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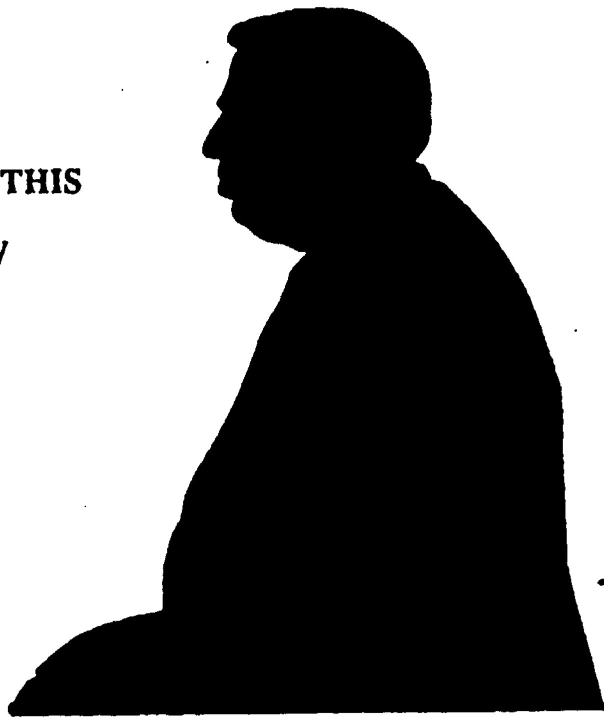


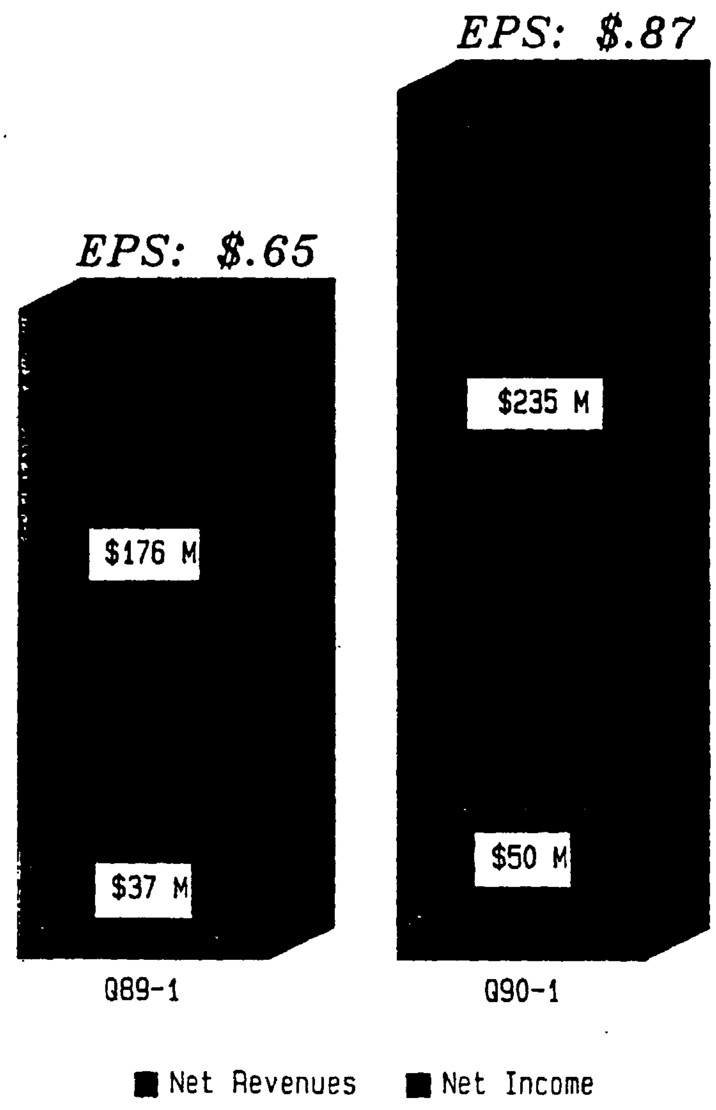
Lurks...

Finance and Administration Report

FOR QUARTER ENDED SEPTEMBER 30, 1989

OCTOBER 27, 1989

...Great Numbers!!



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FINANCE

RESULTS OF OPERATIONS

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RESULTS OF OPERATIONS COMPARED WITH PRIOR YEAR

Consolidated statements of income compared with prior year for the three months ended September 30, 1989 and 1988, are presented below. Amounts are in thousands, except net income per share.

	Q90-1		Q89-1		Change Percentage
Net revenues	$235,161	100.0%	$176,393	100.0%	33
Cost of revenues	50,759	21.6	45,931	26.0	11
Gross profit	184,402	78.4	130,462	74.0	41
Operating expenses:					
Research and development	39,690	16.9	22,938	13.0	73
Sales and marketing	66,974	28.5	48,673	27.6	38
General and administrative	8,349	3.5	6,297	3.6	33
Total operating expenses	115,013	48.9	77,908	44.2	48
Operating income	69,389	29.5	52,554	29.8	32
Non-operating income	5,037	2.1	3,346	1.9	51
Stock option program expense	(1,500)	(0.6)	(2,101)	(1.2)	29
Income before income taxes	72,926	31.0	53,799	30.5	36
Provision for income taxes	23,338	9.9	17,217	9.8	36
NET INCOME	$ 49,588	21.1%	$ 36,582	20.7%	36
Average shares outstanding	57,180		56,076		
NET INCOME PER SHARE	$ 0.87		$ 0.65		34

Net revenues for the first quarter of fiscal year 1990 (Q90-1) increased 33% to $235.2 million from $176.4 million for the corresponding period of the prior year (Q89-1). The following is a breakdown of net revenues by Channel of Distribution and Product Group.

	Q90-1		Q89-1		Growth Percentage
Channel of Distribution					
USSMD	$ 79,526	33.8%	$ 62,570	35.5%	27
International Retail	80,213	34.1	57,548	32.6	39
Worldwide Retail	159,739	67.9	120,118	68.1	33
Domestic OEM	35,161	14.9	22,715	12.9	55
International OEM	35,189	15.0	28,645	16.2	23
Worldwide OEM	70,350	29.9	51,360	29.1	37
Press	3,002	1.3	3,438	2.0	(13)
US MSU	1,210	0.5	1,065	0.6	14
US PSS	381	0.2	132	0.1	189
Int'l PSS	211	0.1	-	-	-
Systems Journal	258	0.1	230	0.1	12
Int'l Consulting	10	-	-	-	-
CD ROM	-	-	50	-	-
Total	$235,161	100.0%	$176,393	100.0%	33
Product Group					
Applications	$106,425	45.3%	$ 72,054	40.8%	48
Systems	75,232	32.0	58,965	33.4	28
SPAG	25,297	10.8	20,451	11.6	24
Languages	12,973	5.5	16,043	9.1	(19)
Books	3,038	1.3	3,735	2.1	(19)
Xenix	2,309	1.0	2,457	1.4	(6)
Services	1,926	0.8	1,314	0.8	47
Network	7,650	3.2	1,103	0.6	594
Systems Journal	266	0.1	288	0.2	(8)
Multimedia	240	0.1	137	0.1	75
Intergroup Royalty	(195)	(0.1)	(154)	(0.1)	-
Total	$235,161	100.0%	$176,393	100.0%	33

The Company's leading products for the quarter (compared with prior year) were as follows:

Q90-1	Q89-1		Q90-1 Units	Q90-1 Revenue	Q89-1 Units	Q89-1 Revenue	Revenue Growth %
1	1	DOS/GW Basic	3,519,434	$ 51,691	2,287,067	$ 34,641	49
2	3	PC Word	135,637	25,463	97,222	17,382	46
3	2	Microsoft Mouse	304,332	25,237	255,243	19,367	30
4	5	Win Excel	84,169	17,552	42,342	10,447	68
5	4	Windows	642,802	13,077	506,318	10,685	22
6	7	Mac Word	75,926	12,298	66,707	9,292	32
7	6	Mac Excel	58,001	10,774	47,121	9,476	14
8	10	PC Works	193,929	9,341	54,431	3,494	167
9	8	Pro C	37,859	5,493	33,609	5,417	1
10	9	PC Multiplan	40,417	4,240	45,101	4,269	(1)
11	12	Mac Works	24,861	3,340	21,068	2,522	32
12	13	Xenix	37,844	2,308	29,594	2,447	(6)
13	14	PC Chart	8,097	1,594	14,444	2,342	(32)
14	15	Pro Fortran	6,883	1,580	8,997	2,030	(22)
15	-	QuickBasic	27,591	1,564	24,126	1,350	16
				$185,552		$135,161	
		Percent of net revenues		79%		77%	

Q89-1 #11 PC - Flight Simulator ($2,967)

Cost of revenues for Q90-1 was 21.6% of net revenues compared with 26.0% for Q89-1. Product costs as a percentage of net revenues were 16.2% for Q90-1 compared with 18.0% for Q89-1. The analysis on page 4 contains the Q90-1 and Q89-1 product cost percentage for each channel of distribution and each product group. Regarding the reduction in the composite product cost percentage, channel mix was not a significant factor (Q90-1 revenue consisted of 68% worldwide retail, 30% worldwide OEM and 2% other, whereas Q89-1 consisted of 68% worldwide retail, 29% worldwide OEM and 3% other). However, we did experience a fairly significant shift in product group mix, which had a favorable effect. Specifically, Applications accounted for 45% of total revenue, compared with 41% for Q89-1. Applications' increase came at the expense of Languages and Hardware. Additionally, we experienced product cost reductions within several product groups (most notably Applications and Hardware).

Non-product costs included in cost of revenues as a percentage of net revenues were 5.4% for Q90-1 compared with 8.0% for Q89-1. This 2.6% margin improvement resulted from gains in manufacturing variances (0.7%), inventory adjustments (0.6%), freight, shipping and other (0.9%) and royalties (0.4%). In general, these improvements resulted from economies of scale in manufacturing and distribution, as well as better inventory management. Q90-1 results include an inventory reserve accrual of $2.0 million.

Operating expenses grew 48% from period-to-period (from $77.9 million to $115.0 million). The growth in operating expenses exceeded the growth in net revenues (33%) and, as such, operating expenses as a percentage of net revenues increased from 44.2% to 48.9%. Categorized in SEC format and expressed as a percentage of net revenues, research and development increased from 13.0% to 16.9%, sales and marketing increased from 27.6% to 28.5%, and general and administrative decreased from 3.6% to 3.5%. Payroll (up $14.2 million or 56% to $39.4 million) accounted for 38% of the period-to-period growth in operating expenses. Q90-1 results include a marketing accrual of $8.4 million and a bad debt reserve accrual of $1.0 million.

Non-operating income for Q90-1 was $5.0 million compared with $3.3 million for Q89-1. Non-operating income for the current quarter consists of investment income of $6.0 million, SCO valuation adjustment of $500,000 and miscellaneous expense of $500,000. Non-operating income for Q89-1 consists of investment income of $3.9 million, loss on equity investment in EIKON of $400,000 and miscellaneous expense of $200,000.

Stock option program expense is the result of the Company's program regarding incentive stock options under which employees, if they elect to participate, receive a cash payment in exchange for taking certain actions that result in a tax benefit to the Company. Under current accounting rules, the Company reports the gross benefit under the program as a contribution to capital, whereas the expense net of directly related taxes is charged against income. Accounting rules require that this expense be recognized ratably over the vesting period of the related options as opposed to being recognized when paid. As of September 30, 1989, our accrual for stock option program payments to be made upon exercise of vested options is $9.4 million. See page 5 for an analysis of the adequacy of this accrual.

The effective tax rate for Q90-1 was 32.0%, the same as Q89-1.

Net income for Q90-1 was $49.6 million compared with $36.6 million for Q89-1. Net income as a percentage of net revenues increased from 20.7% to 21.1%.

MICROSOFT CORPORATION
CONSOLIDATED COST OF GOODS SOLD
Q90-1 COMPARED WITH Q89-1

CHANNEL	Q90-1 SALES MIX	Q90-1 COST %	Q90-1 WEIGHTED COST %	Q89-1 SALES MIX	Q89-1 COST %	Q89-1 WEIGHTED COST %
USSMD	34.5%	21.7%	7.5%	36.3%	24.3%	8.8%
INTL RETAIL	33.3%	22.3%	7.4%	31.8%	24.7%	7.8%
US OEM	14.0%	3.4%	0.5%	12.6%	2.2%	0.3%
INTL OEM	16.3%	0.0%	0.0%	16.6%	0.0%	0.0%
PRESS	1.2%	19.2%	0.2%	1.9%	20.3%	0.4%
US PSS	0.2%	1.6%	0.0%	0.1%	0.0%	0.0%
INTL PSS	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
US MSU	0.5%	0.0%	0.0%	0.6%	0.0%	0.0%
CD ROM	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
MSJ	0.1%	37.5%	0.0%	0.1%	51.1%	0.1%
PRODUCT COST - GROSS	100.0%		15.6%	100.0%		17.4%
EFFECT OF REVENUE ADJUSTMENTS		x	103.8%		x	103.5%
PRODUCT COST - NET			16.2%			18.0%
MFG VARIANCES			-0.4%			0.3%
INVENTORY ADJ.			1.8%			2.4%
FREIGHT, SHIPPING & OTHER			2.5%			3.5%
ROYALTIES			1.4%			1.8%
			21.6%			26.0%

PRODUCT GROUP	Q90-1 SALES MIX	Q90-1 COST %	Q90-1 WEIGHTED COST %	Q89-1 SALES MIX	Q89-1 COST %	Q89-1 WEIGHTED COST %
APPLICATIONS	45.3%	16.6%	7.5%	40.8%	18.6%	7.6%
BOOKS	1.2%	19.3%	0.2%	2.1%	20.7%	0.4%
SPAG	10.7%	41.7%	4.5%	11.6%	44.0%	5.1%
MSJ	0.1%	37.5%	0.0%	0.1%	51.1%	0.1%
LANGUAGES	5.5%	21.9%	1.2%	9.1%	21.7%	2.0%
MULTIMEDIA	0.1%	7.7%	0.0%	0.1%	-13.1%	0.0%
NETWORKS	1.1%	1.0%	0.0%	0.6%	0.0%	0.0%
NON-SPECIFIC	6.6%	-0.4%	0.0%	5.8%	0.2%	0.0%
SERVICES	0.8%	6.5%	0.0%	0.8%	0.0%	0.0%
SYSTEMS	27.8%	7.8%	2.2%	27.6%	8.0%	2.2%
XENIX	0.9%	0.0%	0.0%	1.3%	0.0%	0.0%
PRODUCT COST - GROSS	100.0%		15.7%	100.0%		17.4%

MICROSOFT CORPORATION
Status of Converted Stock Options
As of September 30, 1989

	Balance as of 30-Jun-89	Activity Q90-1	Balance as of 30-Sep-89
Converted	3,306,000	375	3,306,375
Exercised	-2,158,142	-152,808	-2,310,950
Cancelled	-227,917	-6,375	-234,292
Outstanding	919,941	-158,808	761,133

ACCRUED STOCK OPTION PAYMENTS AS OF SEPTEMBER 30, 1989

Shares vested and exercisable	390,715	390,715	390,715	390,715	390,715
Fair market value per share	60	70	80	90	100
Total fair market value	23,442,900	27,350,050	31,257,200	35,164,350	39,071,500
Exercise proceeds (basis)	-1,589,447	-1,589,447	-1,589,447	-1,589,447	-1,589,447
Spread	21,853,453	25,760,603	29,667,753	33,574,903	37,482,053
Payment multiplier	20.48%	20.48%	20.48%	20.48%	20.48%
Payment	4,475,587	5,275,771	6,075,956	6,876,140	7,676,324

Shares outstanding	761,133	761,133	761,133	761,133	761,133
Fair market value per share	60	70	80	90	100
Total fair market value	45,667,980	53,279,310	60,890,640	68,501,970	76,113,300
Exercise proceeds (basis)	-3,828,288	-3,828,288	-3,828,288	-3,828,288	-3,828,288
Spread	41,839,692	49,451,022	57,062,352	64,673,682	72,285,012
Payment multiplier	20.48%	20.48%	20.48%	20.48%	20.48%
Payment	8,568,769	10,127,569	11,686,370	13,245,170	14,803,970

Accrual as of Sept. 30	9,436,000
Additional accrual fy90	4,500,000
	13,936,000

RESULTS OF OPERATIONS COMPARED WITH COMPETITION

Consolidated statements of income for Microsoft, Lotus, and Oracle are presented below. The first set is the most recent quarter; the second set is trailing twelve months' results. Amounts are in thousands, except net income per share.

	Microsoft		Lotus		Oracle	
Net revenues	$235,161	100.0%	$153,906	100.0%	$175,490	100.0%
Cost of revenues	50,759	21.6	27,843	18.1	28,630	16.3
Gross profit	184,402	78.4	126,063	81.9	146,860	83.7
Operating expenses:						
Research and development	39,690	16.9	26,222	17.0	19,666	11.2
Sales and marketing	66,974	28.5	55,341	36.0	95,278	54.3
General and administrative	8,349	3.5	14,998	9.7	12,777	7.3
Total operating expenses	115,013	48.9	96,561	62.7	127,721	72.8
Operating income	69,389	29.5	29,502	19.2	19,139	10.9
Non-operating income	5,037	2.1	565	0.3	(1,956)	(1.1)
Stock option program expense	(1,500)	(0.6)	--	--	--	--
Income before income taxes	72,926	31.0	30,067	19.5	17,183	9.8
Provision for income taxes	23,338	9.9	7,090	4.6	5,504	3.1
NET INCOME	$49,588	21.1%	$22,977	14.9%	$11,679	6.7%
Average shares outstanding	57,180		42,262		136,125	
NET INCOME PER SHARE	$ 0.87		$ 0.54		$ 0.09	

	Microsoft		Lotus		Oracle	
Net revenues	$862,298	100.0%	$518,452	100.0%	$668,524	100.0%
Cost of revenues	209,013	24.3	103,380	19.9	109,447	16.4
Gross profit	653,285	75.7	415,072	80.1	559,077	83.6
Operating expenses:						
Research and development	126,972	14.7	91,133	17.6	63,007	9.4
Sales and marketing	237,298	27.5	208,308	40.2	323,942	48.5
General and administrative	29,950	3.5	59,619	11.5	40,473	6.0
Total operating expenses	394,220	45.7	359,060	69.3	427,422	63.9
Operating income	259,065	30.0	56,012	10.8	131,655	19.7
Non-operating income	18,257	2.1	6,853	1.3	(4,775)	(0.7)
Stock option program expense	(7,399)	(0.8)	--	--	--	--
Income before income taxes	269,923	31.3	62,865	12.1	126,880	19.0
Provision for income taxes	86,379	10.0	15,329	2.9	40,502	6.1
NET INCOME	$183,544	21.3%	$47,536	9.2%	$86,378	12.9%
Average shares outstanding	56,521		42,493		135,484	
NET INCOME PER SHARE	$ 3.25		$ 1.12		$ 0.64	

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Consolidated statements of income for Microsoft for each of the four quarters ended September 30, 1989 are presented below. Amounts are in thousands. except net income per share.

