alone basis to the small number of OEMS (<10%) who do not sign up for Chicago, and to non-Windows users that want to upgrade to MS-DOS 7.0. We are assuming OEM pricing for Chicago of \$35 per unit, approximately the same as the combined prices for MS-DOS and Windows. Attachment 1 provides more details of the data in the table on the next page.

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**Personal Systems Business Summary: FY93-95**

	MS-DOS		Windows			Windows	Total
	OEM	Upgrade	OEM	Retail	Upgrade	Access	
<b>Units (Millions)</b>							
FY93	18.1	6.1	12.3	3.9	1.2	n/a	n/a
FY94	21.3	2.3	16.5	2.5	1.0	n/a	n/a
FY95	2.0	0.5	22.0	1.3	7.5	n/a	n/a
<b>Revenues (\$ Millions)</b>							
FY93	\$317	\$242	\$209	\$269	\$61	\$25	\$1,123
FY94	398	90	281	152	50	35	1,005
FY95	44	20	770	82	525	50	1,490

In FY95, Windows OEM revenue increase sharply because the revenues that formerly would have flowed to MS-DOS transfer to Windows. Total MS-DOS + Windows revenue on new machines increases 6-8% per year over the period, from \$795 million in FY93 (i.e., \$317 + \$209 + \$269) to \$831 in FY94 and \$896 in FY95.

The Windows enhancement business is incremental to what is shown above. Penetration on new Chicago units will have to exceed 25% at a \$100 price point (\$80/unit revenue to MSFT) to bring in \$500 million in revenues. At the \$100 price point, incremental profit per unit is estimated at 70% of revenue. This is comparable to the profitability of the MS-DOS upgrade business. The table below summarizes the impact on revenues and incremental profit (i.e., revenue less variable costs - COGS, PSS, marketing, etc.) of varying levels of success in attaching the Enhancement to copies of Chicago sold through the OEM channel.

**Incremental Windows Enhancement Revenues and Profits**

% Pen on Chicago	Enhance't Units (Millions)	@ \$80/unit	
		Revenue (\$ Mills)	Incr Prof (\$ Mills)
5%	1.2	\$93	\$65
10%	2.3	186	130
15%	3.5	279	195
25%	5.8	465	326
50%	11.6	930	651

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