From: Kurt Kolb
Sent: Tuesday, June 02, 1998 6:02 AM
To: Ken Myer
Subject: FW: FY99 memo

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-----Original Message-----
From: Joachim Kempin
Sent: Monday, May 11, 1998 2:22 PM
To: OEM Personnel Sales Communication; OEM Personnel Sales Communication - Intl.
Cc: Nell Miller; Bill Norman
Subject: FY99 memo

I hope this will make you understand our FY 99 directions and prepare you for the sales meeting. I am sending this to you as the chairman of MSLI. See you in Vail.

FY99 the Year of the "NTW Drive"

Preamble

During FY98 we have seen a slowdown in the PC market caused by the Asian crisis. The incremental sales of < $1k PCs did not offset this. Therefore, we expect the market to show less than 13% worldwide unit growth for FY 98. Unit growth impacts not only the OEM but all of MS business. While I am cautiously optimistic to see a recovery to a 15% growth level by the second half of FY99- I am more pessimistic about the immediate, CY98, outlook.

As a result of this I expect our revenue growth for the next 12 months to slow from our traditional 40%+ growth rate to 25-30%, but even that might not be guaranteed. When analyzing why we are growing revenue faster than the demand for PC units is developing the following crosses my mind:

1. **We continue to see higher valued operating systems**
   While the shift from the MSDOS/Windows 3.x combo to Windows 95 is basically complete, customers are now shifting their focus to NTW.
2. **We continue to increase our penetration in the SB segment.**
   While this is getting tougher in some industrial countries- not fighting piracy as effectively as I would have hoped for- we are still seeing good progress in most development countries.
3. **We continue to find opportunities in the server, hardware, and consumer area.**
   Over the last 18 months we have fine-tuned our value selling skills. Recently this has been instrumental to closing additional business in non-OS areas and has helped us to better position all our products. It is key for us to continue to learn this because we are by no means perfect.

Competitive Landscape

We continue to watch for computing paradigm shifts. While the NC was a big threat to us two years ago, I believe low priced PCs and CE handhelds/terminals have made this an unlikely new desktop computing platform proposition despite the fact that SUN and IBM are still trying. The Java threat on the other hand is real and will not go away. After examining this more carefully, it becomes clear to me that the Java OS will try to conquer the embedded marketplace from palm pilots over game machines to low-end terminals, while infesting all other computing devices with it's programming language. "Develop once, run anywhere." While this sounds promising, it is not reality, at least not yet and probably never will be. Any on-the-fly compiler/interpreter will be big in code and slow in execution and would need to guard it's standard. While we see some derivatives already, big and slow does not make it easy to put Java OS into devices with less than 8MB of RAM. This is a huge limitation, which we can easily explore with Win CE and it's thinner kernel.

Our disadvantage in this area today is not having enough feet on the street, not talking to the right potential customers and not having a real-time extension. As you can imagine, FY98 will be the year to change this and deliver more design wins with Win CE while improving the product.

Supporting the Java initiative are Sun, Oracle, IBM, and Netscape. The biggest issue for us is IBM's support, while at the same time being in the PC camp and trying to get favorable treatment from us. IBM continues to be our largest software competitors, not just in size. Notes, DBII, and Smart Suite are the other examples where we compete with them and this means we will continue to treat the PC company as a valued customer- with respect but with less trust than Compaq/Digital, Dell and HP. Meaning you will not see any field engagements with IBM and only a bare minimum of product marketing activities if any.

Application Bundling

The PC price erosion will continue for our consumer title prices, and will probably lead to less bundling over time. This will be true for DAD applications as well. Corel is at a point where they are offering their "office" suite for free, counting only on upgrade revenue- later! We have to stay flexible and opportunistic in the area and watch the competitors constantly to avoid surprises and loss of business. Stay flexible when customers propose to bundle lower priced application solutions on lower end systems while retaining office product bundles in special market segments like small business. The key for us is that they bundle Microsoft solutions and do not give their money to competitors- so we need to win their hearts and minds!

FY99 goals

1. *Double NTW marketshare in all segments*
2. *Increase SB bootable units by 30%*
3. *Expand embedded group customer base and allow no key design wins for Java OS*
4. *Continue to improve relationships with all customers*
5. *Reach $6.5B in OEM revenue*

1. *Double NTW Share in All Segments*

- Royalty accounts
  - offer penetration based incentive pricing
  - focus marketing spend
  - develop programs for small business and "PC buyer" segment
  - introduce NT 5.0 upgrade opportunities around launch
  - continue to sell NT 4.0 and 5.0 values
- SB
  - incent DSPs to promote/sell and SBs to buy
  - get all regions/subs behind an NTW drive to create more customer demand (this should be funded out of ROEM marketing money)
  - have an upgrade program available like the one we are doing for Windows 98

This is going to be very hard work for all of us and the #1 priority for FY 99.

2. *Increase SB bootable units by 25%*

This might be easy in development countries but the industrial countries will need extra efforts and out of the box thinking to contribute to this goal knowing that they contribute the highest volume.

- have a consistent DSP incentive program around the globe which rewards results and NOT just activities
- develop and promote a reward program for repeat purchases of BOS products
- connect all customers (SBs) where possible to the web and use it to help them grow their business (creating non-counterfeitable value)
- increase investigative activities
- keep the anti-piracy devices current and innovative

3. *Expand embedded group customer base and allow no key design wins for Java OS*

We will add 15-20 people to this group in CY98 and direct them to talk to embedded device manufacturers outside the current OEM customer base. The expansion will be clustered around the world while maintaining a critical mass in locations where we put manpower. It will contain AMs and SEs as well as 2-3 customer competence centers for second tier customers. Management directions will come from Redmond while being fully integrated into the subsidiaries of choice. This will be an exciting thrust focussing on market share and not on high per unit prices. The key is not to allow design wins for Java and to definitely win the strategic business opportunities.

4. *Continue to improve relationships with all customers*

We started 2 years ago to relearn how we do our business and while I have seen good progress we have still a long way to go. The entrenchment of the value selling process is not complete and as such I am suggesting we apply some methods to make FY 99 a break through year in this regard. I am thinking of the following and need your active participation:

- Policy improvements, to make it easier to do business with us
- Make the Holden concept the way you work with customers
- Offer an equivalent Holden training to the DSP group
- Improve feedback and the best practice process inside the group

5. ***Reach $6.5B in OEM revenue***

While operating system revenue will remain more than 80% of our revenue, the shift to NTW is going to be the largest contributor to this goal after pure unit growth. Without more then doubling our NTW penetration this goal will be impossible to reach. In addition, it is the most strategic thing for us to do for MS, all other opportunities are way less important. Looking at Novel's current recovery it will be important to continue the server opportunities in OEM more then in the past. In case Novel starts bundling with OEMs or persues more opportunities through the DSP channel please let us know and we are prepared to act as we see fit. The following are the other opportunities, which could contribute to achieving this goal:

- higher mouse and keyboard penetration
- doubling ROEM revenues (SBE and SBS sales)
- pursuing per-system IMG, SBE, and server agreements with royalty