	Dec. 31, 1988	Mar. 31, 1989	June 30, 1989	Sep. 30, 1989	Trailing 12 months
Net revenues	$209,882	$197,024	$220,231	$235,161	$862,298
Cost of revenues	54,721	48,891	54,642	50,759	209,013
Gross profit	155,161	148,133	165,589	184,402	653,285
Operating expenses:					
Research and development	25,177	29,128	32,977	39,690	126,972
Sales and marketing	53,637	55,211	61,476	66,974	237,298
General and administrative	7,290	6,693	7,618	8,349	29,950
Total operating expenses	86,104	91,032	102,071	115,013	394,220
Operating income	69,057	57,101	63,518	69,389	259,065
Non-operating income	2,642	5,403	5,175	5,037	18,257
Stock option program expense	(1,862)	(2,037)	(2,000)	(1,500)	(7,399)
Income before income taxes	69,837	60,467	66,693	72,926	269,923
Provision for income taxes	22,352	19,348	21,341	23,338	86,379
NET INCOME	$ 47,485	$ 41,119	$ 45,352	$ 49,588	$183,544
Average shares outstanding	55,896	56,434	56,575	57,180	56,521
NET INCOME PER SHARE	$ 0.85	$ 0.73	$ 0.80	$ 0.87	$ 3.25

Net revenues	100.0%	100.0%	100.0%	100.0%	100.0%
Cost of revenues	26.1	24.8	24.8	21.6	24.3
Gross profit	73.9	75.2	75.2	78.4	75.7
Operating expenses:					
Research and development	12.0	14.8	15.0	16.9	14.7
Sales and marketing	25.5	28.0	27.9	28.5	27.5
General and administrative	3.5	3.4	3.5	3.5	3.5
Total operating expenses	41.0	46.2	46.4	48.9	45.7
Operating income	32.9	29.0	28.8	29.5	30.0
Non-operating income	1.3	2.7	2.4	2.1	2.1
Stock option program expense	(0.9)	(1.0)	(0.9)	(0.6)	(0.8)
Income before income taxes	33.3	30.7	30.3	31.0	31.3
Provision for income taxes	10.7	9.8	9.7	9.9	10.0
NET INCOME	22.6%	20.9%	20.6%	21.1%	21.3%

Consolidated statements of income for Lotus for each of the four quarters ended September 30, 1989 are presented below. Amounts are in thousands, except net income per share.

	Dec. 31, 1988	Apr. 1, 1989	Jul. 1, 1989	Sept. 30, 1989	Trailing 12 months
Net revenues	$112,377	$119,970	$132,199	$153,906	$518,452
Cost of revenues	22,847	24,785	27,905	27,843	103,380
Gross profit	89,530	95,185	104,294	126,063	415,072
Operating expenses:					
Research and development	22,165	20,565	22,181	26,222	91,133
Sales and marketing	45,065	53,207	54,695	55,341	208,308
General and administrative	14,304	15,319	14,998	14,998	59,619
Total operating expenses	81,534	89,091	91,874	96,561	359,060
Operating income	7,996	6,094	12,420	29,502	56,012
Non-operating income	3,472	1,165	1,651	565	6,853
Stock option program expense	--	--	--	--	--
Income before income taxes	11,468	7,259	14,071	30,067	62,865
Provision for income taxes	2,480	1,960	3,799	7,090	15,329
NET INCOME	$ 8,988	$ 5,299	$ 10,272	$ 22,977	$ 47,536
Average shares outstanding	43,771	42,121	41,816	42,262	42,493
NET INCOME PER SHARE	$ 0.21	$ 0.13	$ 0.25	$ 0.54	$ 1.12

Net revenues	100.0%	100.0%	100.0%	100.0%	100.0%
Cost of revenues	20.3	20.7	21.1	18.1	19.9
Gross profit	79.7	79.3	78.9	81.9	80.1
Operating expenses:					
Research and development	19.7	17.1	16.8	17.0	17.6
Sales and marketing	40.1	44.3	41.4	36.0	40.2
General and administrative	12.8	12.8	11.3	9.7	11.5
Total operating expenses	72.6	74.2	69.5	62.7	69.3
Operating income	7.1	5.1	9.4	19.2	10.8
Non-operating income	3.1	0.9	1.3	0.3	1.3
Stock option program expense	--	--	--	--	--
Income before income taxes	10.2	6.0	10.7	19.5	12.1
Provision for income taxes	2.2	1.6	2.9	4.6	2.9
NET INCOME	8.0%	4.4%	7.8%	14.9%	9.2%

Consolidated statements of income for Oracle for each of the four quarters ended August 31, 1989 are presented below. Amounts are in thousands, except net income per share.

	Nov. 30, 1988	Feb. 28, 1989	May 31, 1989	Aug. 31, 1989	Trailing 12 months
Net revenues	$123,745	$153,354	$215,935	$175,490	$668,524
Cost of revenues	23,141	26,475	31,201	28,630	109,447
Gross profit	100,604	126,879	184,734	146,860	559,077
Operating expenses:					
Research and development	11,523	11,798	20,020	19,666	63,007
Sales and marketing	55,158	69,179	104,327	95,278	323,942
General and administrative	9,119	9,224	9,353	12,777	40,473
Total operating expenses	75,800	90,201	133,700	127,721	427,422
Operating income	24,804	36,678	51,034	19,139	131,655
Non-operating income	851	(1,970)	(1,700)	(1,956)	(4,775)
Stock option program expense	--	--	--	--	--
Income before income taxes	25,655	34,708	49,334	17,183	126,880
Provision for income taxes	8,466	10,744	15,788	5,504	40,502
NET INCOME	$17,189	$23,964	$33,546	$11,679	$ 86,378
Average shares outstanding	134,720	134,974	136,116	136,125	135,484
NET INCOME PER SHARE	$ 0.13	$ 0.18	$ 0.25	$ 0.09	$ 0.64

Net revenues	100.0%	100.0%	100.0%	100.0%	100.0%
Cost of revenues	18.7	17.3	14.5	16.3	16.4
Gross profit	81.3	82.7	85.5	83.7	83.6
Operating expenses:					
Research and development	9.3	7.7	9.3	11.2	9.4
Sales and marketing	44.6	45.1	48.3	54.3	48.5
General and administrative	7.4	6.0	4.3	7.3	6.0
Total operating expenses	61.3	58.8	61.9	72.8	63.9
Operating income	20.0	23.9	23.6	10.9	19.7
Non-operating income	0.7	(1.3)	(0.8)	(1.1)	(0.7)
Stock option program expense	--	--	--	--	--
Income before income taxes	20.7	22.6	22.8	9.8	19.0
Provision for income taxes	6.8	7.0	7.3	3.1	6.1
NET INCOME	13.9%	15.6%	15.5%	6.7%	12.9%

Consolidated statements of financial position for Microsoft, Lotus, and Oracle are presented below. Amounts are in thousands.

	Microsoft Sept. 30		Lotus Sept. 30		Oracle Aug. 31	
ASSETS						
Current assets:						
Cash and short-term investments	$336,496	42%	$221,603	41%	$ 42,340	9%
Accounts receivable - net	130,332	16	106,438	20	259,306	55
Inventories	35,974	4	26,388	5	-	-
Other	24,011	3	28,582	5	31,028	7
Total current assets	526,813	65	383,011	71	332,674	71
Property, plant and equipment - net	232,096	29	115,503	22	101,984	22
Other assets	50,270	6	39,636	7	32,409	7
TOTAL	$809,179	100%	$538,150	100%	$467,067	100%
LIABILITIES AND STOCKHOLDERS' EQUITY						
Current liabilities	$184,601	23%	$103,079	19%	$173,117	37%
Long-term liabilities	-	-	191,134	36	49,404	11
Stockholders' equity	624,578	77	243,937	45	244,546	52
TOTAL	$809,179	100%	$538,150	100%	$467,067	100%

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Selected market statistics for Microsoft, Lotus, and Oracle are presented below.

	Microsoft Sept. 30		Lotus Sept. 30		Oracle Sept. 30	
	1989	1988	1989	1988	1989	1988
Closing Stock Price	$68.50	$52.25	$28.50	$20.00	$23.63	$10.00
Common Shares Outstanding (in millions)	55.0	53.9	41.0	44.4	127.0	120.2
Market Value (in millions)	$3,768	$2,816	$1,169	$888	$3,001	$1,202
Trailing Twelve Months Revenues (in millions)	$862	$665	$518	$472	$669	$331
Price/Revenues Ratio	4.4x	4.2x	2.3x	1.9x	4.5x	3.6x
Trailing Twelve Months EPS	$3.25	$2.49	$1.12	$1.58	$0.64	$0.36
Price/Earnings Ratio	21.1x	21.0x	25.4x	12.7x	36.9x	27.8x
Cash (in millions)	$336	$204	$222	$196	$42	$32
Cash per Share	$6.11	$3.78	$5.41	$4.41	$0.33	$0.27
Price/Cash Ratio	11.2x	13.8x	5.3x	4.5x	71.5x	37.6x
Book Value (in millions)	$625	$413	$244	$267	$245	$139
Book Value per Share	$11.36	$7.66	$5.95	$6.01	$1.93	$1.16
Price/Book Value Ratio	6.0x	6.8x	4.8x	3.3x	12.2x	8.6x

RESULTS OF OPERATIONS COMPARED WITH PLAN

Consolidated statements of income compared with plan for the three months ended September 30, 1989, are presented below. Amounts are in thousands, except net income per share.

	Actual Q90-1		Plan Q90-1		Variance Percentage
Net revenues	$235,161	100.0%	$211,709	100.0%	11
Cost of revenues	50,759	21.6	49,979	23.6	2
Gross profit	184,402	78.4	161,730	76.4	14
Operating expenses					
Research and development	39,690	16.9	47,020	22.2	(16)
Sales and marketing	66,974	28.5	73,894	34.9	(9)
General and administrative	8,349	3.5	9,099	4.3	(8)
Total operating expenses	115,013	48.9	130,013	61.4	(12)
Operating income	69,389	29.5	31,717	15.0	119
Non-operating income	5,037	2.1	5,644	2.7	(11)
Stock option program expense	(1,500)	(0.6)	(1,500)	(0.7)	-
Income before income taxes	72,926	31.0	35,861	17.0	103
Provision for income taxes	23,338	9.9	10,758	5.1	117
NET INCOME	$49,588	21.1%	$ 25,103	11.9%	98
Average shares outstanding	57,180		57,000		
NET INCOME PER SHARE	$ 0.87		$ 0.44		98

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Net revenues for the first quarter of fiscal year 1990 at $235.2 million were 11% above plan of $211.7 million. The following is a breakdown of net revenues by Channel of Distribution and Product Group.

	Actual Q90-1		Plan Q90-1		Variance Percentage
Channel of Distribution					
USSMD	$ 79,526	33.8%	$ 64,715	30.6%	23
International Retail	80,213	34.1	77,939	36.8	3
Worldwide Retail	159,739	67.9	142,654	67.4	12
Domestic OEM	35,161	14.9	28,083	13.3	25
International OEM	35,189	15.0	35,393	16.7	(1)
Worldwide OEM	70,350	29.9	63,476	30.0	11
Press	3,002	1.3	3,107	1.5	(3)
US MSU	1,210	0.5	1,389	0.6	(13)
Int'l MSU	-	-	129	0.1	-
US PSS	381	0.2	327	0.1	17
Int'l PSS	211	0.1	342	0.2	(38)
Systems Journal	258	0.1	285	0.1	(9)
Int'l Consulting	10	-	-	-	-
Total	$235,161	100.0%	$211,709	100.0%	11
Product Group					
Applications	$ 106,425	45.3%	$ 97,770	46.2%	9
Systems	75,232	32.0	65,640	31.0	15
SPAG	25,297	10.8	21,886	10.3	16
Languages	12,973	5.5	11,178	5.3	16
Books	3,038	1.3	3,107	1.5	(2)
Xenix	2,309	1.0	1,889	0.9	22
Services	1,926	0.8	2,252	1.1	(14)
Network	7,650	3.2	7,380	3.5	4
Systems Journal	266	0.1	285	0.1	(7)
Multimedia	240	0.1	445	0.2	(46)
Intergroup Royalty	(195)	(0.1)	(123)	(0.1)	-
Total	$235,161	100.0%	$211,709	100.0%	11

The Company's leading products for the quarter (compared with plan) were as follows:

			Actual Q90-1		Plan Q90-1		Revenue
Actual	Plan		Units	Revenue	Units	Revenue	Variance %
1	1	DOS/GW Basic	3,519,434	$ 51,691	2,734,472	$ 40,515	28
2	3	PC Word	135,637	25,463	97,989	21,156	20
3	2	Microsoft Mouse	304,332	25,237	267,464	22,456	12
4	4	Win Excel	84,169	17,552	77,073	19,293	(9)
5	5	Windows	642,802	13,077	641,475	12,051	9
6	6	Mac Word	75,926	12,298	50,023	9,441	30
7	7	Mac Excel	58,001	10,774	42,265	9,003	20
8	8	PC Works	193,929	9,341	146,046	7,701	21
9	10	Pro C	37,859	5,493	19,827	4,757	15
10	13	PC Multiplan	40,417	4,240	23,915	2,980	42
11	11	Mac Works	24,861	3,340	32,439	4,506	(26)
12	-	Xenix	37,844	2,308	26,140	1,889	22
13	15	PC Chart	8,097	1,594	6,985	1,605	(1)
14	-	Pro Fortran	6,883	1,580	7,029	1,553	2
15	-	QuickBasic	27,591	1,564	41,412	2,327	(33)
				$185,552		$161,233	
Percent of net revenues				79%		76%	

Plan #9 - Office ($5,954); #12 - OS/2 ($3,663); #14 - Mac PowerPoint ($2,704)

Actual cost of revenues for Q90-1 was 21.6% of net revenues compared with a plan of 23.6%. Product costs as a percentage of net revenues were 16.2% compared with a plan of 16.7%. The analysis on page 15 contains the actual and plan product cost percentage for each channel of distribution and each product group. Neither channel mix or product group mix varied significantly from plan. The favorable variance in the composite product cost percentage is attributed to Applications, which had an actual product cost of 16.6% compared with plan of 17.7%. As Applications accounts for approximately 45% of the business, this 1.1% Applications variance would account for the 0.5% company-wide variance. The favorable Applications situation occurred in the International Retail channel and is primarily attributed to strong sales of high margin Mac Word and PC Word.

Non-product costs included in cost of revenues as a percentage of net revenues were 5.4% compared with plan of 6.9%. This 1.5% margin improvement resulted from gains in manufacturing variances (0.4%), freight, shipping and other (0.7%), and royalties (0.4%). The favorable manufacturing variance results from greater than planned through-put at both Campus North and Ireland, combined with a lower than planned cost of operation for both facilities. The favorable variance in freight and shipping results from several factors, including the unbudgeted reclassification to marketing expense of freight costs for promotional materials and as yet unexplained savings in most European subsidiaries (GmbH and LTD being the largest). The favorable royalties variance is primarily due to lower than planned sales of OS/2, Flight Simulator and Mac Works..

Operating expenses for the quarter at $115.0 million were 12% under plan of $130.0 million, and as a percentage of net revenues were 48.9% compared with plan of 61.4%. Categorized in SEC format, research and development was under plan by 16% ($39.7 million versus $47.0 million), sales and marketing was under plan by 9% ($67.0 million versus $73.9 million) and general and administrative was under plan by 8% ($8.3 million versus $9.1 million). Primary areas of underspending are payroll ($39.4 million actual versus $44.3 million plan), third-party product development ($5.9 million actual versus $9.1 million plan), employee fringes ($6.0 million actual versus $7.8 million plan), marketing funds and incentive programs ($1.9 million actual versus $3.6 million plan) and travel and entertainment ($5.2 million actual versus $6.7 million plan). The analysis on page 16 shows Q90-1 product marketing expense, actual to budget, by responsible group. This favorable variance in product marketing of $7.8 million was offset by a marketing accrual of $8.4 million, resulting in a net unfavorable product marketing variance of approximately $700,000.

Non-operating income for the quarter was $5.0 million compared with a plan of $5.6 million. Actual non-operating income consists of investment income of $6.0 million, an unplanned SCO valuation adjustment of $500,000 and miscellaneous expense of $500,000, whereas plan non-operating income consists of investment income of $6.1 million and miscellaneous expense of $500,000.

Stock option program expense - see discussion on page 3.

The effective tax rate for the quarter was 32.0% compared with a plan of 30.0%.

Net income for the quarter was $49.6 million compared with a plan of only $25.1 million, and as a percentage of net revenues was 21.1% compared with a plan of only 11.9%.

