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 Sent: Tuesday, March 07, 2000 10:45 AM
 To: Richard Fade's Direct Reports; OEM Carl Sittig's Direct Reports; OEM Thomas Bauer's Direct Reports; OEM SPAR Managers; Bengt Akerlind's Direct Reports
 Cc: Mark Emyre (Microsoft Licensing, Inc.); Mark Nickerson; Claude Changamier; Alain Crozier; Scott Langmack; Bill Benack; Ben Matheson
 Subject: OEM Budget Timeline

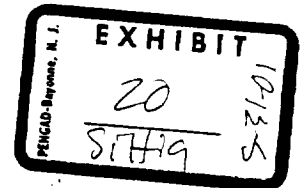
The final review of the budget will be 6/16/00, we have build a timeline below that will allow us to have the budget and the presentations done by then.

OEM FY01 Budget timeline



Send Processor Forecast kick off mail and model to the subs	2/28
MNA processor worksheet distributed	3/3
Subs and MNA submit first pass of processor Forecast	3/10
Processor Forecasts consolidated and analyzed	3/13
WWSIS	3/13 to 3/14
Kempin review Processor Forecast	3/15
Subs update Processor Forecast	3/17
Final Processor submittal by Subs	3/28
Final Processor numbers published	3/31
MNA Excel Revenue worksheets available	4/1
MNA Excel Revenue worksheets 1st Pass due	4/14
MNA meeting with HW, IMG and DAD	4/17
FY01 Headcount, Marketing and Rebates requests due	4/17
Budget Work Bench (BWB) open	4/24
Finance input FY01 expense budget into BWB	4/25 to 5/2
DSP/Named input FY01 revenue budget into BWB	4/25 to 5/5
Review and analyze WW FY01 OEM Revenues	5/5 to 5/8
Kempin Reviews FY01 OEM Revenue and P&L	5/8 to 5/12
WWSMM	5/8 to 5/11
Revised FY01 Revenue due	5/15
Budget review Templates available	5/15
Budget presentation preparation	5/15 to 6/14
BWB closed	6/11
Budget presentation	6/16

Attached is Joachim's planning Memo.



This is a Microsoft confidential memo

The overall process will be similar to prior years. We will start with the processor forecast for FY01. Ben Matheson, who did an excellent job coordinating this for the MYR, has already started this process and we should have the FY01 processors locked down by the end of March.

Once the processor forecast has been completed we will start the revenue budget. For MNA we will use excel sheets similar to the ones used last year. Richard will be sending out his Objectives Memo separately.

For the ESG and Named/DSP revenues we will use the Budget Work Bench, a corporate wide tool, for the revenue budget. We will send out more details on process and training later. This year we will budget the DSP and Named revenue at the country level only, except for Named accounts with revenue expected to be over \$5M. For the budget exercise, we

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will assume that the top 150 to 200 SB customer will be moved from DSP to Named effective July 1, 00. In other words we should include the revenues for these "new" customers in the Named budget for the full year.

We will be sending out more details as we get into the process.

Happy budgeting.

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Directions for a FY 2001 OEM Business Plan

Situation analysis

While we had a solid start in the first quarter of this FY, Q2 of FY00 finished with a disappointing result. Let me remind you that our traditional revenue growth rate has been between 30-40% over the last 10 years. Last quarter we only achieved 10.5%. Historically, we outgrew units by 50-100% in revenue but even this did not take place as BOS growth came in at 8.6%. This means we did not increase our penetration in the SB segment. We did not get a substantial revenue gain out of increased NT sales and additional applications or hardware sales did not help us significantly either. In addition, some of the market forces listed below were not favorable or controllable for us:

