

Fiscal Year 1994 Business Plan

Solution Provider OEM Group

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I. Executive Summary

FY94 Market Outlook

Compaq, Dell expected to continue to grow market share
Increased pressures on 2nd tier OEMs to remain profitable and competitive
Huge challenges for HP, NCR to remain competitive in PC market - may see some pullback from commodity desktop segment
End of Desktop III puts increased pressure on Unisys - could see them withdrawing from PC business
Possible make or break year for DEC - everything riding on Alpha market success
First PDA machines expected to ship in Q3-Q4

FY94 Revenue Plan Summary

Forecasted revenue, estimated conservatively, of \$155 million (32% growth) assuming Compaq ships 2.5M units and Dell ships 1M units. Optimistic "best case" revenue forecast would be \$200 million assuming 3.5M units shipped by Compaq, and 1.5M units shipped by Dell.

Observations

FY94 will be a critical year for many of our OEMs. With the exception of Compaq and Dell, it is doubtful if any of the other OEMs in my group (HP, NCR, DEC and Unisys) are currently profitable in the PC business. If these companies don't successfully transition to profitability (by cutting costs, increasing differentiation, or some combination thereof) it is conceivable that some will be seriously considering withdrawal, at least from the commodity desktop PC segment. We know that HP, for example, has internally discussed withdrawing from desktop PCs, and focusing on sub-notebooks, high end servers and highly differentiated products like the "Pike" fax project.

OEMs in this group are looking for a way to break out of the commodity model and find a niche where the market rewards them for high engineering value adds. This I think is why the PDA market is so appealing - it is an opportunity to break in on the ground floor, not be constrained by current market dynamics or standards, and establish value for differentiated features.

All of this represents an incredible opportunity for MS. I believe that we now have more ability than we have ever had to influence our large OEMs' future directions. They are looking to us for leadership, and are particularly looking to us to help them become more differentiated. They want to know where we are investing, and what areas within MS standards are available for them to differentiate. I believe that if we can focus on a core group of OEMs to help them pursue a strategy of differentiation within MS standards, we could capture some significant design-ins and position the OEM group strongly for future revenue growth in FY94.

At the same time, we are also greatly at risk. If we do not respond effectively, we risk losing business to competitors (particularly in new markets like PDAs).

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II. Market Conditions

Business Climate, Conditions, Trends

The overall business climate is expected to be one of moderate worldwide growth for unit shipments in the 10% range. Last year's dramatic price cuts, initiated by Compaq's June 1993 announcements, have left some very difficult business conditions. Those OEMs that are unable to achieve economies of scale and drive their costs down will not be able to sustain a position that is both competitive and profitable. Compaq and Dell have risen to this challenge, and have been able to leverage their volumes to reduce their costs. They have seen reductions in gross margins, but have nevertheless been able to generate reasonable profits. While both of these companies are successful today in the commodity PC market, they are also both actively looking for other opportunities where differentiation and higher margins can be realized. Compaq seems to have the most aggressive plans and the greatest chances of success. Over the next 12 months, they have plans to ship at least three highly differentiated new products: a plug and play machine based on Windows 3.1, a convertible notebook, and a PDA machine. Dell is also actively working on a PDA project, and is looking to become more differentiated with some of its server products.

HP, DEC, NCR and Unisys have not been as successful adapting to the new business conditions. All have followed Compaq's lead and cut prices to remain competitive, but it is probably safe to assume that none are profitable in the PC area today. HP, NCR and Unisys are all profitable in other areas of the company and are essentially subsidizing their PC businesses. DEC of course is still bleeding red ink throughout the company and is in the process of re-inventing itself, with a focus on customer-centered, autonomous business units. All four of these OEMs are trying to make their PC businesses profitable and self-sustaining. The challenge for all four is to find areas within the PC market where they can command higher margins for differentiated products, which would then allow them to continue to operate in the commodity segment of the market and show an overall profit for their PC businesses. Differentiated products from HP to be launched over the next 12-18 months include the Lion sub-notebook, Pike PC/fax product, and PenLizard PDA machine. NCR is working on convertible and PDA projects, and is investing heavily in high end multiprocessor technology.

Unisys is clearly the most vulnerable of the large OEMs in my group. With the downturn of Desktop 3, their run rate for PCs is likely to shrink to about 80K for FY94, almost all of which would be sold directly to the Unisys installed base. They have no plans that we are aware of for highly differentiated products, and no plans to expand into alternate distribution channels.

System and Application Software Competition

Novell has been our most significant competitor in the system software area. Their attempts to leverage superior Netware client connectivity in DR DOS, however, have been a complete failure. We just completed signing all of the OEMs in my group to long term, per processor MS-DOS 6 contracts and DR DOS was not a significant issue in any of the negotiations. Novell has of course been a much tougher competitor with its Netware products. They struck a strategic partnership agreement with HP, in which they will work jointly to port native Netware to PA-RISC, and HP in turn agreed to provide strong marketing support for Netware. They also were very aggressive in selling Netware Lite against WFW, in Dell and Compaq. In the case of Dell, they were successful in convincing them that it would be unwise to bundle WFW with every network ready system, given that they intended to have an improved product out soon after. With Compaq, they sold very hard against us, offering Compaq very low royalties and a percentage of future upgrade business, but ultimately we prevailed.