MICROSOFT CORPORATION
CONSOLIDATED COST OF GOODS SOLD
Q90-1 ACTUAL COMPARED WITH PLAN

CHANNEL	ACTUAL Q90-1 SALES MIX	ACTUAL Q90-1 COST %	ACTUAL Q90-1 WEIGHTED COST %	PLAN Q90-1 SALES MIX	PLAN Q90-1 COST %	PLAN Q90-1 WEIGHTED COST %
USSMD	34.5%	21.7%	7.5%	32.0%	21.7%	6.9%
INTL RETAIL	33.3%	22.3%	7.4%	36.3%	23.0%	8.4%
US OEM	14.0%	3.4%	0.5%	12.9%	3.0%	0.4%
INTL OEM	16.3%	0.0%	0.0%	16.2%	0.0%	0.0%
PRESS	1.2%	19.2%	0.2%	1.4%	19.3%	0.3%
US PSS	0.2%	1.6%	0.0%	0.1%	0.0%	0.0%
INTL PSS	0.0%	144.4%	0.0%	0.2%	107.0%	0.2%
US MSU	0.5%	0.0%	0.0%	0.6%	0.0%	0.0%
INTL MSU	0.0%	0.0%	0.0%	0.1%	0.0%	0.0%
MSJ	0.1%	37.5%	0.0%	0.1%	38.2%	0.0%
PRODUCT COST - GROSS	100.0%		15.7%	100.0%		16.2%
EFFECT OF REVENUE ADJUSTMENTS		x	103.8%		x	103.0%
PRODUCT COST - NET			16.2%			16.7%
MFG VARIANCES			-0.4%			0.0%
INVENTORY ADJ.			1.8%			1.8%
FREIGHT, SHIPPING & OTHER			2.5%			3.3%
ROYALTIES			1.4%			1.8%
			21.6%			23.6%

PRODUCT GROUP	ACTUAL Q90-1 SALES MIX	ACTUAL Q90-1 COST %	ACTUAL Q90-1 WEIGHTED COST %	PLAN Q90-1 SALES MIX	PLAN Q90-1 COST %	PLAN Q90-1 WEIGHTED COST %
APPLICATIONS	45.3%	16.6%	7.5%	46.9%	17.7%	8.3%
BOOKS	1.2%	19.3%	0.2%	1.4%	19.3%	0.3%
SPAG	10.7%	41.7%	4.5%	10.4%	40.9%	4.3%
MSJ	0.1%	37.5%	0.0%	0.1%	38.2%	0.0%
LANGUAGES	5.5%	21.9%	1.2%	5.3%	18.7%	1.0%
MULTIMEDIA	0.1%	7.7%	0.0%	0.2%	4.3%	0.0%
NETWORKS	1.1%	1.0%	0.0%	1.7%	0.2%	0.0%
NON-SPECIFIC	6.6%	-0.4%	0.0%	4.2%	0.0%	0.0%
SERVICES	0.8%	6.5%	0.0%	1.0%	18.7%	0.2%
SYSTEMS	27.8%	7.8%	2.2%	27.8%	7.5%	2.1%
XENIX	0.9%	0.0%	0.0%	0.9%	0.0%	0.0%
PRODUCT COST - GROSS	100.0%		15.7%	100.0%		16.2%

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MICROSOFT CORPORATION
CONSOLIDATED MARKETING EXPENSE
Q90-1 ACTUAL COMPARED WITH PLAN

(in thousands)

ACTUAL	US RETAIL	US OEM	OTHER	SUBS	TOTAL
MULTIMEDIA PM	(81)	0	0	0	(81)
SPAG PM	255	0	0	0	255
LANGUAGES PM	514	0	0	0	514
NETWORK PM	0	85	0	0	85
WINDOWS PM	224	0	0	0	224
DOS PM	0	47	0	0	47
OS/2 PM	0	191	0	0	191
ANALYSIS PM	1,852	0	0	0	1,852
DATA ACCESS PM	203	0	0	0	203
ENTRY PM	496	0	0	0	496
GRAPHICS PM	101	0	0	0	101
OFFICE PM	973	0	0	0	973
CHANNEL MARKETING	381	0	0	0	381
DOMESTIC NON-POOL MRKTG	131	8	569	0	708
SUBSIDIARY MRKTG	0	0	0	5,682	5,682
	5,049	331	569	5,682	11,631

PLAN	US RETAIL	US OEM	OTHER	SUBS	TOTAL
MULTIMEDIA PM	74	0	0	0	74
SPAG PM	698	0	0	0	698
LANGUAGES PM	593	0	0	0	593
NETWORK PM	0	389	0	0	389
WINDOWS PM	687	0	0	0	687
DOS PM	0	304	0	0	304
OS/2 PM	0	463	0	0	463
ANALYSIS PM	2,947	0	0	0	2,947
DATA ACCESS PM	530	0	0	0	530
ENTRY PM	767	0	0	0	767
GRAPHICS PM	281	0	0	0	281
OFFICE PM	1,829	0	0	0	1,829
CHANNEL MARKETING	726	0	0	0	726
DOMESTIC NON-POOL MRKTG	227	57	1,029	0	1,313
SUBSIDIARY MRKTG	0	0	0	7,813	7,813
	9,359	1,213	1,029	7,813	19,414

VARIANCE FAV(UNFAV)	US RETAIL	US OEM	OTHER	SUBS	TOTAL
MULTIMEDIA PM	155	0	0	0	155
SPAG PM	443	0	0	0	443
LANGUAGES PM	79	0	0	0	79
NETWORK PM	0	304	0	0	304
WINDOWS PM	463	0	0	0	463
DOS PM	0	257	0	0	257
OS/2 PM	0	272	0	0	272
ANALYSIS PM	1,095	0	0	0	1,095
DATA ACCESS PM	327	0	0	0	327
ENTRY PM	271	0	0	0	271
GRAPHICS PM	180	0	0	0	180
OFFICE PM	856	0	0	0	856
CHANNEL MARKETING	345	0	0	0	345
DOMESTIC NON-POOL MRKTG	96	49	460	0	605
SUBSIDIARY MRKTG	0	0	0	2,131	2,131
	4,310	882	460	2,131	7,783

FINANCIAL CONDITION

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FINANCIAL CONDITION

Consolidated balance sheets as of September 30, 1989 and June 30, 1989 and consolidated statements of cash flows for Q90-1 and Q89-1 are presented below (in thousands).

	Sept. 30 1989	June 30 1989	Quarter Change	Quarter % Change
Current assets:				
Cash and short-term investments	$336,496	$300,791	$35,705	12
Accounts receivables - net	130,332	111,180	19,152	17
Inventories	35,974	37,755	(1,781)	(5)
Other	24,011	19,223	4,788	25
Total current assets	526,813	468,949	57,864	12
Property, plant and equipment - net	232,096	198,825	33,271	17
Other assets	50,270	52,824	(2,554)	(5)
TOTAL ASSETS	$809,179	$720,598	$88,581	12
Current liabilities:				
Accounts payable	$ 52,409	$ 41,953	$ 10,456	25
Customer deposits and deferred revenue	14,074	10,043	4,031	40
Accrued compensation	20,201	25,718	(5,517)	(21)
Notes payable	27,477	25,419	2,058	8
Income taxes payable	51,314	30,269	21,045	70
Other	19,126	25,416	(6,290)	(25)
Total current liabilities	184,601	158,818	25,783	16
Stockholders' equity:				
Common stock	55	55	-	-
Paid-in capital	125,634	110,425	15,209	14
Retained earnings	505,140	455,552	49,588	11
Translation adjustment	(6,251)	(4,252)	(1,999)	(47)
Total stockholders' equity	624,578	561,780	62,798	11
TOTAL LIABILITIES & EQUITY	$809,179	$720,598	$88,581	12

	Q90-1	Q89-1
Cash flows from operations		
Net income	$ 49,588	$ 36,582
Depreciation and amortization	9,497	5,065
Current liabilities, excluding notes payable	23,725	11,354
Accounts receivable	(19,152)	(9,849)
Inventories	1,781	(4,388)
Other current assets	(4,788)	(2,183)
Translation adjustment	(1,999)	(4,433)
Net cash from operations	58,652	32,148
Cash flows from financing		
Notes payable	2,058	6,791
Common stock issued	10,815	1,275
Income tax benefits related to stock options	4,394	3,764
Net cash from financing	17,267	11,830
Cash flows used for investments		
Additions to property, plant and equipment	(40,384)	(22,622)
Acquisition of intellectual property rights	(786)	(1,621)
Other	956	(671)
Net cash used for investments	(40,214)	(23,572)
Net change in cash and short-term investments	35,705	20,406
Cash and short-term investments at beginning of period	300,791	183,225
Cash and short-term investments at end of period	$336,496	$203,631

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And the beat goes on! Microsoft recorded yet another excellent performance during the first quarter as is corroborated by the measures of financial strength in the table below. All of these indicators registered gains ranging from 10.4% to 13.7% except for the "cash flow from operations" indicator. This indicator, which is a component of the cash flow format recently adopted by the FASB, declined 16.6% or $11.7 million primarily because of the increase in receivables. This presentation of cash flows reflects not only the effect of operations on cash flow, but also provides insight into the management of the company's balance sheet. For example, while operations threw off $58.7 million and financing contributed $17.3 million, the Company invested $40.2 million, virtually all in property, plant and equipment. The net effect of these cash flows resulted in an increase of $35.6 million or 11.8% in cash for a total of $336.4 million.

While working capital increased $32.1 million or 10.4% to a new high of $342.2 million, current liabilities grew at a somewhat faster clip (16%) than current assets (12%); thus, both the current and quick ratios declined slightly to 2.9 and 2.5, respectively.

Further reflecting the Company's overall growth, total assets increased $88.6 million to $809.2 million while stockholders' equity grew $62.8 million to $624.6 million. Net income from operations accounted for $49.6 million of the equity growth, and paid in capital contributed $15.2 million

MEASURES OF FINANCIAL STRENGTH
(dollars in millions)

	Q90-1	Q89-4	Change	% Change
Cash flow from operations	$ 58.7	$ 70.4	$ (11.7)	(16.6)%
Income statement cashflow	59.1	52.0	7.1	13.7
Cash and short-term investments	336.4	300.8	35.6	11.8
Working capital	342.2	310.1	32.1	10.4
Total assets	809.2	720.6	88.6	12.3
Stockholders' equity	624.6	561.8	62.8	11.2

The stable pattern of the critical growth indicators in the table below underscores the impressive strength of Microsoft, especially as reflected in the 72.3% annualized rate of return on non-cash equity. The following rates of return are based on the average equity and assets employed during the respective periods.

GROWTH INDICATORS
(annualized)

Return On:	Q90-1	Q89-4	Q89-3	Q89-2	Q89-1
Equity	33.4	33.9%	33.7%	43.3%	37.1%
Assets	25.9	26.6%	26.4%	32.9%	28.1%
Non-cash equity	72.3	73.4%	71.1%	86.7%	72.9%
Non-cash assets	44.4	46.1%	44.8%	53.2%	44.7%
Net revenues	21.1	20.6%	20.9%	22.6%	20.7%

Finally, book value during the first quarter increased 10.4% (annualized rate of 41.6%) to $11.36 per share, while shares outstanding increased 0.7% to 55 million shares.

Cash and Short-Term Investments

As previously noted, cash and short-term investments (at cost) increased $35.6 million in Q90-1 to $336.4 million. These liquid assets comprise 63.9% of current assets and 41.6% of total assets. As of quarter-end, the portfolio consisted of the security types and amounts listed below (also, see the accompanying pie chart and detailed listing of securities on the following pages):

	$ in Millions			
Security	Domestic	International	Total	Percent
Cash and Money Market Funds	$ 1.7	$ 19.2	$ 20.9	6.2%
Repurchase Agreements	3.4	-	3.4	1.0
Loan Participations	55.1	15.3	70.4	20.9
Floating Rate Notes	16.0	-	16.0	4.8
Auction Preferred Stock	5.0	-	5.0	1.5
Increasing Rate Notes	0.5	15.9	16.4	4.9
Corporate Bonds	8.0	-	8.0	2.4
Money Market Preferreds	90.8	-	90.8	27.0
Fixed Adjustable Rate Preferreds	18.3	-	18.3	5.4
Tax Exempt Municipals	87.2	--	87.2	25.9
	$286.0	$50.4	$336.4	100.0%

As can been seen from the table above, there were $19.2 million of cash at quarter-end distributed among the subs as follows: ten subs had less than a half million, and nine subs had more than one million. However, only IBV had cash in excess of its payables.

Concerning compliance, as of September 30, the portfolio was in compliance with all of the investment guidelines, save one stipulation. Namely, not more than $2 million shall be invested in any one issuer of high yield "junk" securities. In the category of increasing rate notes, the portfolio included $2.7 million of Goodson Newspapers which overage results from interest payments being "paid in kind". As of this writing, however, the "takeout" financing for Goodson is in registration and these notes are scheduled for redemption by calendar yearend.

In an attempt to quantify the value added to investment income by the treasury department during Q90-1, two series of financial data have been compiled (see tables I & II below) which compare the actual investment income realized from the portfolio with alternative investment strategies. Table I summarizes the incremental dollars earned on the respective principal amounts invested in each category versus the alternative investments of 90-day Libor, 90-day T-bills or overnight repos. For comparative purposes, the dollar amounts listed in Table I in the money market preferred and municipal security categories have been grossed up to reflect their pretax equivalents. From table II below, it can be seen that our actual investment results were 31% better than investing only in overnight repurchase agreements at First Interstate; 31% better than investing only in 90-day treasury bills; and 20% better than investing only at 90-day libor rates. Of particular interest are the wide margins by which increasing rate notes (97%), money market preferreds (30%), and municipal securities (29%) have outperformed the overnight repo strategy.

TABLE 1
Comparative Investment Incomes from 4 Investment Strategies for Q90-1 (Results Reflect Pre-tax Equivalents)
(dollars in thousands)

	90-Day Libor	90-Day T-Bill	Overnight Repo	Actual
Overnight Repurchase Agreements	$ 44	$ 40	$ 40	$ 41
Commercial Paper & Bank Loan Participations	1,399	1,277	1,283	1,496
Auction Preferred Stock & Floating Rate Notes	266	243	246	299
Fixed Adjustable Rate Preferred	206	188	193	224
Increasing Rate Notes	432	393	400	790
Money Market Preferreds	2,619	2,393	2,417	3,152
Municipal Securities	2,166	1,968	1,962	2,539
TOTAL	$7,132	$6,502	$6,541	$8,541

TABLE 2
Comparative Percentages by which Actual Investment Income Over or (Under) Performed 3 Alternative Investment Strategies for Q90-1

	90-Day Libor	90-Day T-Bill	Overnight Repo
Overnight Repurchase Agreements	(7)%	2%	1%
Commercial Paper & Bank Loan Participations	7	17	17
Auction Preferred Stock & Floating Rate Notes	12	23	22
Fixed Adjustable Rate Preferred	8	19	16
Increasing Rate Notes	83	101	97
Money Market Preferreds	20	32	30
Municipal Securities	17	29	29
78			
TOTAL	20	31	31

In summary, during Q90-1, the investment portfolio generated $6.04 million on a worldwide basis which was $60,000 or 1% under plan. The factors that produced these results were (1) interest rates were lower than planned, but (2) cash was significantly higher than planned.

Finally, the $6.0 million investment income translates into $5.0 million of equivalent after-tax income, which amounts to 10.1% of the Company's total net income, or 8.7 cents per share.

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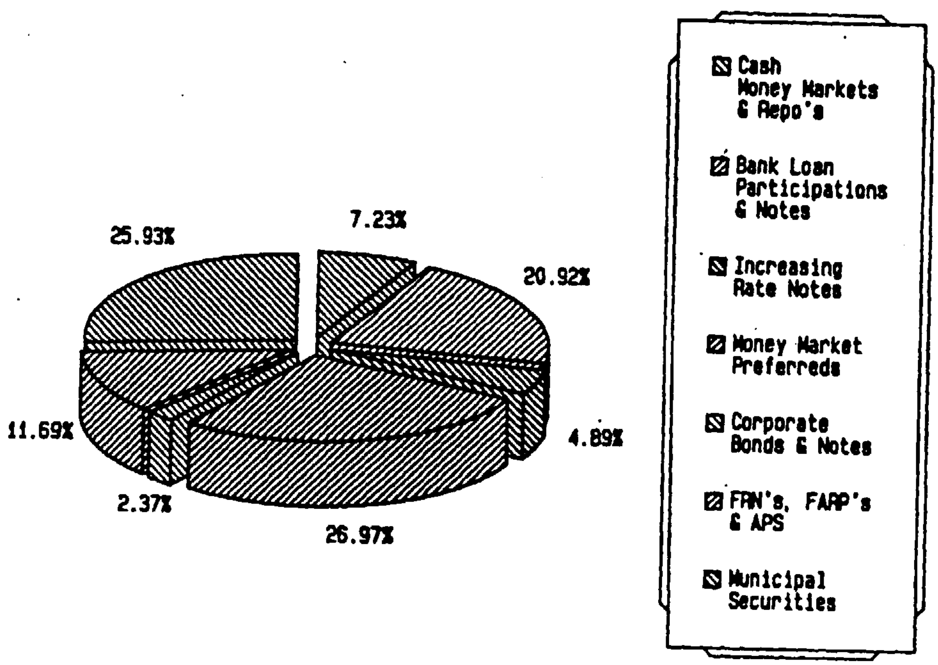
Investment Portfolio
September 30, 1989



Total Investments
(in Millions)

Domestic	$286.1
International	50.4

	$336.5

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MICROSOFT CORPORATION
DOMESTIC INVESTMENT PORTFOLIO
AS OF SEPTEMBER 30, 1989

	ISSUER	MATURITY DATE	EFFECTIVE RATE	PRINCIPAL	PERCENT OF PORTFOLIO	RATING MOODY/S&P
CASH		N/A	N/A	$1,728,498	0.51%	N/A
REPURCHASE AGREEMENTS						
1	REPO - GOLDMAN SACHS	10/2/1989	9.10%	3,400,000	1.01%	TSY
				3,400,000	1.01%	
LOAN PARTICIPATIONS						
1	ALCO STANDARD	10/2/1989	9.30%	3,100,000	0.92%	A1/P2
2	FREEPORT MCMORAN	10/10/1989	9.40%	10,000,000	2.97%	BBB-
3	GREAT LAKES CHEMICAL	10/2/1989	9.70%	2,000,000	0.59%	A1/P2
4	JAMES RIVER	10/2/1989	9.65%	10,000,000	2.97%	A2/P2
5	MCDONALD DOUGLAS	10/2/1989	9.65%	10,000,000	2.97%	A1/P2
6	NEWMONT MINING	10/11/1989	9.50%	4,000,000	1.19%	BBB-
7	SOCIETY N.Y. HOSPITAL	10/10/1989	9.30%	4,000,000	1.19%	BBB+
8	SONAT, INC.	10/2/1989	9.50%	12,000,000	3.57%	A2/P2
				55,100,000	16.37%	
FLOATING RATE NOTES						
1	LOMAS FINANCIAL CORP	10/6/1989	13.69%	5,000,000	1.49%	BAA2
2	NAT'L MEDICAL ENTERPRISES	10/11/1989	9.75%	5,000,000	1.49%	BAA2/BBB-
3	NAT'L MEDICAL ENTERPRISES	10/25/1989	9.70%	6,000,000	1.78%	BAA2/BBB-
				16,000,000	4.75%	
AUCTION PREFERRED STOCK						
1	ENGLISH CHINA CLAY - A	10/24/1989	7.60%	1,000,000	0.30%	A3/A
2	ENGLISH CHINA CLAY - C	11/7/1989	7.70%	1,000,000	0.30%	A3/A
3	RANK ORGANIZATION - C	10/25/1989	7.60%	3,000,000	0.89%	A3/A-
				5,000,000	1.49%	
INCREASING RATE NOTES						
1	GOODSON NEWSPAPERS	7/15/1997	18.00%	112,209	0.03%	N/R
2	RC HOLDING	10/15/1989	14.75%	400,000	0.12%	N/R
				512,209	0.15%	
CORPORATE BONDS						
1	COMMONWLTH ED 12.125%	5/15/2013	9.13%	1,092,450	0.32%	BAA1/BBB
2	COMMONWLTH ED 12.125%	5/15/2013	9.15%	1,091,640	0.32%	BAA1/BBB
3	COMMONWLTH ED 12.125%	5/15/2013	11.88%	1,087,500	0.32%	BAA1/BBB
4	PHILADELPHIA ELECTRIC	11/15/1990	10.52%	568,100	0.17%	BBB
5	SOUTH CENTRAL BELL	12/30/1989	9.38%	1,087,500	0.32%	AAA/AAA
6	TEXAS UTILITIES ELEC. CO	12/1/1990	10.25%	2,159,400	0.64%	BAA1/BBB+
7	U.S. GYPSUM 7.375% 91	12/15/1991	12.43%	896,350	0.27%	BA3/BB-
				7,982,940	2.37%	

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MICROSOFT CORPORATION
DOMESTIC INVESTMENT PORTFOLIO
AS OF SEPTEMBER 30, 1989