1. Consumers bought way less PCs this Christmas season than expected. While this might have to do with slightly higher prices (caused by some component shortages) it looks to me that for the first time in years Windows PCs were less popular than other electronic devices. Have we, and the OEMs, lost the edge to attract more PC buyers or are consumers and business people just taking a Y2k/Win2000 break? We will know by Q4 FY 2000.
2. Business PCs definitely stalled because of a combination of the Y2k effect, the Win2000 ship-date and some CPU and chip-set shortages by Intel.
3. Our SB business is stalling for several reasons. SBs are getting out of the consumer business and the Multinationals, who pay less on a per-unit basis are gaining share. We have nearly stopped converting the top SBs into Named accounts. This has led to less control over the BOS penetration and attachment rates in these accounts. We are less focused on BOS and more on ROEM revenue. Our distis aren't working as hard to find new customers because it seems easier for them to serve the larger volume sub-distributors, which in turn makes it harder for us to know who the real customers are. Last but not least, there is too much gray and counterfeit product in the market place.
4. We are experiencing a trend to have less application bundling in the market because we are not looking for all the opportunities and/or are unable to sell the merits of our products against the "free" product hype. I firmly believe that in losing the BOS sales, we always lose the applications sales as well and this might get worse in the future if Linux gets a stronghold on the DT.
5. The mouse business is suffering from quality issues. These, as well as product delays, also plague the keyboard business.

While OEM cannot be held responsible for a less attractive environment for Windows, the Y2k effect as well as the Win2000 ship date- we are responsible for the complications we created in the SB and Named business and our inability to create more bundling opportunities for HW and SW products with Named and MN accounts. At the same time, I am not criticizing anyone of not working hard enough. I believe the opposite is true, but I am afraid that working harder alone will not get us the desired results. We need to start changing some of our business infrastructure and processes to regain control over our destiny.

Let me remind you that job #1 remains to create competitive immunity (as defined by Holden training), job #2 is to support industry growth by working closely with our partners and job #3 is to go after the numerous non-OS opportunities. In the SB and Named segment we seem to be struggling in getting job #1 done, while in MN we are having trouble achieving #2 and #3. This is not a pretty picture knowing

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that in the years ahead we are going to face an even tougher competitive environment. No reason to panic or get depressed – the fun starts here in turning this around and exceeding expectations again.

The job ahead

We should recognize that the OEM business is a great business for Microsoft and we have exciting opportunities ahead of us. As long as we see this temporary set back as an opportunity to make the right decisions in restructuring our go-to-market strategies, I am convinced we can overcome this slow down and get back on an improved growth path.

We will continue in the foreseeable future to license products through the OEM channel to consumers as well as businesses. We will continue going through distribution channels, as well as having direct relationships with OEMs. All the 21st century hardware everybody expects to sell will need software preinstalled to work out of the box. Even if high-speed connections become a reality I consider them a great way to enhance and update the original software, but not a substitute for the installation process.

Products of the future will have much higher service content than the ones we have licensed in the past. This should help us get closer to serving the users of our products on a daily basis. As a group, we have to learn how to sell these new services in the context of an extended partnership model. We will also experience new devices and form factors, which might challenge the Windows platform harder than ever before. We need to ensure that OEMs and their resellers understand and promote the value Windows delivers for them and the end-users while the product divisions continue their crusade to make the Windows platform the most attractive computing platform in the computing universe.

It was very timely for the company to endorse this new competitive environment by changing its mission statement to: "empower people with software on all devices anywhere". I am sure there will be many new scenarios in the future, which we have to answer with embedded, traditional and more service-focused solutions. This is one of the reasons we have been investing in our Embedded System Group over the last couple of years, why we have engaged in MSN negotiations with customers and why we have a Windows Update service built into our products. We are not as far behind in implementing our new vision as some people might think.

The next big push for our company will be to attract more developers to a new programming model which allows them to cover a larger range of form factors with a single development environment and be more cross platform compatible. This will then be topped by a new UI paradigm in 2002 to make working with electronic devices simpler than ever before. This is just a start of things to come. We, nor our competitors, can become complacent and I hope you will help lay a foundation in FY01 for tackling these and other OEM opportunities in the years ahead.

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Objectives for FY 2001

1. Regain control of the SB business by returning it to a 25% growing BOS business
2. Increase Win2000/NT units by 50% over FY00
3. Enlarge focus for Named business by signing up 200 new direct accounts
4. Improve customer satisfaction with OEM operations significantly
5. Exceed \$9.0B in revenue

Strategies and Tactics for Achieving FY 2001 Objectives

1. SB business

To reduce the volatility of this business we have take several actions over the next six months. (The 25% growth is calculated on the reduced business opportunity after we sign up an additional 200 direct accounts.)