Lotus remains our number one competitor for applications. They have been extremely aggressive with their royalty pricing of the SmartSuite products, and have captured wins with HP, DEC and Compaq (which will offer a SmartSuite bundle with their initial direct mail catalog). Given their low market share in Windows applications, they seem to be pursuing a penetration strategy through select OEMs, and offer huge discounts and flexible, per copy-type terms. Although our products command a price premium over Lotus (and OEMs recognize this), Lotus' pricing in some situations has been so aggressive that our best per system pricing is still 50-100% higher, and we have willingly conceded such deals to Lotus.

For low end applications, Spinnaker remains our primary competition. They clearly seem to be losing momentum, however, particularly with the recent Packard Bell switch to Works. Compaq, the only Spinnaker customer in my group, is not happy with Spinnaker, and we have an excellent opportunity to replace the current Spinnaker bundle

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with Works over the next couple of months. Spinnaker has been active in NCR as well, offering sub-\$10 royalty pricing with no commitments for NCR's forthcoming mass market product line (which will be marketed under the AT&T name). We are confident, however, that we can overcome this and sign NCR to a per system Works license this quarter.

Major MS Product Focus Areas

On the systems side, major product focuses for FY94 will be Chicago, Windows NT, Winpad and Mobile Chicago. I also expect that we will have some opportunity to license the NT Advanced Services products, to DEC and NCR at a minimum. We will probably have lots of interest in Cairo, in terms of OEMs wanting to understand its architecture, interoperability issues, and opportunities for differentiation.

The Office products will be the primary area of focus for applications, although this will continue to be driven by the demands of our OEMs (influenced by strong competitive pressure from Lotus in the OEM channel) rather than the push of our sales force. At the low end, we will have opportunities to either capture or maintain Works bundles with Compaq, Dell, HP and NCR.

I would also expect increased opportunity for our multimedia applications, with products like Encarta becoming available and OEMs shipping significantly higher volumes of CD ROM drives next year.

We have a great opportunity with the introduction of Carrera and Defender mouse products to gain huge amounts of business with Compaq and Dell. The PS/2 Defender (targeted for late fall) is the key product that should provide the opportunity us to capture the large volume business, as it should give us a superior product vs. the competition at a comparable price.

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III. FY94 Key Customer Account Plan

COMPAQ

Objectives

1. Compaq shipping WFW on all desktops upon release of "Snowball"
2. Implementation of Strategic Partnership Agreement
3. Completion and successful launch of Winpad/PDA product
4. Close world wide Works bundle and Office bundle.
5. Compaq aggressively shipping and marketing NT and Advanced Server

DELL

FY94 Objectives

1. Win the major share of Dell's mouse business back from Logitech
2. Maintain control over Dell's Applications Bundles (no design losses)
3. Shift Dell's focus from Novell to NT and WFW
4. Sign Chicago license

HP

FY94 Objectives

1. Sign NT license for PA-RISC and Intel
2. Gain HP commitment to aggressively market NT
3. Sign Pike/Strider license
4. Sign Winpad license
5. Sign Chicago license

DEC

FY94 Objectives

1. Complete DEC NT projects (part of Advanced Services, MS apps to Alpha)
2. Sign NT Advanced Services license
3. DEC shipping MS Mail as strategic mail product across all products
4. Extend Lan Manager/Pathworks agreement
5. Sign Chicago license

NCR

FY94 Objectives

1. Gain NCR commitment to port NT to level 6 and level 7 systems
2. Gain NCR commitment to aggressively market NT
3. Sign NT Advanced Services license
4. Sign Winpad license for Safari/PDA machine
5. Sign Chicago license

UNISYS

FY94 Objectives

1. Gain Unisys commitment to offer NT on high end MP machines
2. Sign Chicago license
3. Sign WFW license
4. Sign LM/U license

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IV. Regional Revenue and CPU Forecast

Revenue Forecast

Rough estimates available only at this time. See "FY94 Revenue Plan Summary" section in the Executive Summary section of this document.

CPU Forecast

Account	FY93	FY94
Compaq	2,300,000	3,000,000
Dell	1,300,000	1,700,000
HP	325,000	375,000
NCR	250,000	275,000
Digital	240,000	260,000
Unisys	85,000	80,000
Tandem/BB	5,000	5,000
Tot Act/Fcast	4,685,000	5,140,000

Overall growth for the group is 26% from FY'93 to FY'94. Compaq and Dell are both showing tremendous growth year to year at 30% and 33% respectively. We are forecasting HP to grow 15%, and NCR 10%.

Staffing Needs

Beyond additional headcount needed for Compaq (a second Account Manager and a marketing programs person, both to be added this year), I would like to see one additional, senior SE assigned to the group. This SE would specifically focus on working with 4-5 target OEMs to help them achieve differentiation within MS standards, with primary focus on Chicago, Cairo and Winpad. As stated earlier, our OEMs are looking for us to help them differentiate their products, and these 3 product areas offer opportunities for differentiation within MS standards. Our product groups, however, are well equipped to work effectively with multiple OEMs to help them achieve this. A focused SE residing in this group with the right qualifications could do this effectively. The person should be a very technical person from the product group, one who is well respected internally and good with customers. Someone like Tom Lennon would be an ideal candidate in my opinion. I believe that we could potentially get a huge return from having such a person. Not only could we lock in design wins early on, but we could strengthen our partnerships with key OEMs and help them break out of the low margin commodity business.

It could be argued that our existing SE's could do this, but I do not feel that they will have the bandwidth. I am assuming that Tom Davis will become dedicated to Compaq projects (he is spending 80% of his time with Compaq now and the number and scope of Compaq projects is going to increase), and that Jim Kott will be occupied full time with the DEC comprehensive agreement, HP port of NT to PA RISC, and NCR port of NT to ATM's.

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