	ISSUER	MATURITY DATE	EFFECTIVE RATE	PRINCIPAL	PERCENT OF PORTFOLIO	RATING MOODY/S&P
MONEY MARKET PREFERRED - 70% TAX FREE						
1	AMR CORP - A	10/18/1989	10.69%	5,000,000	1.49%	A3/A
2	AMR CORP - B	10/20/1989	10.71%	1,500,000	0.45%	A3/A
3	AMR CORP - B	10/20/1989	10.93%	3,500,000	1.04%	A3/A
4	AMR CORP - C	10/30/1989	11.16%	2,000,000	0.59%	A3/A-
5	ANA HOTEL	11/13/1989	7.37%	2,000,000	0.59%	AAA/AAA
6	BLUE SHIELD, MARYLAND	10/18/1989	7.00%	1,000,000	0.30%	AAA/AAA
7	CENTRAL PWR & LT	10/30/1989	7.45%	1,000,000	0.30%	A2/BBB+
8	CENTRAL PWR & LT - IIA	10/3/1989	7.10%	2,000,000	0.59%	A2/BBB+
9	CHRYSLER - 1	10/6/1989	7.09%	1,000,000	0.30%	BAA2/BBB
10	CHRYSLER - A	10/11/1989	6.98%	1,000,000	0.30%	BAA2/BBB
11	CHRYSLER - D	11/1/1989	7.25%	2,000,000	0.59%	BAA2/BBB
12	CHRYSLER - E	11/8/1989	7.20%	2,000,000	0.59%	BAA2/BBB
13	CHRYSLER - F	11/15/1989	7.38%	4,000,000	1.19%	BAA2/BBB
14	CLEVELAND ELECTRIC	10/31/1989	8.70%	2,000,000	0.59%	BAA2/BB+
15	CLEVELAND ELECTRIC - A	11/14/1989	8.85%	2,000,000	0.59%	BAA2/BB+
16	CLEVELAND ELECTRIC - B	10/3/1989	8.90%	3,000,000	0.89%	BAA2/BB+
17	CONNECTICUT P&L	11/14/1989	7.39%	1,000,000	0.30%	BAA1/BBB
18	CORP. INVESTORS FUND	10/15/1989	7.50%	661,482	0.20%	N/A
19	CSX - 2	10/25/1989	8.60%	1,000,000	0.30%	BAA1/BBB
20	CSX C-1	10/18/1989	8.10%	9,000,000	2.67%	BAA1/BBB
21	CSX C-2	10/25/1989	9.80%	500,000	0.15%	BAA1/BBB
22	FIRST INTERSTATE 1-C	11/10/1989	7.74%	1,700,000	0.51%	A2/BBB+
23	GTE-C	11/10/1989	7.43%	1,000,000	0.30%	A3/A-
24	HELLER FINANCIAL - A	11/10/1989	7.70%	3,000,000	0.89%	A3/A-
25	HELLER FINANCIAL - C	10/31/1989	7.37%	3,000,000	0.89%	A3/A-
26	INT'L LEASING - A	11/6/1989	7.15%	2,500,000	0.74%	A3/A-
27	INT'L PAPER - D	10/2/1989	7.09%	1,000,000	0.30%	A3/BBB+
28	PACIFIC ENTERPRISES	10/10/1989	6.95%	2,000,000	0.59%	A3/BBB
29	PACIFICORP - B	11/3/1989	7.37%	1,000,000	0.30%	BAA1/BBB+
30	PUGET SOUND PWR & LT - B	11/17/1989	7.40%	4,000,000	1.19%	BAA1/BBB+
31	SERVICE CORP INT'L - B	10/24/1989	7.50%	3,000,000	0.89%	BAA1/A-
32	SERVICE CORP INT'L - B	10/24/1989	7.65%	2,000,000	0.59%	BAA1/A-
33	SERVICE CORP. INT'L	10/17/1989	7.25%	4,000,000	1.19%	BAA1/A-
34	TOKYU - B	10/10/1989	7.11%	1,000,000	0.30%	AAA/AAA
35	TUCSON ELECTRIC - A	11/17/1989	11.65%	10,400,000	3.09%	BA3/BBB-
36	UNION BANCORP	10/2/1989	7.09%	2,000,000	0.59%	A1/A
37	WESTERN MASS ELECTRIC	10/24/1989	7.35%	2,000,000	0.59%	BAA1/BBB
				90,761,482	26.97%	
FIXED ADJUSTABLE RATE PREFERREDS - 70% TAX FREE						
1	ALCOA (STRAP)	5/15/1993	8.63%	1,000,000	0.30%	BAA1/A-
2	CITICORP (GRCPS)	8/15/1992	8.50%	1,500,000	0.45%	A2/A+
3	CITICORP (GRCPS)	8/15/1994	8.75%	2,000,000	0.59%	A2/A+
4	FIRST INTERSTATE FRAP - C	3/1/1992	9.88%	5,500,000	1.63%	A2/BBB+
5	MELLON BANK - FRAP - C1	11/15/1989	8.10%	3,320,000	0.99%	BAA2/BBB
6	MELLON BANK FRAP - G	11/15/1989	9.50%	4,000,000	1.19%	BAA2/BBB
7	TALMAN FINANCIAL - H	10/31/1990	7.70%	1,001,250	0.30%	AAA/AAA
				18,321,250	5.44%	

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MICROSOFT CORPORATION
DOMESTIC INVESTMENT PORTFOLIO
AS OF SEPTEMBER 30, 1989

	ISSUER	MATURITY DATE	EFFECTIVE RATE	PRINCIPAL	PERCENT OF PORTFOLIO	RATING MOODY/S&P
	MUNICIPAL SECURITIES - 100% TAX FREE					
1	ALABAMA HFA	10/1/1989	6.25%	2,000,000	0.59%	VMIG1/AA1
2	DALLAS AREA RAPID TRANSIT	10/1/1989	6.05%	1,000,000	0.30%	VMIG1/SPA+
3	DELAWARE HEALTH CARE FAC.	10/2/1989	7.50%	1,000,000	0.30%	VMIG1/AAA
4	LORAIN, OHIO	10/6/1989	6.50%	1,003,020	0.30%	BAA
5	CONNECTICUT DEV. AUTH. PCR	10/15/1989	6.25%	650,000	0.19%	AA1
6	BEXAR CNTY. TX	11/1/1989	7.38%	1,000,000	0.30%	AAA
7	FAYETTEVILLE, N.C.	11/1/1989	6.25%	1,000,000	0.30%	VMIG1
8	N.HAMPSHIRE IDA-TIMCO	11/1/1989	6.40%	994,850	0.30%	BAA1/BBB
9	TRINITY RIVER, TX IDA	11/1/1989	6.25%	1,000,000	0.30%	AA1
10	JEANETTE, PA	11/15/1989	6.70%	2,001,920	0.59%	BBB
11	JEANETTE, PA	11/15/1989	6.90%	600,000	0.18%	BBB
12	WYOMING HSG	11/30/1989	6.38%	675,000	0.20%	VMIG1/A1+
13	BEAUFORT, N.CAROLINA	12/1/1989	6.38%	1,000,000	0.30%	AAA
14	KANSAS CITY, MO GANS	12/1/1989	6.50%	2,008,840	0.60%	MIG1
15	RICHMOND CNTY. GA	12/1/1989	6.74%	1,017,950	0.30%	BAA
16	SALINA, KANSAS	12/1/1989	6.75%	2,495,000	0.74%	BAA1/BBB
17	ST. CHARLES PARISH, LA	12/1/1989	6.75%	1,000,000	0.30%	A1/A+
18	TUCSON, AZ	12/1/1989	6.63%	2,000,000	0.59%	VMIG1/AAA
19	TULSA, OK. - HILLCREST PARTNERS	12/1/1989	6.38%	1,000,000	0.30%	AA2
20	TULSA, OK. - MED SUPPLY SERV.	12/1/1989	6.25%	1,000,000	0.30%	AAA
21	ESSEX, N.J. BAN	12/22/1989	6.75%	2,003,740	0.60%	U:A1
22	BREMERTON	1/26/1990	6.63%	1,500,000	0.45%	U:A
23	SPRINGFIELD, OH. GO BANS	1/26/1990	6.75%	1,002,990	0.30%	N/R
24	LOUISIANA STATE	2/1/1990	7.46%	225,396	0.07%	BAA1/BBB+
25	MATAGORDA, TX PCR	2/1/1990	6.63%	1,000,000	0.30%	AA1/AA
26	MINNESOTA HSG. FIN.AGENCY	2/1/1990	6.25%	1,200,000	0.36%	A1/AA
27	FLORIDA STATE COPS	2/15/1990	6.80%	887,534	0.26%	MIG1
28	CLARK CNTY. WA - BANS	3/1/1990	6.88%	998,750	0.30%	U:AA
29	EVERETT LID # 728	3/1/1990	6.50%	500,000	0.15%	N/R
30	WICHITA, KS - RAMADA INN	3/1/1990	7.00%	1,002,210	0.30%	N/R
31	WICHITA, KS - RAMADA INN	3/1/1990	7.10%	1,031,761	0.31%	N/R
32	WICHITA, KS - RAMADA INN	3/1/1990	7.50%	2,000,000	0.59%	N/R
33	BI-STATE MO & ILL RANS	3/7/1990	7.30%	1,004,180	0.30%	U:MIG1
34	WINONA, MN. TACS	3/30/1990	7.00%	902,673	0.27%	A1
35	KENTUCKY HSG. CORP	5/1/1990	12.17%	1,333,200	0.40%	AA
36	N.Y. STATE HFA	5/15/1990	7.63%	706,867	0.21%	A/BBB+
37	ALABAMA STATE 4.5S 6/1/90	6/1/1990	6.91%	676,627	0.20%	AA/AA
38	BROCKTON, MASS - GO	6/29/1990	8.00%	4,766,685	1.42%	BAA/A
39	PARK CITY, UTAH	6/29/1990	6.64%	3,000,000	0.89%	U:BAA
40	S. SUMMIT SCH. UTAH	6/29/1990	6.60%	1,002,760	0.30%	U:BAA1
41	N.SLOPE BORO, ALASKA - GO	6/30/1990	6.70%	1,019,030	0.30%	AAA/AAA
42	SHELBY CNTY. TENNESEE	8/1/1990	6.05%	2,000,000	0.59%	AAA
43	E. GUERNSEY, OHIO	8/3/1990	6.50%	1,246,720	0.37%	N/R
44	MISSOURI HIGHER ED.	8/15/1990	7.39%	568,487	0.17%	VMIG1
45	BREVARD CNTY. FLA	9/1/1990	6.75%	2,000,000	0.59%	AAA
46	OLIVER CNTY. N.D.	9/1/1990	6.45%	1,000,000	0.30%	A3/A
47	KIRBYVILLE, TEXAS	9/20/1990	6.80%	700,000	0.21%	SP1+

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MICROSOFT CORPORATION
DOMESTIC INVESTMENT PORTFOLIO
AS OF SEPTEMBER 30, 1989

	ISSUER	MATURITY DATE	EFFECTIVE RATE	PRINCIPAL	PERCENT OF PORTFOLIO	RATING MOODY/S&P
48	OKLAHOMA CITY, OKLA	10/1/1990	6.55%	489,935	0.15%	AA/AA
49	CHICAGO, ILL - GO	10/31/1990	7.50%	730,688	0.22%	AAA
50	REDMOND, WA LID 88-ST-52	11/1/1990	6.42%	997,480	0.30%	N/R
51	EAST ST. LOUIS, ILL PORT FAC	12/15/1990	7.90%	1,513,019	0.45%	SP1+
52	EAST ST. LOUIS, ILL PORT FAC	12/15/1990	7.88%	4,930,959	1.47%	SP1+
53	EAST ST. LOUIS, ILL RES. RECOVERY	12/15/1990	7.90%	1,416,515	0.42%	A1+
54	EAST ST. LOUIS, ILL RES. RECOVERY	12/15/1990	7.75%	1,762,492	0.52%	A1+
55	INDEPENDENCE CNTY. ARK	1/1/1991	8.00%	1,200,308	0.36%	BA3/B
56	INDEPENDENCE CNTY. ARK	1/1/1991	9.50%	2,000,000	0.59%	BA3/B
57	LOUISIANA STATE	2/1/1991	7.00%	242,563	0.07%	BAA1/BBB+
58	CHICAGO PEOPLES GAS	3/1/1991	6.50%	1,484,805	0.44%	AA3/AA-
59	JACKSONVILLE, FLA	4/1/1991	6.60%	1,075,459	0.32%	AAA
60	OHIO ST. - GO	5/15/1991	7.50%	936,470	0.28%	AA/AA
61	MARICOPA CNTY. AZ - GO	7/1/1991	7.80%	698,858	0.21%	AA/AA
62	TACOMA, WA PUB UTIL	7/1/1991	7.68%	244,990	0.07%	ESC - TSY
63	WAKE CNTY., N.C. - PCR	7/1/1991	8.07%	1,516,935	0.45%	A2/A
64	CHESTER, PA	8/1/1991	8.50%	3,797,238	1.13%	SP1+
65	DOUGLAS CNTY. CO. GONDOLIER	9/1/1991	7.95%	1,000,000	0.30%	N/R
66	WASHINGTON - GO	9/1/1991	7.68%	482,738	0.14%	A/AA
67	STEVENS CNTY. WA	3/1/1992	7.38%	1,000,000	0.30%	U:A
				87,247,621	25.93%	
	TOTAL DOMESTIC INVESTMENTS			286,054,000	85.01%	

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MICROSOFT CORPORATION
INTERNATIONAL INVESTMENT PORTFOLIO
AS OF SEPTEMBER 30, 1989

	ISSUER	MATURITY DATE	EFFECTIVE RATE	PRINCIPAL	PERCENT OF PORTFOLIO	RATING MOODY/S&P
CASH		N/A	N/A	19,211,295	5.71%	N/A
LOAN PARTICIPATIONS						
1	ALCO STANDARD	10/2/1989	9.30%	5,300,000	1.58%	A1/P2
2	CENTURY COMMUNICATIONS	10/2/1989	9.51%	5,000,000	1.49%	N/R
3	PENSKE TRUCK LSG	10/4/1989	9.55%	5,000,000	1.49%	N/R
				15,300,000	4.55%	
INCREASING RATE NOTES						
1	BLACK BOX, INC. (MICRON)	9/15/1996	15.50%	2,000,000	0.59%	N/R
2	EASCO	9/15/1997	16.50%	2,000,000	0.59%	N/R
3	G.HEILEMAN BREWING	9/30/1996	17.50%	2,000,000	0.59%	N/R
4	GOODSON NEWSPAPERS	1/15/1997	20.50%	2,296,628	0.68%	N/R
5	HICKORY FURNITURE	5/1/1990	17.00%	1,996,250	0.59%	N/R
6	STONE FOREST INDUSTRIES	10/2/1989	17.50%	2,001,250	0.59%	N/R
7	UNIROYAL PLASTICS	11/1/1993	13.50%	1,635,327	0.49%	N/R
8	KAISERTECH ACQUISITION CORP	10/28/1991	16.94%	2,001,250	0.59%	N/R
				15,930,705	4.73%	
	TOTAL INTERNATIONAL INVESTMENTS			50,442,000	14.99%	
	TOTAL DOMESTIC & INTERNATIONAL INVESTMENTS			336,496,000	100.00%	

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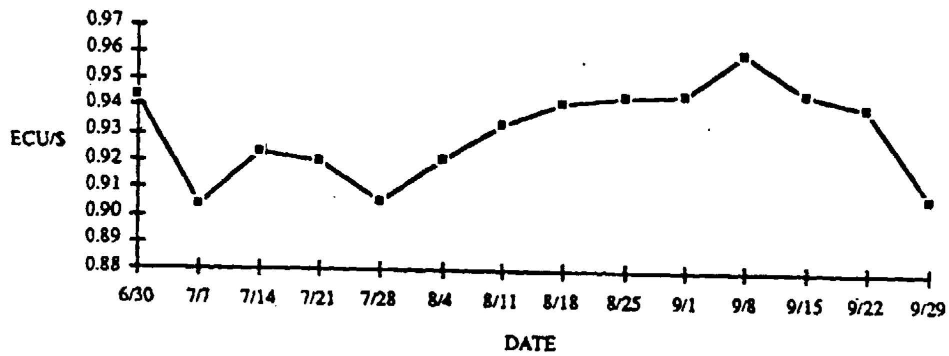
Foreign Exchange Hedging Program

As illustrated in the graph below, the dollar was extremely volatile during the quarter. It climbed to its strongest point on September 8. Had the Company's hedging program not been in effect, this strengthening of the dollar would have resulted in Microsoft's incurring a $615,000 foreign currency loss for the period July 1 through September 8. However, the Company's hedging program largely avoided this loss. The dollar then fell 5.4% within three weeks after September 8. This fall, absent our hedging program, could have resulted in an undetermined gain to the Company. However, our hedging program also resulted in our not realizing this gain, as our program locked in the dollar value of foreign currency balances.

In summary, on a total of $39.4 million of foreign currency sales during a quarter where the dollar was volatile, the Company's hedging program limited foreign currency losses to $41,000 for the period.

During October, the Microsoft Treasury department has installed the Advanced Reuters Terminal 2000 service (ART 2000). ART 2000, running under Microsoft Windows, allows live market data from Reuters to be instantaneously linked to Microsoft Excel spreadsheets. This will allow our currency exposure models and sensitivity analyses to be updated continuously, providing real time analysis and decision support capabilities. The Treasury department is a beta test site for this innovative and as yet unreleased application. The cover article in the current October 30th issue of Forbes magazine discusses this Reuters Information Service and how it represents the leading edge of technology. With this program in place, the Treasury department will be able to further refine its hedging program.

1st Quarter Movement of U.S. Dollar Against the ECU



The following table summarizes the status of the Hedging Program as of September 30, 1989 (dollars in millions).

Exposure type	Potential Exposure	Amount Hedged	Percent Hedged
Intercompany trade receivable	$32.2	$28.7	89.1%
Intercompany loan receivable	13.3	13.3	100.0%
Intercompany dividend receivable	0.0	0.0	–
Intercompany royalty receivable	2.3	1.7	73.4%
Intercompany interest receivable	0.5	0.4	80.0%
Total	$48.3	$44.1	91.3%

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Accounts Receivable

Accounts receivable (net) increased 17% or $19.2 million, from $111.2 million at the end of Q89-4 to $130.3 million at the end of Q90-1. This increase in receivables is considerably more than the 7% increase in sequential quarterly revenues, reflecting strong sales in the second half of the quarter. Consolidated days sales outstanding (DSO), shown below for the past five quarters, increased from 48.9 days at the end of Q89-4 to 56.0 days at the end of Q90-1.

FY Quarter	DSO
Q90-1	56.0
Q89-4	48.9
Q89-3	49.5
Q89-2	51.7
Q89-1	55.5

An analysis of the receivable aging shows that accounts over 60 days comprise 14% of collectible receivables, compared with 15% at the end of Q89-4. The $17.8 million allowance for doubtful accounts represents 84% of all accounts over 60 days, compared with 78% at the end of the preceding quarter. The allowance for doubtful accounts is equal to 12% of total collectible receivables, unchanged from Q89-4. Due to the currency of the receivables and the adequacy of the allowance, we are not particularly concerned about the increase in DSO and we expect the figure to decrease in Q90-2.