- a) Determine the Named accounts to sign up for FY 2001 and start as soon as the operational capacity allows us to do so. Experience shows that we get more business from direct customers than from customers who only buy our products through distribution- this is true for the total BOS units as well as all additional revenues coming from other products. I expect that we will be ready for this at the end of March.
- b) Review distributor effectiveness and determine how many more and which distis it will take to penetrate deeper into the SB segment. Our distis seem to be focused on serving the larger SBs and the sub-distis. In order to recruit and convert the dishonest part of the SB segment we will have to review and possibly change our distributor criteria.
- c) Formulate a short term and long term anti-piracy plan and put it into action. This includes controlling gray marketing, counterfeiting and other regional measures. We are only making a first step eliminating some of the OEM gray market distribution with the new CD and COA technology. We need to continue working closely with Legal and the product groups to ensure we get paid for our products and services. The future service aspect, in particular, makes me believe that we could gain more control over the situation if we start thinking about this today.
- d) Find a way to allocate more marketing money towards our business without having to beg the subsidiaries for funds.
- e) Increase team effectiveness by creating account management tools, which allows better business control of dropouts and increases efforts for more value creation activities for paying SBs.
- f) Figure out how to re-qualify third party installers and put manual controls in place until we find an IT supported solution.

2. NT/Win2000 penetration

This remains the key objective for gaining revenue upside in the business segment, which will be under severe price pressure over the next 12 months. While we can expect a very strong push for Win2000 in the subsidiaries, initially our success in FY 2001 depends on how well we can engineer attractive follow up activities with SB, Named and MN customers.

- a) Gain access to funds to allow a significant small business push in FY 2001 in conjunction with OEMs and their marketing money.
- b) Increase the number of business systems being offered as a default option by 100%.
- c) Use MDA funds for Windows 2000 promotional and PR activities.
- d) Support Windows 2000 pricing by selling its values to the OEMs and the business community.

- e) Allocate most of the SB marketing money into promoting this platform. Small business customers are the main segment for SB and are the hardest to convince.

3. Named business focus

This will challenge our execution excellence in MSLI and the field but it remains the only known way to me to regain control of this business. We made a mistake letting too much go through distribution and we have to go back to our roots.

- a) Make this a key goal of every field manger for the second half of FY00.
- b) Create a management tool, which shows operational capacity and sign up rate/goal by region.
- c) Do not let current ROEM goal achievement get in the way of the sign up activity – meaning if ROEM will be below budget so be it. We can always find a way to reconcile this as needed. I believe internal and artificial budget goals should not get in the way of improving business.
- d) Create a very short (less than 4 page contract body) for Named accounts.
- e) Allocate more marketing funds in 2001 and review headcount redeployment/add-on needs at budget time only after all redeployment options have been exhausted.

4. Satisfaction with operations

Operational excellence is not our strength today. We run our business with insufficient IT systems and most of our processes are therefore inflexible and not scalable. At the end of the day we will have to get rid of all paper-based systems and also interface seamlessly with our customers. In addition, I firmly believe that the right IT systems can improve control over the business, in particular with gray market distribution. This is the only way we will be able to do "business at the speed of thought". In order to enable OEM customers to more efficiently and effectively do business with us, we will have to provide them with a secure web-enabled operational interface.

- a) Define business requirements and security model in Q3 FY00
- b) Start development of online licensing model, COA and ATM ordering and online payment modules over the next 9-12 months based on a priority schedule.
- c) Hire and train sufficient temporary staff to deal with the increased workload when signing up more direct customers.
- d) Effectively help the field organization by conducting systematic and helpful audits for all level of business partners: ARs, OEMs, 3rd party installers and distributors. As soon as we have the IT system in place these may not be necessary any longer.
- e) Provide monthly analysis of shipment and inventory for all levels of business partners and use this to drive business, anti-piracy and audit decisions.
- f) Get commitment from legal to improve their services, especially for creating new contracts and turn around time.

5. Exceed \$9.0B

This might be ambitious without an overall unit turn around, but does represent less than 20% growth over FY00. I will focus the rest of this discussion on upside opportunities instead of discussing how to obtain overall Windows popularity, which I consider the key marketing challenge for the next 2-3 years. Having discussed the Win2000 opportunities already I will disregard this as well.