		Aging Summary			
	Total	Current	30-60	61-90	Over 91
Retail					
USSMD	$ 46,275	$30,416	$14,489	$ 119	$ 1,251
International	58,686	37,378	13,454	3,119	4,735
Worldwide Retail	104,961	67,794	27,943	3,238	5,986
OEM					
Domestic	7,418	2,696	3,171	1,081	470
International	30,385	19,916	759	465	9,245
Worldwide OEM	37,803	22,612	3,390	1,546	9,715
Press	2,816	2,073	75	77	591
Other	779	468	223	22	66
Accounts Receivables-Collectible	146,359	$92,947	$32,172	$4,883	$16,358
Aging Percentages		64%	22%	3%	11%
OEM GAAP adjustment	1,800				
Allowance	(17,827)				
Accounts Receivables-Net	$130,332				
Total Quarterly Net Revenues	$235,161				
Days Sales Outstanding(1)	56.0				

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(1) Calculation uses "Accounts Receivable - Collectible" divided by "Total Quarterly Net Revenues" times 90.

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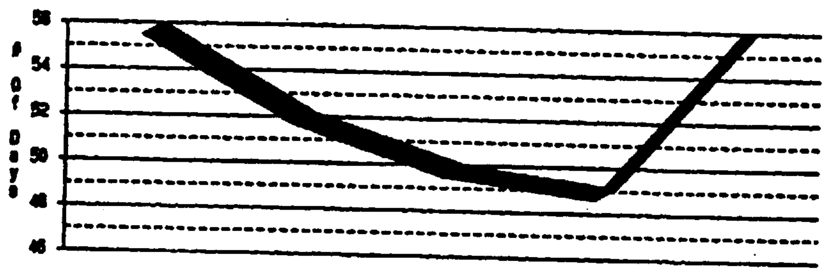
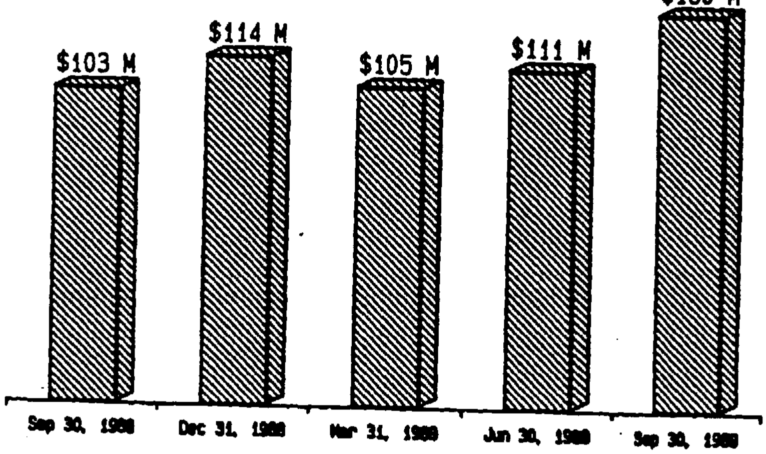
Days' Sales Outstanding

(Based on Revenues for the Quarter)



Accounts Receivable - Net



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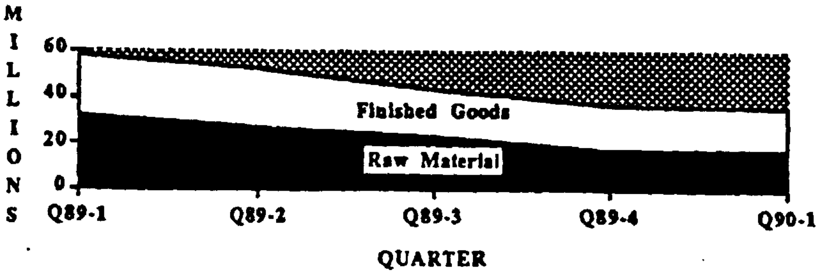
Inventories

Total inventories at the end of Q90-1 were $36.0 million. This represents a 5% decrease from Q89-4. The change consisted of a $5.3 million decrease in domestic inventory, partially offset by a $3.5 million increase in international inventories. At quarter-end, our inventory by location was Campus North ($16.0 million), subsidiary warehouses ($16.5 million) and Ireland ($3.5 million).

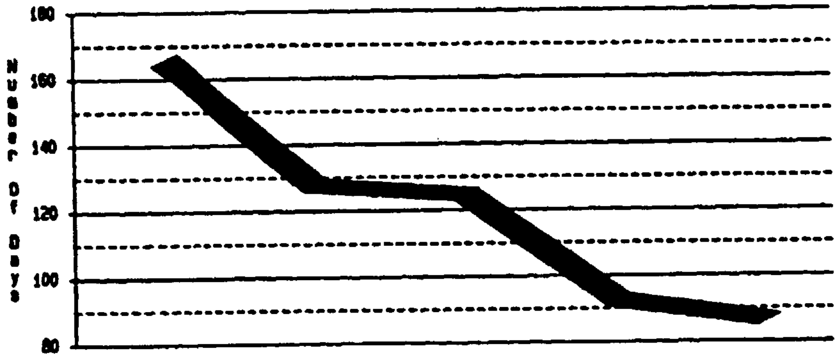
Gross domestic inventory decreased by $2.3 million. Domestic raw material inventories decreased $613,000 (3%) and finished goods decreased $1.7 million (16%). The decrease in both domestic raw material and finished good inventories in Q90-1 is primarily due to sales demand in excess of forecast for a number of products, thereby reducing buffer stock. Of note were decreases in the inventory level of PC Word, Mice, Mac Excel and Mac Word. Mice and Mac Excel inventory decreased due to the release of new versions during Q90-1. International raw material increased $454,000 (8%) and finished goods increased $1.2 million (8%). The majority of the increase in international inventories was due to an accumulation of inventory in anticipation of a busy Q90-2. Further, the subsidiaries are stockpiling inventory to meet demand of newly released products. In addition to these seasonal increases in inventory, a portion of the increase was attributed to a change in freight terms made during Q90-1. Inventory is now shipped via ocean freight rather than air freight to the Australian subsidiary from Campus North, thereby increasing shipping time two-fold as well as the amount of inventory in-transit. Since title of the inventory transfers to the Australian subsidiary at Campus North's shipping dock, the increase of inventory in-transit has in turn increased the subsidiary's inventory. Consolidated inventory allowances increased 10% ($1.1 million). The increase in domestic reserves is a result of the release or anticipated release of Mac Excel 2.2, PC Flight Simulator 4.0, Windows 3.0, Basic Compiler 6.0, PC Works 2.0, Cobol 4.0 and MASM 6.0. Furthermore, for good measure, the domestic reserve was increased by a $2.0 million accrual. Currently, the domestic reserve is sufficient to cover all identified and potentially obsolete inventory.

	September 30	June 30	Change
Raw materials	$17,124	$17,737	$ (613)
Finished goods	9,105	10,828	(1,723)
Allowances	(10,202)	(7,274)	(2,928)
Domestic Inventory	16,027	21,291	(5,264)
Raw materials	$ 5,829	$ 5,375	$ 454
Finished goods	16,601	15,374	1,227
Allowances	(2,483)	(4,285)	1,802
International Inventory	19,947	16,464	3,483
Raw materials	$22,953	$23,112	$ (159)
Finished goods	25,706	26,202	(496)
Allowances	(12,685)	(11,559)	(1,126)
Consolidated Inventory	$35,974	$37,755	$(1,781)

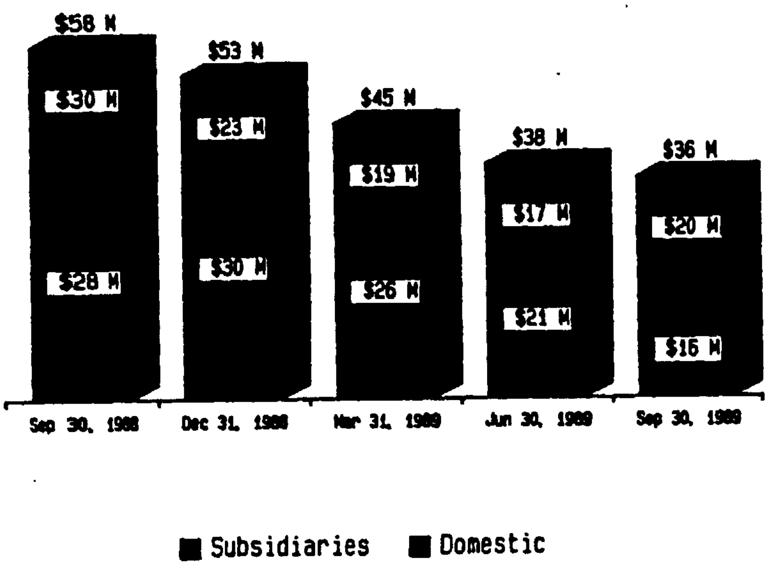


Days' Supply in Ending Inventory

(Based on Three Month Average Product Costs)



Inventory



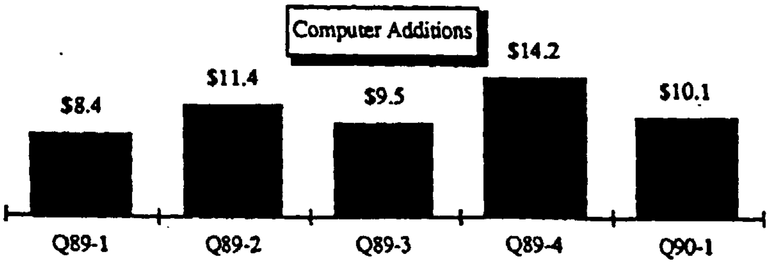
Property, Plant and Equipment

Net property, plant and equipment increased $33.3 million in Q90-1 to $232.1 million from $198.8 million at June 30, 1989. The increase can be primarily attributed to the acquisition of land and acquisition/construction of buildings to accommodate growth in headcount. Property, plant and equipment at September 30, 1989 and June 30, 1989 consists of the following (in thousands):

	Sept. 30	June 30	Change
Land	$ 48,566	$ 41,465	$ 7,101
Buildings	87,284	68,828	18,456
Leasehold improvements	12,214	10,215	1,999
Furniture and equipment	30,312	29,933	379
Computer equipment	102,385	98,224	4,161
	280,761	248,665	32,096
Accumulated depreciation	(48,665)	(49,840)	1,175
Net	$232,096	$198,825	$33,271

The increase in land was due to the acquisition at Corporate Campus, known as Phase 5-East Tech ($6.6 million) and Phase 3 ($547,000). The increase in buildings primarily consists of the purchase of the East Tech buildings ($11.4 million), additional construction on Corporate Campus buildings 9 through 11 ($6.2 million) and Ireland's new IPG facility ($200,000) and manufacturing plant ($200,000). The increase in leaseholds mainly consists of improvements made at KK ($700,000), Corporate Campus ($700,000) and to the new facility at Koll Office Park ($200,000). The increase in furniture and equipment is due to general additions to Corporate Campus ($1.6 million) and the subsidiaries ($1.0 million), which were offset by the retirement of old, missing equipment ($2.4 million). Computer equipment experienced a modest increase during the quarter. The following table summarizes the additions during Q90-1 (total costs are in thousands):

	Quantity Purchased	Cost
Compaq 386 computers	309	$ 3,167
Subsidiaries	-	1,987
Networking equipment	-	1,773
IBM System 2 computers	136	1,148
Apple computers	192	1,083
Additional memory	-	615
Wyse computers	61	285
Printers	62	269
Disk Drives	78	231
VAX equipment	-	165
Software	-	155
Toshiba computers	19	115
Net A/P accrual	-	-1,356
Other insignificant items	-	418
Gross additions		10,055
Retirements		5,895
Net additions		$ 4,160



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Other Assets

During Q90-1, other assets decreased $2.5 million to $50.3 million from $52.8 million at the end of the prior quarter. Other assets at September 30, 1989 and June 30, 1989 consists of the following (in thousands):

	Sept. 30	June 30	Change
Intellectual property rights - net	$13,905	$15,503	$(1,598)
Long-term investments	20,680	21,180	(500)
Other	15,685	16,141	(456)
	$50,270	$52,824	$(2,554)

Intellectual property rights decreased $1.6 million during the quarter, the net result of additional "milestone" payments for PC Paintbrush 4.0 ($450,000), SQL Server ($167,000), Ruby ($148,000) and MS Mail 2.0 ($21,000), offset by amortization of $2.4 million. Amortization has increased from prior quarters, due largely to the Q89-4 acquisition of Bauer Enterprises. Long-term investments decreased $500,000 to $20.7 million, the result of a valuation allowance to amortize the investment in the Santa Cruz Operation (SCO). Other long-term assets decreased $500,000 due to an $800,000 reduction in the subsidiaries' prepaids, offset by an additional $300,000 pre-payment to DCL for Matterhorn.

Current Liabilities

During Q90-1, current liabilities increased $25.8 million to $184.6 million from $158.8 million as of June 30, 1989. Income taxes payable accounted for the largest part of that increase ($21.0 million) due to an increase in taxable income and the absence of a U.S. Federal payment during the quarter. Accounts payable grew by $10.1 million during the quarter due primarily to marketing accruals. Customer deposits experienced an increase of $3.6 million, comprised of an increase of $3.9 million in reseller rebates owed to distributors, large volume dealers, franchises and major chains, partially offset by a decrease in receipts from customers prior to acceptance of product ($265,000). Short-term notes payable increased $2.1 million due to more borrowings for the hedging program ($7.7 million), plus increases in KK's ($3.2 million) and AB's ($1.7 million) lines of credit. The increase in subsidiary borrowings was significantly offset by the Company covering a short position in U.S. Treasury notes ($10.4 million) as part of a program to utilize capital equity losses for tax purposes. Deferred revenue increased $400,000 due to advance payments on future MSU courses and an upcoming CD ROM conference. Commissions payable also increased $400,000 as a function of increased sales during the quarter. Offsetting the above increases were decreases in several other current liabilities. Payroll and payroll taxes decreased $5.5 million to $20.2 million resulting from the payment of semi-annual performance bonuses. Business taxes payable decreased $3.4 million because of payments made during the quarter. Other current liabilities decreased $2.3 million due primarily to the satisfaction of a $2.0 million obligation arising from the purchase of Bauer Enterprises. Marketing programs payable decreased $619,000 during Q90-1 primarily due to the payment of obligations related to the Winter '89 Campaign, while royalties payable was virtually unchanged for the quarter.

Stockholders' Equity

Stockholders' equity increased $62.8 million during Q90-1, from $561.8 million at June 30, 1989. Company earnings of $49.6 million again accounted for most of the increase. Issuance of stock, including those issued in connection with the Company's ESPP program, was $9.8 million. That and the Company's estimated tax benefit relating to NQSO transactions of $4.4 million, accounted for the $14.2 million increase in contributed capital. Offsetting those increases was a $2.0 million unfavorable foreign currency translation adjustment, the result of a strengthening dollar during the quarter.

CHANNEL REPORTING

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CHANNEL REPORTING Q90-1

The contribution to net revenues and operating income for Q90-1 on a channel of distribution basis was as follows (amounts in thousands):

Net Revenues

	Actual		Plan		Variance Percentage
USSMD	$ 79,526	33.8%	$ 64,715	30.6%	23
International Retail	80,213	34.1	77,939	36.8	3
Worldwide Retail	159,739	67.9	142,654	67.4	12
Domestic OEM	35,161	14.9	28,083	13.3	25
International OEM	35,189	15.0	35,393	16.7	(1)
Worldwide OEM	70,350	29.9	63,476	30.0	11
Press	3,002	1.3	3,107	1.5	(3)
US MSU	1,210	0.5	1,389	0.6	(13)
Int'l MSU	-	-	129	0.1	-
US PSS	381	0.2	327	0.1	17
Int'l PSS	211	0.1	342	0.2	(38)
Systems Journal	258	0.1	285	0.1	(9)
Int'l Consulting	10	-	-	-	-
Total	$235,161	100.0%	$211,709	100.0%	11

Burdened Operating Income (Loss)

	Actual			Plan			
	Income (Loss)	Percentage Total	Percentage Revenue	Income (Loss)	Percentage Total	Percentage Revenue	Variance
USSMD	$12,560	18.1	15.8	$(3,244)	(10.2)	(5.0)	$15,804
International Retail	16,301	23.5	20.3	3,551	11.2	4.6	12,750
Worldwide Retail	28,861	41.6	18.1	307	1.0	0.2	28,554
Domestic OEM	20,501	29.5	58.3	13,148	41.4	46.8	7,353
International OEM	21,430	30.9	60.9	20,100	63.4	56.8	1,330
Worldwide OEM	41,931	60.4	59.6	33,248	104.8	52.4	8,683
Press	113	0.2	3.7	(99)	(0.3)	(3.2)	212
US MSU	24	-	2.0	6	-	0.4	18
Int'l MSU	(4)	-	-	69	0.2	53.8	(73)
US PSS	(932)	(1.3)	-	(1,225)	(3.9)	-	293
Int'l PSS	(453)	(0.7)	-	(306)	(1.0)	(89.5)	(147)
Systems Journal	(119)	(0.2)	(46.1)	(243)	(0.8)	(85.2)	124
US Consulting	(37)	-	-	(41)	(0.1)	-	4
Int'l Consulting	10	-	-	-	-	-	10
Difference	(5)	-	-	1	-	-	(6)
Total	$69,389	100.0	29.5	$31,717	100.0	15.0	$37,672

MICROSOFT CORPORATION

Quarterly Revenues by Channel

	Q90-1		Q90-2		Q90-3		Q90-4		FY 1990	
	Dollars	%	Dollars	%	Dollars	%	Dollars	%	Dollars	%
USSMD	$79,526	33.8							$79,526	33.8
Intl Retail	80,213	34.1							80,213	34.1
US OEM	35,161	15.0							35,161	15.0
Intl OEM	35,189	15.0							35,189	15.0
Press	3,002	1.3							3,002	1.3
US PSS	381	0.2							381	0.2
Intl PSS	211	0.1							211	0.1
US MSU	1,210	0.5							1,210	0.5
Intl MSU	0	0.0							0	0.0
Systems Journal	258	0.1							258	0.1
US Consulting	0	0.0							0	0.0
Intl Consulting	10	0.0							10	0.0
	$235,161	100.0	$0	0.0	$0	0.0	$0	0.0	$235,161	100.0

	Q89-1		Q89-2		Q89-3		Q89-4		FY 1989	
	Dollars	%	Dollars	%	Dollars	%	Dollars	%	Dollars	%
USSMD	$62,570	35.5	$59,751	28.5	$43,845	22.3	$65,100	29.6	$231,266	28.8
Intl Retail	57,548	32.6	82,368	39.2	79,603	40.4	79,160	35.9	298,679	37.2
US OEM	22,715	12.9	27,431	13.1	32,380	16.4	32,508	14.8	115,034	14.3
Intl OEM	28,645	16.2	36,247	17.3	35,975	18.3	38,730	17.6	139,597	17.4
Press	3,438	1.9	2,480	1.2	3,361	1.7	2,705	1.2	11,984	1.5
US PSS	132	0.1	160	0.1	249	0.1	346	0.2	887	0.1
US MSU	1,065	0.6	1,075	0.5	1,224	0.6	1,338	0.6	4,702	0.6
Systems Journal	230	0.1	370	0.2	387	0.2	344	0.2	1,331	0.2
CD ROM	50	0.0	0	0.0	0	0.0	0	0.0	50	0.0
	$176,393	100.0	$209,882	100.0	$197,024	100.0	$220,231	100.0	$803,530	100.0

	Q88-1		Q88-2		Q88-3		Q88-4		FY 1988	
	Dollars	%	Dollars	%	Dollars	%	Dollars	%	Dollars	%
USSMD	$30,609	29.8	$54,059	34.7	$53,258	32.9	$51,082	30.0	$189,008	32.0
Intl Retail	31,842	31.0	49,008	31.4	55,420	34.2	66,101	38.8	202,371	34.3
US OEM	21,866	21.3	31,517	20.2	25,971	16.0	23,137	13.6	102,491	17.3
Intl OEM	14,389	14.0	17,914	11.5	22,197	13.7	25,386	14.9	79,886	13.5
Press	1,809	1.8	1,834	1.2	3,067	1.9	3,281	1.9	9,991	1.7
US PSS	1,392	1.4	1,282	0.8	1,180	0.7	1,091	0.6	4,945	0.8
Systems Journal	478	0.5	219	0.1	668	0.4	394	0.2	1,759	0.3
CD ROM	251	0.2	63	0.0	62	0.0	0	0.0	376	0.1
	$102,636	100.0	$155,896	100.0	$161,823	100.0	$170,472	100.0	$590,827	100.0

	Q87-1		Q87-2		Q87-3		Q87-4		FY 1987	
	Dollars	%	Dollars	%	Dollars	%	Dollars	%	Dollars	%
USSMD	$21,092	31.6	$31,173	38.5	$33,156	33.7	$34,244	34.3	$119,665	34.6
Intl Retail	16,020	24.0	23,398	28.9	29,071	29.5	29,198	29.3	97,687	28.2
US OEM	16,915	25.3	16,404	20.2	20,139	20.5	18,958	19.0	72,416	20.9
Intl OEM	11,316	16.9	8,245	10.2	13,572	13.8	15,397	15.4	48,530	14.0
Press	1,437	2.2	1,765	2.2	2,425	2.5	1,965	2.0	7,592	2.2
	$66,780	100.0	$80,985	100.0	$98,363	100.0	$99,762	100.0	$345,890	100.0

USSMD

The condensed burdened operating income statement for USSMD for Q90-1 follows (in thousands):

	Actual		Plan		Variance
Net revenues	$79,526	100.0%	$64,715	100.0%	$14,811
Cost of revenues	23,379	29.4	20,378	31.5	(3,001)
Operating expenses	25,007	31.4	26,121	40.4	1,114
Allocations - Research and development	11,385	14.3	13,292	20.5	1,907
Allocations - Sales and marketing	5,027	6.3	5,802	9.0	775
Allocations - General and administrative	2,168	2.8	2,366	3.6	198
Burdened operating income (loss)	$12,560	15.8%	$ (3,244)	(5.0)%	$15,804

Net revenues for Q90-1, at $79.5 million, were 23% above plan of $64.7 million. As shown in the following table, with the exception of Multimedia, all product groups were above plan. USSMD net revenues by product group for the quarter were as follows (in thousands):

	Actual		Plan		Variance
Applications	$58,665	73.8%	$50,009	77.3%	$ 8,656
SPAG	13,441	16.9	10,689	16.5	2,752
Languages	7,366	9.3	5,374	8.3	1,992
Systems	4,535	5.7	3,242	5.0	1,293
Multimedia	75	0.1	461	0.7	(386)
Non-Specific	2	0.0	0	0.0	2
Adjustments	(4,558)	(5.8)	(5,060)	(7.8)	502
Net revenues	$79,526	100.0%	$64,715	100.0%	$14,811

In terms of gross revenue generation, the division's ten leading products (compared with plan) for the quarter were as follows (dollars in thousands):

Actual	Plan	Product	Actual Units	Actual Revenue	Plan Units	Plan Revenue	Variance
1	1	Mouse	144,908	$13,308	116,250	$10,689	$2,619
2	3	PC Word	70,752	9,060	48,700	6,396	2,664
3	2	Win Excel	52,075	8,763	43,750	8,472	291
4	4	Mac Word	56,218	8,706	36,588	6,140	2,566
5	6	Mac Excel	43,880	7,949	27,835	5,195	2,754
6	8	PC Works	114,648	5,206	46,563	3,238	1,968
7	-	Mac Excel Updates	62,879	5,187	17,976	876	4,311
8	9	Windows	67,212	4,089	55,300	2,727	1,362
9	10	Professional C	12,945	3,128	9,600	2,213	915
10	-	PC Word Updates	58,535	2,709	24,500	1,286	1,423
				$68,105		$47,232	$20,873
Percent of USSMD net revenues				86%		73%	

Plan #5 - MS Office ($5,954); #7 - Mac Works ($3,319)

The division's top ten list comprised 86% of total net revenue compared to plan of 73%. The new 400 ppi Mouse was released in August boosting Mouse to the No. 1 position, raw materials availability being the revenue pacing item. Mouse revenues of $13.3 million surpassed plan by 25%. At quarter end, there was a $5.3 million Mouse product backlog, with $4.4 million (48,172 units) in shippable orders. PC Word revenues continued to be strong, surpassing plan by 42%. Win Excel, with revenues of $8.8 million, surpassed plan by 3%, while units shipped surpassed plan by 19%. This revenue variance is a result of higher than forecast sales of lower revenue Academic Edition versions and nodepacks. Demand for Mac

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Word and Mac Excel continued to surpass plan, with variances of 42% and 53%, respectively. PC Works was 61% over plan due to shipments to IBM.

During Q90-1, sales to Distributors ($32.6 million), Franchisors ($3.0 million) and Contracted Dealers ($21.0 million) represented 67% of gross revenue. Contracted pricing remained unchanged during Q90-1. Special pricing on Win Excel was discontinued for all new orders placed after July 1st, however shipments at the lower price continued through August 31, 1989. PC Word special pricing ($185 for Distributors and Franchisors, and $190 for LVD's and Major Chains) continued to negatively affect the overall discount percentage. Sales to Value Added Resellers dramatically increased due to IBM bundles. IBM placed an order for 210,000 units of PC Works at $39 each, a 74% discount (100,000 units shipped in September). PC Works will be bundled with all PS/2 Model 25-55SX machines sold from October through January. The IBM ACIS bundle continues, with shipments of Windows 286 and 386 (19,733 units), Win Excel (11,858 units), and PC Word (18,587 units). Sales in all the non-reseller channels increased over the previous quarter. The most noticeable increase was in Government sales (increasing 94%), due to a large FBI order and heavy ordering before the end of the Federal Government's fiscal year end (September 30th). USSMD gross revenues and average discount by customer type were as follows (in thousands):

	Q90-1			Q89-4		
	Sales	%	Discount %	Sales	%	Discount %
Distributors/Franchisors	$35,642	42.4	47.9	$32,844	44.9	49.7
Contracted Dealers (LVDs/ Major Chains)	20,979	25.0	47.0	23,852	32.6	50.2
Fulfillment	6,997	8.3	34.2	6,093	8.3	36.6
Value Added Resellers	6,990	8.3	68.2	507	0.7	71.6
Education	6,148	7.3	48.3	4,645	6.3	54.7
Government	3,342	4.0	57.8	1,726	2.4	48.4
Other	3,986	4.7	57.3	3,493	4.8	62.9
Gross Revenues	$84,084	100.0%	50.5	$73,160	100.0%	50.4

Sales to the top 8 customers, by quarter, for the past five quarters were as follows (in thousands):

	Q90-1	Q89-4	Q89-3	Q89-2	Q89-1
Ingram/Micro D	$20,034	$19,499	$12,612	$19,723	$18,220
Softsel	8,889	7,410	5,153	3,161	5,545
Egghead	7,310	10,921	6,054	8,585	8,790
IBM	6,979	489	2,872	1,206	2,662
Microamerica	3,605	2,374	1,142	3,417	1,133
Softwre Spectrum	2,852	2,097	1,138	1,160	1,039
Businessland	2,847	3,200	2,473	2,864	2,409
Computerland	2,574	2,077	1,816	2,428	2,312
	$55,090	$48,067	$33,260	$42,544	$42,110

In Q90-1, USSMD processed $4.1 million in returned product, representing 5% of net revenues. The division's returns were spread across all product lines with Mac PowerPoint (3,081 units), Mac Excel (2,937 units), PC Word (2,811 units), and Mac Word (1,183 units) contributing the most significant return volume. Of the total returns, Major Chains returned $1.3 million (32%), Distributors returned $1.2 million (29%), and Education customers returned $560,000 (14%).

Open Returns Authorizations (RAs approved for return, but not received) were $3.2 million at quarter-end. This represents a 26% decrease over last quarter's balance of $4.3 million. Despite this decrease, the reserve for sales returns was increased by $600,000 in accordance with plan. Products with large outstanding returns are: PC Word (1,723 units), PowerPoint (1,703 units), and Mac Excel (1,619 units).

Rebates were 5.1% of net revenues, versus plan of 6.9%. Reseller Rebates were consistent with plan at $3.9 million. The variance, as a percentage of net revenues, was due to the shift in sales mix away from

Major Chains and LVD's and toward VAR's (IBM) and contracted schools, who are not eligible for rebates. Rebates to end-users were $91,000 creating a positive variance of $453,000. The end-user rebate consists primarily of the $75 Excel "Push" Rebate paid to end-users for upgrading from Lotus to Excel.

The Fall Trimester began in September and concludes in December with several components of the buy-in program being modified. Rebates for Distributors and Franchisors are earned by maintaining a 30-day stocking level for 25 key Microsoft products, attempting to ensure adequate supply of Microsoft product in the sales channel. Rebates for LVD's and Major Chains are earned by attaining a predetermined internal market share for specific products based on sell-through (versus competitive products) for the individual reseller. This is designed to generate a consistent sell-through of product, not sell-in, striving to prevent excessive inventories. Emphasized product for both Marketing Funds and Rebate attainment levels have been eliminated for all categories of resellers. Distributors and Franchisors no longer earn marketing funds. LVD's and Major Chains earn 3.1% marketing funds on net purchases.

Cost of revenues, as a percentage of net revenues, was 29.4% compared to plan of 31.5%. Actual cost of revenues consisted of 22.9% product costs, 1.4% royalties and 5.1% allocation of manufacturing and distribution costs; whereas the budgeted cost of revenues of 23.4% product costs, 1.8% royalties and 6.3% allocation of manufacturing and distribution costs. The gross margin for Q90-1 was 70.6% compared to plan of 68.5%. This is the highest quarterly gross margin since Q88-1. USSMD's gross profit margin for the last five quarters follows:

Q90-1	70.6%
Q89-4	65.4%
Q89-3	61.5%
Q89-2	64.3%
Q89-1	63.9%

Product costs were 22.9% versus plan of 23.4%. As illustrated in the table below, product costs as a percentage of gross revenue mirrored plan of 21.7%. The small shift in budgeted sales mix from Applications to other product groups was offset by lower product costs for SPAG and Systems. The reduced effect of adjustments is due to the previously mentioned shift in sales away from our resellers and to non-rebated VARs (IBM) and schools.

	Actual			Budget		
	Sales Mix %	Cost %	Weighted Cost %	Sales Mix %	Cost %	Weighted Cost %
Applications	69.8%	17.5	12.2%	71.7%	17.7	12.7%
SPAG	16.0	38.8	6.2	15.3	40.3	6.2
Languages	8.8	20.1	1.8	7.7	16.4	1.3
Systems	5.4	28.2	1.5	4.6	32.5	1.5
Multimedia	0.1	18.7	0.0	0.7	4.6	0.0
Product Cost - Gross	100.0%		21.7	100.0%		21.7
Effect of Adjustments			x 105.7			x 107.8
Product Cost - Net			22.9%			23.4%

Applications' product costs approximated budget. Lower than anticipated product costs for Excel and Word (both PC and Mac) were partially offset by the very low margin revenue from the sale of PC Works to IBM. The SPAG variance is due to the shipping of the new 400 ppi Mouse and sales mix. The new 400 ppi Mouse, which enjoys lower product costs than the old Mouse, was released earlier than forecasted. A shift in product mix towards lower cost Bus Mice also accounted for a portion of the variance. The Serial Mouse further contributed to the favorable variance with lower than planned product costs. Languages' product costs exceeded budget with higher than anticipated product costs for the Fortran update and higher

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than expected sales of the lower margin Quick products. <u>Systems'</u> product cost variance is primarily due to robust sales of the high-margin Windows 386, as well as lower than expected sales of low-margin units to IBM.

Royalty expense of $1.1 million, 1.4% of net revenue, approximated plan of $1.2 million and 1.8%. This variance is primarily due to lower than budgeted sales of Flight Simulator and Mac Works.

Allocations of manufacturing and distribution costs were 5.1% of net revenues compared to budget of 6.3%. In absolute terms, the allocation of manufacturing and distribution costs was $4.1 million the same as plan. The percentages are somewhat distorted by the large revenue variance, since a significant portion of the plant's costs are fixed.

<u>Operating expenses</u> of $25.0 million were $1.1 million under a planned $26.1 million. Favorable variances in travel and entertainment ($310,000), supplies and equipment ($269,000), employee fringes ($241,000), and less significant variances in several other operating expense categories were responsible for the variance. Favorable variances in marketing ($4.3 million) and marketing fund incentive programs ($1.2 million) were offset by an accrual for marketing expenses of $5.5 million, resulting in a net unfavorable marketing variance of $28,000.

The favorable travel and entertainment variances appears to be due to delays in receiving travel expenses related to the Field staff's travel to Seattle for the National Sales Meeting. The supplies and equipment variance is primarily due to lower than planned furniture expenditures related to the move of several of the USSMD Field offices. The employee fringe variance is primarily the result of a delay in expenditures by the USSMD Training group. Marketing expenditures were $5.0 million compared to a planned $9.4 million. Each product marketing group, as well as Corporate programs and Brand Statement advertising, was under budget. US channel marketing campaigns were $1.2 million under a plan. The marketing variances are the result of the inherent difficulty in budgeting the actual months in which expenditures will be incurred and marketing commitments which have not yet been invoiced. As such, the variance represents timing differences which can be expected to turn around in future quarters. Accordingly, $5.5 million in marketing expenses were accrued at the end of Q90-1. This accrual will be used to offset such expenditures in future quarters.

<u>Allocations</u> to USSMD were $2.9 million under a plan of $21.5 million. Every allocated expense category was under plan, the most significant being Applications development ($1.2 million), PSS Operations ($581,000) and Languages development ($315,000).

For Q90-1, USSMD had a burdened operating income of $12.6 million (15.8% of net revenues) compared to a planned loss of $3.2 million (-5.0% of net revenues). Strong Q90-1 sales combined with lower than planned cost of revenues, operating and allocated expenses resulted in an excellent initial quarter for USSMD.

International Retail

The condensed burdened operating income statement for International Retail for Q90-1 follows (in thousands):

	Actual		Plan		Variance
Net revenues	$80,213	100.0%	$77,939	100.0%	$ 2,274
Cost of revenues	22,483	28.0	24,822	31.8	2,339
Operating expenses	23,550	29.4	27,805	35.7	4,255
Allocations - Research and development	16,923	21.1	20,494	26.3	3,571
Allocations - General and administrative	956	1.2	1,267	1.6	311
Burdened operating income	$16,301	20.3%	$ 3,551	4.6%	$12,750

A summary of Q90-1 revenues by product group sold by the International Retail channel follows (in thousands):

	Actual		Plan		Variance
Applications	$50,378	62.8%	$50,891	65.3%	$ (513)
Systems	12,975	16.2	10,639	13.7	2,336
SPAG	11,889	14.8	11,443	14.7	446
Languages	5,598	7.0	6,090	7.8	(492)
Services	264	0.3	68	0.1	196
Multimedia	50	0.1	24	-	26
Books	34	-	-	-	34
Networks	18	-	77	0.1	(59)
Adjustments	(993)	(1.2)	(1,293)	(1.7)	300
	$80,213	100.0%	$77,939	100.0%	$2,274

The International Retail channel's leading product families for the quarter were as follows (in thousands):

Actual	Plan		Actual Units	Actual Revenue	Plan Units	Plan Revenue
1	1	PC Word	62,979	$16,341	47,989	$14,599
2	2	Mouse	195,239	11,877	155,691	11,403
3	3	Win Excel	31,001	8,725	31,523	10,660
4	4	Packaged DOS	106,219	6,844	64,658	4,293
5	9	PC Multiplan	23,991	3,956	14,597	2,796
6	8	Mac Word	19,708	3,592	13,435	3,300
7	5	PC Works	37,866	3,566	37,783	3,870
8	6	Mac Excel	14,121	2,826	14,430	3,807
9	7	Windows 286	34,353	2,553	40,934	3,407
10	-	Windows 386	15,632	2,092	13,032	1,834
				$62,372		$59,969
		Percent of net revenues		78%		77%

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International Retail activities are primarily those of wholly-owned subsidiaries. Translation of foreign currency denominated financial statements into U.S. dollars affects comparisons to plan by increasing actual amounts if the U.S. dollar is weaker or decreasing actual amounts if the U.S. dollar is stronger than planned. During Q90-1, the U.S. dollar was considerably stronger than planned. The actual (weekly average) rates versus planned exchange rates and the related percentages of variance for Q90-1 are as follows:

Currency	U.S. dollars per unit of Foreign Currency: Actual Rate	Planned Rate	Variance %
British Pound	1.59259	1.77300	(10.2)
Swedish Krona	.15248	.16141	(5.5)
Deutsch Mark	.51848	.56481	(8.2)
Swiss Franc	.60063	.65512	(8.3)
French Franc	.15322	.16468	(7.0)
Dutch Guilder	.45964	.50052	(8.2)
Italian Lira	.00072	.00076	(5.3)
Spanish Peseta	.00826	.00893	(7.5)
Canadian Dollar	.84502	.84679	(0.2)
Australian Dollar	.76277	.81090	(5.9)
Japanese Yen	.00701	.00806	(13.0)
Korean Won	.00151	.00156	(3.2)
Irish Pound	1.38527	1.50214	(7.8)

International Retail Q90-1 revenues of $80.2 million were 3% more than a planned $77.9 million and comprised 34% of the Company's total Q90-1 net revenues. This $2.3 million favorable variance was the net result of an $8.3 million favorable sales volume variance and a $6.0 million unfavorable exchange rate variance. Actual and planned Q90-1 retail net revenues of each consolidating unit are included in the schedule below.