- a) Server opportunities can be seen in several areas. The one-server-fits-all era is over and we will see more dedicated servers being deployed. This should give us more

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opportunity in the OEM channel. We need to aggressively pursue volume appliance server opportunities on the low end; while for standard and advanced server products we should stay with the current strategy (sell with min. commits where we can and gain more share compared to going through distribution). However, we need to watch and act fast when these standard servers become PC-like commodities and will create more OEM bundling opportunities. We will then have to pursue more OEM opportunities than we do today and not leave these to our competitors like Novell. Data server is absolutely a great MN/OEM opportunity and we should try harder to get per system design-ins and not sell it on a per copy basis. For the SB channel we have to push server sales more through marketing activities.

- b) Hardware sales might continue to suffer if we can't get the quality and reputation back on track. This means we have to monitor PG progress closely. Additionally, we need to stay alert to price pressures and act quickly to counter any potentially large share loss. We also have to improve our serviceability in this segment in order to compete effectively. This starts with simplified legal documents and taking purchase orders instead of just signing complicated contracts. The plan calls for halting delivery of goods through UPS and deploying our internal retail model for the OEM HW operations.
- c) The applications business remains a cornerstone of our profitability and we need creative marketing and sales activities to increase this business. It is under siege from the "all for free" community. With Sun and Corel having a lot of visibility in the Office space, a renewed value selling push throughout the year is needed to create demand for our products. The strategy should be to maintain status quo for MN and significantly increase ROEM and Named licensing business for the small business segment. To win these sockets for MS, a low priced WORD and Works strategy complements the above. Selling additional consumer applications could be easier in the future knowing that our games are being viewed as being more popular than in the past.
- d) Embedded opportunities exist inside and outside the embedded group customer base. While the embedded area is focused on certain market segments like automotive, mobile devices and Web TV - a lot of business can potentially come from distribution opportunities. We have still a long way to go to make CE and NTE market leaders in their categories. FY 2001 is the opportunity to get closer to this goal as both operating systems will undergo a major release. Traditional OEMs, in my view, will see some of these segments as opportunities to design or just resell new emerging devices. While we should always focus on design wins, we should also be recommending the right strategy to these OEMs and ideally influence their decision to embrace and resell one of our partner solutions. It is easy to see that the business in this segment could potentially exceed \$200M next FY and that design wins for new Internet appliances with traditional OEMs could tremendously help achieve this goal.
- e) The SB segment needs to focus on penetrating the non-paying OS segment. Complemented by the right anti-piracy actions, systematic education and raids I am confident we can grow this business faster. We need to challenge Legal to come up with a plan and execute systematically. At least 50% of this segment WW is not paying us properly. The numbers differ widely by country, but even in W-Europe 30% of the supply come from non-legit sources. This remains close to a \$1B opportunity for us and even more if we can move the SBs to Win2000.

In summary

I expect FY01 to be difficult as well as an exciting year knowing that we are facing a transition from NT to Windows 2000. Windows 98 improvements, while urgently needed, are not going to give us an edge and we should therefore completely focus on making Windows 2000 a default position in the business market. Revenue could improve significantly for us if the move to Windows 2000 accelerates. We are in good shape with the next version of Office being released in spring. But we will have to work very hard to overcome the free SW syndrome, which AOL might champion in the future to increase value to their

customers. If they offer Star Office online as a free service or with value add services, it could endanger MSN revenue as well as Office revenue. This means companies who now bundle Office and promote AOL services bundles might drop Office completely in the future because the user can get an alternative to Office free over the Web. We will have to sell our value proposition much harder and may have to get more aggressive on price.

To close this memo let me say that we as an organization, as well as individuals, have to be willing to accept the risk of change to create a self-sustaining cycle of improvements and ongoing sense of learning and renewal. Our individual and collective success, which we have enjoyed over the last 10 years can only continue if we embrace change as an opportunity rather than reacting to it in a crisis mode. Let's do exactly that and we should see huge improvements in the FY ahead.

As a follow up to this direction memo, I expect all regional managers to write their implementation plans by end of February 2000, followed by global marketing plans for the Named, SB and MN segment by end of March 2000 at the latest.

Happy planning and good selling.

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