	Actual		Plan		Net Variance	Operations Variance	Exchange Rate Variance
EUROPE							
MS LTD (England)	$ 7,996	10.0%	$ 7,000	9.0%	$ 996	$1,914	$ (918)
MS AB (Sweden)	4,986	6.2	4,058	5.2	928	1,234	(306)
MS GmbH (Germany)	16,092	20.1	17,479	22.3	(1,387)	76	(1,463)
MS AG (Switzerland)	2,288	2.9	2,877	3.7	(589)	(381)	(208)
MS SARL (France)	15,842	19.7	16,895	21.7	(1,053)	140	(1,193)
MS BV (Netherlands)	2,785	3.5	2,805	3.6	(20)	234	(254)
MS SPA (Italy)	2,186	2.7	2,163	2.8	23	146	(123)
MS SRL (Spain)	1,161	1.4	910	1.2	251	347	(96)
	53,336	66.5	54,187	69.5	(851)	3,710	(4,561)
ICON							
MS INC (Canada)	6,156	7.7	5,982	7.7	174	184	(10)
MS PTY (Australia)	5,944	7.4	6,707	8.7	(763)	(388)	(375)
Mexico	783	1.0	582	0.7	201	201	-
Brazil	2,976	3.7	867	1.1	2,109	2,109	-
AIME (Africa/India/Mid East)	2,260	2.8	492	0.6	1,768	1,768	-
Asia Pacific	380	0.5	347	0.4	33	33	--
	18,499	23.1	14,977	19.2	3,522	3,907	(385)
FAR EAST							
MS KK (Japan)	6,816	8.5	7,502	9.7	(686)	339	(1,025)
MS CH (Korea)	271	0.3	415	0.5	(144)	(135)	(9)
Taiwan	371	0.5	321	0.4	50	50	-
Redmond FE	197	0.2	537	0.7	(340)	(340)	--
	7,655	9.5	8,775	11.3	(1,120)	(86)	(1,034)
Other Redmond	723	0.9	--	--	723	723	--
Total Non-Europe	26,877	24.0	23,752	30.5	4,544	(1,419)	3,125
Total	$80,213	100.0%	$77,939	100.0%	$2,274	$8,254	$(5,980)

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The channel's total cost of revenues was 28% of net revenues for Q90-1, compared with a planned 31.8%. Product costs as a percentage of net revenues, were 22.6% versus a planned 23.4%. The actual and planned product cost percentages for Q90-1 of the four principal product groups were:

	Actual			Plan		
	Sales Mix %	Cost %	Weighted Cost %	Sales Mix %	Cost %	Weighted Cost %
Applications	62.0%	15.8	9.8%	64.2%	18.1	11.6%
Systems	16.0	26.1	4.2	13.4	27.3	3.7
SPAG	14.6	44.2	6.5	14.4	41.7	6.0
Languages	6.9	25.5	1.8	7.7	21.3	1.6
Other	0.5	28.7	0.1	0.3	36.1	0.1
Product Cost - Gross	100.0%		22.4%	100.0%		23.0%
Effect of Adjustments			x 1.012			x 1.016
Product Cost - Net			22.6%			23.4%

The favorable product cost percentage for Applications is largely attributed to a shift in individual product mix toward higher-margin PC Word. In an effort to sell older Mouse products prior to the release of the new Mouse, discounts were given to customers, resulting in less than planned per unit revenues and margins. Language updates accounted for 7.8% of Language revenues compared with a planned 1.1%, which adversely affected the product cost percentage for Languages.

Non-product costs included in the cost of revenues were $4.4 million, or 5.4% of net revenues, compared with a planned $6.6 million, or 8.4% of net revenues. The $2.2 million favorable non-product cost variance resulted from positive Ireland manufacturing variances of $961,000, warehouse subsidiary shipping costs variances of $621,000 and inventory adjustment variances of $472,000. The units produced during Q90-1 at the Irish factory were 34% over plan.

International Retail operating expenses in Q90-1 were $23.6 million, or 15% less than a planned $27.8 million. This $4.2 million favorable variance was the combined result of a $2.7 million favorable operations variance and a $1.5 million favorable exchange rate variance. The actual and planned operating expenses for Q90-1 charged to the channel by the subsidiaries and Corporate headquarters are as follows (in thousands):

	Actual	Plan	Net Variance	Operations Variance	Exchange Rate Variance
MS LTD (England)	$ 1,867	$ 3,137	$1,270	$ 1,056	$ 214
MS AB (Sweden)	1,466	1,492	26	(62)	88
MS GmbH (Germany)	4,112	5,398	1,286	916	370
MS AG (Switzerland)	280	814	534	509	25
MS SARL (France)	3,968	4,899	931	628	303
MS BV (Netherlands)	924	1,058	134	50	84
MS SpA (Italy)	650	816	166	129	37
MS SRL (Spain)	310	432	122	97	25
European Subsidiaries	13,577	18,046	4,469	3,323	1,146
MS INC (Canada)	1,856	2,110	254	138	116
MS PTY (Australia)	1,516	1,566	50	47	3
ICON Subsidiaries	3,372	3,676	304	185	119
MS KK (Japan)	1,847	2,847	1,000	723	277
MS CH (Korea)	108	203	95	92	3
Far East Subsidiaries	1,955	3,050	1,095	815	280
Redmond Operations	4,646	3,033	(1,613)	(1,613)	—
Total Channel	$23,550	$27,805	$ 4,255	$2,710	$1,545

A $4.1 million general underspending in Europe and the Far East and a favorable exchange rate variance of $1.4 million were partially offset by an unfavorable Redmond Operations variance of $1.6 million. The underspending occurred primarily at MS LTD, MS GmbH and MS KK. Of their combined $2.7 million variance, $1.2 million resulted from marketing underspending. An additional $845,000 favorable variance in employee related expenses was incurred. To prevent the channel from recognizing a large unfavorable marketing expense variance in later quarters, an expense accrual was recorded by Corporate headquarters. The Redmond Operations' $1.6 million unfavorable variance was the net result of a $2.1 million marketing expense accrual and a $500,000 general underspending variance.

In Q90-1, actual expenses allocated to International Retail were 18% under plan ($17.9 million compared with $21.8 million). The Applications and Languages development pools were less than plan, producing favorable allocations variances of $1.1 million and $323,000, respectively. In addition, localization spending was $1.7 million under plan during Q90-1.

Relative to plan, all elements of the division's profit model experienced favorable variances. Specifically, revenue had a $2.3 million positive variance, cost of revenues was under plan by 9% and both direct and allocated expenses were less than plan. As a result, the channel's Q90-1 burdened operating income of $16.3 million was 359% more than a planned $3.6 million, and was 23.5% of the Company's total burdened operating income.

Domestic OEM

The condensed burdened operating income statement for Domestic OEM for Q90-1 follows (in thousands):

	Actual		Plan		Variance
Net revenues	$35,161	100.0%	$28,083	100.0%	$7,078
Cost of revenues	2,575	7.3	2,082	7.4	(493)
Operating expenses	3,026	8.6	3,159	11.3	133
Allocations - Research and development	8,096	23.1	8,665	30.9	569
Allocations - Sales and marketing	428	1.2	450	1.6	22
Allocations - General and administrative	535	1.5	579	2.0	44
Burdened operating income	$20,501	58.3%	$13,148	46.8%	$7,353

Domestic OEM net revenues by product group for Q90-1 were as follows (in thousands):

	Actual		Plan		Variance
Systems	$23,373	66.6%	$20,299	72.3%	$3,074
UPB	4,711	13.5	2,130	7.6	2,581
Networks	2,433	6.9	2,698	9.6	(265)
Xenix	2,082	5.9	1,876	6.7	206
SPAG	686	1.9	398	1.4	288
Applications	537	1.5	592	2.1	(55)
Languages	329	0.9	90	0.3	239
Multimedia	9	-	-	-	9
Books	1	-	-	-	1
Subtotal	34,161	97.2	28,083	100.0	6,078
Adjustments (GAAP)	1,000	2.8	-	-	1,000
Total	$35,161	100.0%	$28,083	100.0%	$7,078
Licensing	$31,647	90.0%	$25,216	89.8%	$6,431
Packaged Product	3,514	10.0	2,867	10.2	647
Total	$35,161	100.0%	$28,083	100.0%	$7,078

Significant Domestic OEM customers, by product group, for Q90-1 were (in thousands):

	Systems	LPB	Networks	Xenix	Other*	Total Actual		Total Plan	
Compaq	$2,945	$ 998	$ –	$ –	$ –	$ 3,942	11.5%	$ 3,615	12.9%
Zenith	2,791	350	–	11	294	3,446	10.1	3,299	11.7
Phoenix	2,689	–	6	–	–	2,695	7.9	1,235	4.4
NCR	820	1,000	–	–	53	1,873	5.5	967	3.4
SCO	93	–	32	1,614	66	1,805	5.3	1,872	6.7
3Com	104	914	600	–	–	1,618	4.7	1,638	5.8
Dell	467	611	–	–	78	1,156	3.4	1,078	3.8
Tandy	881	189	–	15	18	1,103	3.2	961	3.4
AST Research	1,024	–	–	–	–	1,024	3.0	730	2.6
AT&T	587	182	177	32	–	978	2.9	1,100	3.9
Commodore	792	20	–	–	129	941	2.8	833	3.0
Hewlett Packard	657	–	116	–	24	797	2.3	618	2.2
DEC	435	(640)	971	–	–	766	2.2	590	2.1
Wyse	681	80	–	–	–	761	2.2	500	1.8
Compuadd	824	(124)	–	–	–	700	2.0	700	2.5
Memorex Telex	272	300	–	–	–	572	1.7	570	2.0
Data General	144	149	262	–	–	555	1.6	78	0.3
Unisys	483	(22)	–	–	78	539	1.6	566	2.0
Supercom	535	–	–	–	–	535	1.6	**	–
Everex	376	151	–	–	2	529	1.5	523	1.9
Atari	389	126	–	–	3	518	1.5	140	0.5
Wang	397	–	13	–	39	449	1.3	423	1.5
Tandon	893	(495)	–	–	(1)	398	1.2	750	2.7
Sun Microsystems	90	290	–	–	–	380	1.1	380	1.4
PC Craft	293	–	–	–	–	293	0.9	**	–
Amdek	–	–	–	–	264	264	0.8	264	0.9
Northgate Comp.	304	(44)	–	–	–	260	0.8	129	0.5
Altos	–	37	–	211	–	258	0.8	307	1.1
Convergent	3	144	15	–	–	250	0.7	250	0.9
Ungermann-Bass	–	177	73	–	–	250	0.7	250	0.9
Other Customers	3,405	318	168	199	514	4,506	13.2	3,717	13.2
Total	$23,374	$4,711	$ 2,433	$2,082	$1,561	$34,161	100.0%	$28,083	100.0%

* Includes product groups not listed.
** Customer not individually forecasted

Total Domestic OEM revenues of $35.2 million were 25% over the planned $28.1 million. Licensing revenues were 125% of plan, and revenues from packaged product sales were 123% of plan.

Compaq held its position as the top customer for the channel, exceeding its prior quarter sales record by an additional 11,000 units. Sales of its SLT/286 and 386-based computers remain strong. Consistent with prior quarters, OS/2 sales were lower than plan (600 units versus 1,500 units planned) and MS-DOS sales were higher than plan (180,600 units versus 159,500 units planned). Phoenix Computer's revenues were more than twice those planned ($2.7 million versus $1.2 million), the result of very aggressive marketing of packaged MS-DOS. Zenith exceeded plan owing to greater Applications and MS-Mouse sales than had been budgeted. An amendment added Word 5.0 and Excel to their license. NCR's favorable variance offsets last quarter's unfavorable variance and results from previously unreported MS-DOS units. NCR is building up prepaid royalties related to OS/2, LAN Manager and Windows/386, none of which it is shipping. Wyse came in greater than plan because of increased sales of MS-DOS (40,000 units for $675,000 against 23,000 for the $414,000 planned). OS/2 sales continue to be significantly lower than minimum commitments. AST Research bettered its plan by 40% through strong sales of MS-DOS (47,000 units for $1 million against a plan of 35,500 units for $612,000). Data General's favorable variance resulted from an unbudgeted due on signing for LAN Manager and LAN Manager/X Source Code

($250,000). Tandon's shortfall resulted from a reduction of previously recognized UPB due to an amendment which retroactively reduced its minimum commitments.

UPB of $4.7 million represents due on signing and minimum commitment billings in excess of the amounts reclassified to product specific revenue as royalty reports were received. In addition to the above mentioned amount from Data General, other significant due on signing amounts for the quarter included Emerson Technologies ($210,000 - MS-DOS/MS-Shell) and Atari ($125,000 - MS-DOS, Windows, Windows/386). This quarter's GAAP adjustment of $1 million reflects an overall higher accrual for earned but unreported royalties in Q90-1 than was accrued at the end of Q89-4 (accounting for a positive $1.7 million), partially offset by a net increase in deferred revenue related to billings prior to product acceptance (accounting for a -$700,000).

Cost of revenues ($2.6 million against a plan of $2.1 million) was unfavorably impacted by the greater than anticipated volume of OEM mice (151,000 units versus 71,000 units), packaged MS-DOS (48,000 units versus 33,000 units), and packaged Windows (4,800 units versus 3,500 units). This was partially offset by a favorable variance in royalty expense related to low sales of OS/2. As a percent of sales, cost of revenues was essentially at plan.

Operating expenses of $3 million were $133,000 under plan. Favorable variances were incurred in the areas of professional fees ($151,000) and payroll ($31,000). The payroll variance resulted from average headcount being slightly below plan during the quarter. All research and development pools were less than plan, causing favorable allocation variances, the largest of which was Systems Development ($383,000). Sales and marketing allocations incurred a favorable variance due to savings in the PSS Operations and CorpCom pools. All general and administrative pools were at or below planned levels.

In summary, favorable variances in revenues, operating expenses and allocations, with only a proportional increase in cost of revenues, produced a burdened operating income of $20.5 million, 56% greater than the plan of $13.1 million.

International OEM

The condensed burdened operating income statement for International OEM for Q90-1 follows (in thousands):

	Actual		Plan		Variance
Net revenues	$35,189	100.0%	$35,393	100.0%	$ (204)
Cost of revenues	279	0.8	306	0.9	27
Operating expenses	4,569	13.0	4,102	11.6	(467)
Allocations - Research and development	8,563	24.2	10,425	29.3	1,862
Allocations - Sales and marketing	35	0.1	120	0.3	85
Allocations - General and administrative	313	0.8	340	1.0	27
Burdened operating income	$21,430	60.9%	$20,100	56.8%	$1,330

International OEM net revenues by product group for Q90-1 were as follows (in thousands):

	Actual		Plan		Variance
Systems	$27,036	76.8%	$26,360	74.5%	$ 676
UPB	11,328	32.2	6,981	19.7	4,347
Applications	791	2.2	871	2.5	(80)
Xenix	227	0.6	13	-	214
Networks	225	0.6	962	2.7	(737)
Languages	105	0.3	66	0.2	39
Multimedia	77	0.2	-	-	77
SPAG	-	-	140	0.4	(140)
Subtotal	39,789	113.1	35,393	100.0	4,396
Adjustments (GAAP)	(4,600)	(13.1)	-	-	(4,600)
Total	$35,189	100.0%	$35,393	100.0%	$ (204)

The contribution (actual and plan) to International OEM net revenues by consolidating unit for Q90-1 follows (in thousands):

	Actual		Plan		Variance
EUROPE					
MS LTD (England)	$ 2,198	6.2%	$ 1,424	4.0%	$ 774
MS AB (Sweden)	2,212	6.3	1,354	3.8	858
MS GmbH (Germany)	4,582	13.0	2,317	6.6	2,265
MS AG (Switzerland)	3	-	-	-	3
MS SARL (France)	1,411	4.0	1,299	3.7	112
MS SRL (Spain)	191	0.5	112	0.3	79
MS BV (Netherlands)	194	0.6	492	1.4	(298)
MS SpA (Italy)	1,293	3.7	1,326	3.7	(33)
	12,084	34.3	8,324	23.5	3,760
ICON					
MS INC (Canada)	2,623	7.5	1,387	4.0	1,237
MS PTY (Australia)	186	0.5	147	0.4	39
Mexico	309	0.9	191	0.5	118
Brazil	200	0.6	336	0.9	(136)
AIME (Africa/India/Mid-East)	111	0.3	83	0.2	28
ASIA Pacific	984	2.8	452	1.3	532
	4,413	12.6	2,596	7.3	1,817
FAR EAST					
MS KK (Japan)	13,274	37.9	13,442	38.0	(168)
MS CH (Korea)	5,363	15.2	4,799	13.6	564
MS TC (Taiwan)	4,655	13.2	5,982	16.9	(1,327)
	23,292	66.2	24,223	68.5	(931)
Other Redmond	-	-	250	0.7	(250)
Total Non-Europe	27,705	78.7	27,069	76.5	636
GAAP Adjustment	(4,600)	(13.1)	-	-	(4,600)
Total	$35,189	100.0%	$35,393	100.0%	$ (204)

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Significant International OEM customers, by product group, for Q90-1 were (in thousands):

	Systems	UPB	Xenix	Networks	Other*	Total Actual		Total Plan	
Epson	$ 3,426	$ (24)	$ –	$ –	$ 28	$ 3,430	8.6%	$ 1,319	3.7%
Sanyo	658	2,500	–	–	–	3,158	8.0	1,520	4.2
Philips Elec.	646	1,719	–	–	–	2,365	6.0	1,099	3.1
Acer	1,363	452	–	–	–	1,815	4.6	2,095	5.9
Sharp	692	1,036	–	–	–	1,727	4.3	–	–
Toshiba	1,826	(129)	–	5	25	1,727	4.3	2,263	6.4
Hyundai	–	1,300	–	–	–	1,300	3.3	1,300	3.7
Siemens AG	153	1,002	136	–	–	1,291	3.2	342	1.0
Samsung Elec.	1,015	238	–	–	–	1,253	3.1	1,250	3.5
Datatronic AB	221	991	–	–	–	1,212	3.0	458	1.3
Schneider Rund.	456	480	–	–	255	1,191	3.0	1,191	3.4
Gold Star	689	436	–	–	–	1,125	2.8	1,125	3.2
Nixdorf	728	347	–	–	–	1,075	2.7	267	0.8
Olivetti SPA	1,944	(952)	–	30	1	1,025	2.6	1,019	2.9
Mitsubishi Elec.	945	(38)	2	–	62	972	2.4	833	2.4
Copam Elec.	473	402	–	–	–	875	2.2	1,010	2.9
Video Tech.	308	508	–	–	–	816	2.1	345	1.0
Nokia Data	643	74	–	60	–	778	2.0	776	2.2
Oki Elec.	192	566	–	–	–	758	1.9	750	2.1
Tatung	917	(167)	–	–	–	750	1.9	1,088	3.1
Bull S.A.	631	86	–	–	–	717	1.8	700	2.0
Daewoo Telecom	89	565	–	1	–	654	1.6	400	1.1
Trigem	449	159	–	–	–	608	1.5	150	0.4
Apricot	–	557	–	–	–	557	1.4	557	1.6
Twinhead Intl.	–	403	–	–	–	403	1.0	**	–
Amstrad PLC	356	44	–	–	–	400	1.0	502	1.4
Fujitsu LTD	757	(538)	14	4	103	340	0.9	131	0.4
Intl Computer	5	300	–	–	–	305	0.8	300	0.8
NEC Corp.	325	(27)	–	–	–	298	0.7	2,472	7.0
Viglen Ltd	97	189	–	–	–	285	0.7	**	–
Datatech	435	(165)	–	–	–	270	0.7	263	0.7
SMT Goupil	347	(104)	–	8	–	251	0.6	293	0.8
Other Customers	6,250	(882)	75	117	499	6,058	15.3	9,575	27.0
Total	$27,036	$11,328	$227	$225	$973	$39,789	100.0%	$35,393	100.0%

* Includes UPB and product groups not listed.
** Customer not individually forecasted.

International OEM revenue for the quarter was $35.2 million, only slightly missing plan of $35.4 million. Prior to GAAP adjustment, Europe and ICON exceeded their budget by $3.8 million and $1.8 million, respectively, whereas the Far East came in $930,000 under plan, primarily due to MS TC (Taiwan) experiencing a shortfall of $1.3 million.

Epson was the channel's top customer for the quarter with revenues of $3.4 million (MS-DOS), reflecting growing market share in Japan as well as strong sales of its Equity computers in the U.S. and Europe. Sanyo's revenues of $3.2 million include $2.5 million of UPB for a due on signing and minimum commitment related to an agreement for OS/2, MS-DOS and MS-Shell. The Philips Electronics favorable variance of $1.3 million resulted from an amendment which increased its minimum commitment by $1.2 million. Lack of a planned LAN Manager license agreement and slightly depressed system sales caused Acer, the largest Taiwanese OEM, to vary from plan. Sharp's favorable variance resulted from an unbudgeted due on signing ($600,000) and minimum commitment ($600,000) resulting from the signing of a new agreement (OS/2, LAN Manager, MS-DOS, MS-Shell, Windows, MS-Networks), as well as exceeding minimum commitments on a previous license. Nixdorf signed a new agreement, generating excess MS-DOS royalties of $563,000 and net UPB of $347,000. Variances for Video Technology and

Trigem also resulted from new license agreements being signed. NEC's shortfall of $2.2 million dollars resulted from a delay in signing a new license agreement that was anticipated for this quarter. Whereas NEC is continuing to ship product and incur a royalty obligation in anticipation of the signing, the resulting revenue will not be recognized until the agreement is executed.

UPB of $11.3 million reflects due on signings and minimum commitment billings in excess of the amounts reclassified to product specific revenue as royalty reports were received. Significant due on signing amounts related to new agreements for the quarter included Sanyo ($1.3 million - MS-DOS, OS/2, Windows, Networks), Datatronic ($1 million - MS-DOS/MS-Shell, Windows, Windows 386, OS/2), and Siemens ($1 million - OS/2, MS-DOS, Windows). This quarter's GAAP adjustment of minus $4.6 million represents an overall lower accrual for earned but unreported royalties in Q90-1 than was accrued at the end of Q89-4 (accounting for -$1.7 million), combined with a net increase in deferred revenue related to billings prior to product acceptance (accounting for -$2.9 million).

The $27,000 favorable variance in cost of revenues was the result of OS/2-related royalty expense that was significantly lower than plan ($21,600 versus $298,200), which was essentially offset by Xenix-related royalty expense that was significantly higher than plan ($213,900 versus $5,100) and $43,700 in unplanned costs related to the sale of camera-ready artwork. A negative variance in bad debt expense of $1.1 million reflects a conservative adjustment to increase the reserve for perceived risk. This variance was partially offset by positive variances in virtually all other areas. All allocation pools were under plan. The most significant favorable variances were created by the International R&D and Systems Development pools ($1 million and $697,000 respectively), contributing to the $1.9 million variance in research and development allocations.

In summary, the large favorable variance in allocated expenses outweighed the unfavorable variances in operating expenses and net revenues, producing an operating income of $21.4 million (60.9% of net revenues) compared to a plan of $20.1 million (56.8% of net revenues).

Microsoft University (MSU)

The condensed burdened operating income statement for MSU for Q90-1 follows (in thousands):

	Actual		Plan		Variance
Net revenues	$1,210	100.0%	$1,389	100.0%	$(179)
Cost of revenues	186	15.4	240	17.3	54
Operating expenses	898	74.1	1,032	74.3	134
Allocations - General and administrative	102	8.5	111	8.0	9
Burdened operating income	$ 24	2.0%	$ 6	0.4%	$ 18

Microsoft University provides training seminars (courses) on a wide range of Microsoft products. These seminars are primarily aimed at ISVs and other software developers. Accordingly, they have centered around Microsoft operating environments and languages. Titles of courses with the highest demand are: "Programming in Microsoft C"; "Microsoft Applications Programming"; "Microsoft OS/2 Programming Environment"; and "Microsoft OS/2 Presentation Manager Applications Programming". Recognition of revenue is deferred until a course is completed.

MSU experienced depressed attendance during the first month of the quarter, partially accounting for the $179,000 negative revenue variance. Attendance is lower than anticipated in classes being offered for LAN Manager and SQL Server. Another contributing factor to the revenue shortfall is the delay in shipment of the MSU Authorized Training Center (ATC) manuals. The plan anticipated shipment of a large number of manuals associated with LAN Manager and SQL Server courses being taught by the ATCs. Cost of revenues was lower than plan as a direct result of the lower revenues.

Operating expenses had a positive variance of $134,000. Major savings were incurred in payroll ($37,000), employee fringe benefits ($32,000), marketing ($41,000) and professional fees ($55,000). These were partially negated by an unfavorable variance in outside product development ($30,000).

The favorable operating expense variance, combined with the favorable cost of revenues variance, outweighed lower revenues and produced a burdened operating income of $24,000 against a planned income of $6,000.

Product Support Services (PSS)

The condensed burdened operating income statement for PSS for Q90-1 follows (in thousands):

	Actual		Plan		Variance
Net revenues	$ 381	100.0%	$ 327	100.0%	$ 54
Cost of revenues	202	53.1	172	52.7	(30)
Operating expenses	264	69.2	390	119.3	126
Allocations - PSS Operations	764	200.6	899	275.0	135
Allocations - General and administrative	83	21.8	91	27.7	7
Burdened operating (loss)	$(932)	(244.7)%	$(1,225)	(374.7)%	$293

The Product Support Services (PSS) channel generates revenue through its OnLine technical assistance subscription service, sold primarily to ISVs and OEMs. OnLine service is a connect time service. Accordingly, OnLine revenue is deferred at the time of billing and is recognized over the contract period. The positive revenue variance of $54,000 is the result of increasing excess connect time charges from users, as well as an increasing amortization base.

The principal component of cost of revenues are the amounts paid to GE under the OnLine contract. The agreement provides for certain minimum amounts to be paid to GE. Connect time activity for the quarter did not exceed the minimum amount. However, in terms of real dollars, cost of revenues experienced an unfavorable variance of $30,000, primarily due to increased storage costs of knowledge base articles. Such storage costs are not tied to connect time usage and are not part of the minimum commitment to GE. As a percentage of revenues, total cost of revenues was essentially at plan.

Total operating expenses had a positive variance of $126,000. The channel experienced favorable variances in payroll ($45,000) and marketing ($100,000). These were partially offset by an unfavorable variance in administrative services ($52,000).

Allocation of PSS Operations expenses generated a positive variance of $135,000. The operations group provides the technical and phone support for all Microsoft products. Its expenses are allocated out to PSS, USSMD and Domestic OEM channels, based upon perceived benefit. These expenses were under planned levels, resulting in the positive variance. The operations group incurred significant favorable expense variances in the areas of payroll ($236,000), employee recruiting ($122,000), supplies and equipment ($107,000) and professional fees ($41,000).

In summary, the favorable variances in all categories, except cost of revenues, combined to produce a net operating loss of $932,000, 24% less than planned. The channel is planned to incur a loss in each quarter of this fiscal year.

PRODUCT GROUP REPORTING

PRODUCT GROUP REPORTING - Q90-1

The contribution to net revenues and operating income for Q90-1 on a product group basis was as follows (amounts in thousands):

Net Revenues

	Actual		Plan		Variance Percentage
Applications	$106,425	45.3%	$97,770	46.2%	9
Systems	75,232	32.0	65,640	31.0	15
SPAG	25,297	10.8	21,886	10.3	16
Languages	12,973	5.5	11,178	5.3	16
Books	3,038	1.3	3,107	1.5	(2)
Xenix	2,309	1.0	1,889	0.9	22
Services	1,926	0.8	2,252	1.1	(14)
Networks	7,650	3.2	7,380	3.5	4
Systems Journal	266	0.1	285	0.1	(7)
Multimedia	240	0.1	445	0.2	(46)
Intergroup Royalty	(195)	(0.1)	(123)	(0.1)	-
Total	$235,161	100.0%	$211,709	100.0%	11

Burdened Operating Income (Loss)

	Actual			Plan			
	Income (Loss)	Percentage Total	Percentage Revenue	Income (Loss)	Percentage Total	Percentage Revenue	Variance
Applications	$20,696	29.8	19.4	$ 1,874	5.9	1.9	$18,822
Systems	42,797	61.7	56.9	30,618	96.5	46.6	12,179
SPAG	5,557	8.0	22.0	2,562	8.1	11.7	2,995
Languages	1,494	2.2	11.5	(792)	(2.5)	(7.1)	2,286
Books	123	0.2	4.1	(99)	(0.3)	(3.2)	222
Xenix	883	1.3	38.2	840	2.7	44.5	43
Services	(1,653)	(2.4)	(85.8)	(1,581)	(5.0)	(70.2)	(72)
Networks	1,302	1.9	17.0	480	1.5	6.5	822
Systems Journal	(112)	(0.2)	(42.0)	(243)	(0.8)	(85.2)	131
Multimedia	(1,696)	(2.4)	-	(1,942)	(6.1)	-	246
Difference	(2)	(0.1)	-	-	-	-	(2)
Total	$69,389	100.0	29.5	$31,717	100.0	15.0	$37,672

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Quarterly Revenues by Product Group

	Q90-1 Dollars	Q90-1 %	Q90-2 Dollars	Q90-2 %	Q90-3 Dollars	Q90-3 %	Q90-4 Dollars	Q90-4 %	FY 1990 Dollars	FY 1990 %
Applications	$106,425	45.3							$106,425	45.3
Systems	75,232	32.0							75,232	32.0
Hardware	25,297	10.8							25,297	10.8
Languages	12,973	5.5							12,973	5.5
Books	3,038	1.3							3,038	1.3
Xenix	2,309	1.0							2,309	1.0
Network	7,650	3.3							7,650	3.3
Services	1,926	0.8							1,926	0.8
Multimedia	240	0.1							240	0.1
Systems Journal	266	0.1							266	0.1
Intergroup Royalty	-195	-0.1							-195	-0.1
	$235,161	100.0	$0	0.0	$0	0.0	$0	0.0	$235,161	100.0

	Q89-1 Dollars	Q89-1 %	Q89-2 Dollars	Q89-2 %	Q89-3 Dollars	Q89-3 %	Q89-4 Dollars	Q89-4 %	FY 1989 Dollars	FY 1989 %
Applications	$72,054	40.8	$86,247	41.1	$77,283	39.2	$105,306	47.8	$340,890	42.4
Systems	58,965	33.4	70,858	33.8	73,576	37.3	75,914	34.5	279,313	34.8
Hardware	20,451	11.6	30,082	14.3	22,011	11.2	18,981	8.6	91,525	11.4
Languages	16,043	9.1	13,642	6.5	10,090	5.1	8,727	4.0	48,502	6.0
Books	3,735	2.1	2,817	1.3	3,898	2.0	2,910	1.3	13,360	1.7
Xenix	2,457	1.4	2,376	1.1	4,014	2.0	2,411	1.1	11,258	1.4
Network	1,103	0.6	1,570	0.7	3,550	1.8	3,404	1.5	9,627	1.2
Services	1,314	0.7	1,617	0.8	2,001	1.0	2,062	0.9	6,994	0.9
Multimedia	137	0.1	556	0.3	397	0.2	340	0.2	1,430	0.2
Systems Journal	288	0.2	312	0.1	387	0.2	343	0.2	1,330	0.2
Intergroup Royalty	-154	-0.1	-195	-0.1	-183	-0.1	-167	-0.1	-699	-0.1
	$176,393	100.0	$209,882	100.0	$197,024	100.0	$220,231	100.0	$803,530	100.0

	Q88-1 Dollars	Q88-1 %	Q88-2 Dollars	Q88-2 %	Q88-3 Dollars	Q88-3 %	Q88-4 Dollars	Q88-4 %	FY 1988 Dollars	FY 1988 %
Applications	$40,312	39.3	$61,362	39.4	$63,429	39.2	$71,187	41.8	$236,290	40.0
Systems	37,272	36.3	55,982	35.9	55,793	34.5	56,337	33.0	205,384	34.8
Hardware	9,675	9.4	15,735	10.1	19,226	11.9	19,652	11.5	64,288	10.9
Languages	9,641	9.4	17,569	11.3	15,392	9.5	15,322	9.0	57,924	9.8
Books	2,165	2.1	2,138	1.4	3,456	2.1	3,692	2.2	11,451	1.9
Xenix	2,285	2.2	1,588	1.0	2,873	1.8	2,896	1.7	9,642	1.6
Network	348	0.3	480	0.3	717	0.4	746	0.4	2,291	0.4
Multimedia	460	0.4	823	0.5	269	0.2	246	0.1	1,798	0.3
Systems Journal	478	0.5	219	0.1	668	0.4	394	0.2	1,759	0.3
	$102,636	100.0	$155,896	100.0	$161,823	100.0	$170,472	100.0	$590,827	100.0

	Q87-1 Dollars	Q87-1 %	Q87-2 Dollars	Q87-2 %	Q87-3 Dollars	Q87-3 %	Q87-4 Dollars	Q87-4 %	FY 1987 Dollars	FY 1987 %
Applications	$22,373	33.5	$33,968	41.9	$36,649	37.3	$37,319	37.4	$130,309	37.7
Systems	26,616	39.8	24,706	30.5	33,652	34.2	36,359	36.4	121,333	35.1
Hardware	5,475	8.2	9,207	11.4	11,154	11.3	11,078	11.1	36,914	10.7
Languages	10,600	15.9	11,093	13.7	14,056	14.3	12,740	12.8	48,489	14.0
Books	1,716	2.6	2,011	2.5	2,852	2.9	2,266	2.3	8,845	2.6
	$66,780	100.0	$80,985	100.0	$98,363	100.0	$99,762	100.0	$345,890	100.0

Applications

The condensed burdened operating income statement for Applications for Q90-1 follows (in thousands):

	Actual		Plan		Variance
Net revenues	$106,425	100.0%	$97,770	100.0%	$ 8,655
Cost of revenues	24,797	23.3	26,911	27.5	2,114
Operating expenses	28,706	27.0	31,810	32.5	3,104
Allocations - Research and development	2,842	2.7	3,562	3.6	720
Allocations - Sales and marketing	27,549	25.9	31,611	32.4	4,062
Allocations - General and administrative	1,835	1.7	2,002	2.1	167
Burdened operating income	$ 20,696	19.4%	$ 1,874	1.9%	$18,822

Applications net revenues by channel for the quarter were as follows (in thousands):

	Actual		Plan		Variance
USSMD	$ 58,665	55.1%	$ 50,009	51.1%	$8,656
International Retail	50,434	47.4	50,816	52.0	(382)
International OEM	791	0.7	871	0.9	(80)
Domestic OEM	537	0.5	592	0.6	(55)
Adjustments	(4,002)	(3.7)	(4,518)	(4.6)	516
	$106,425	100.0%	$97,770	100.0%	$8,655

Applications net revenue by business unit for the quarter were as follows (in thousands):

	USSMD		International Retail		Worldwide OEM		Total Q90-1	
Office	$22,749	20.7%	$23,481	21.3%	$ 66	0.1%	$ 46,296	41.9%
Analysis	22,792	20.6	17,365	15.7	270	0.2	40,427	36.6
Entry	10,965	9.9	7,835	7.1	618	0.6	19,418	17.6
Data Access	1,227	1.1	1,437	1.3	374	0.3	3,038	2.8
Graphics	932	0.8	316	0.3	-	-	1,248	1.1
	$58,665	53.1%	$50,434	45.7%	$1,328	1.2%	110,427	100.0%
Adjustments							(4,002)	
Net revenues							$106,425	

Net revenues for Q90-1, at $106.4 million, were 9% above plan of $97.8 million. In terms of revenue generation, the product group s leading products (compared with plan) for the quarter were as follows (dollars in thousands):

			Actual		Plan		Variance
Actual	Plan		Units	Revenue	Units	Revenue	
1	1	PC Word	135,637	$25,463	97,989	$21,156	$ 4,307
2	2	Win Excel	84,169	17,552	77,073	19,293	(1,741)
3	3	Mac Word	75,926	12,298	50,023	9,441	2,857
4	4	Mac Excel	58,001	10,774	42,265	9,003	1,771
5	5	PC Works	193,929	9,341	146,046	7,701	1,640
6	-	Mac Excel Update	71,274	5,763	21,117	1,090	4,673
7	-	PC Word Update	80,724	4,798	35,225	2,293	2,505
8	8	PC Multiplan	40,417	4,240	23,915	2,980	1,260
9	7	Mac Works	24,861	3,340	32,439	4,506	(1,166)
10	-	Mac Word Update	55,392	2,300	18,797	1,142	1,158
				$95,869		$78,605	$17,264
		Percentage of Applications net revenu :s		90%		80%	

Plan #6 - Office ($5,954); #9 - Powerpoint ($2,704), #10 - Quick Basic ($2,327)

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Word products continue to dominate Applications' revenue stream, accounting for 41% of gross revenues. PC Word held the number one position with revenues of $25.5 million, a 20% increase over plan of $21.2 million. 84,169 units, a record number, of Win Excel were shipped during Q90-1. Win Excel revenues of $17.6 million were below plan of $19.3 million, despite actual units exceeding plan by 9%. The revenue variance was the result of greater than planned USSMD unit shipments of lower priced Academic Editions versions and Nodepacks and lower than planned unit pricing in the International Retail channel. Mac Word surpassed plan by 30% with revenues of $12.3 million compared to a plan of $9.4 million. PC Works revenues of $9.3 million were 21% over plan of $7.7 million, fueled partially by the release of version 2.0. As part of IBM's "Free-For-All" promotion, PC Works will be bundled with all PS/2 model 25-55SX machines sold from October thru January. IBM has placed an initial order for 210,000 units at $39 per unit. 100,000 units shipped in Q90-1 resulting in $3.9 million in revenue.

The following table shows PC Applications versus Mac Applications by channel for Q90-1 (in thousands):

	USSMD		International Retail		Worldwide OEM		Total Q90-1		Plan
PC Apps	$29,512	26.7%	$40,347	36.6%	$1,318	1.2%	$ 71,177	64.5%	64.8%
Mac Apps	29,160	26.4	9,722	8.8	1	0.0	38,883	35.2	34.3
Other	(7)	0.0	365	0.3	9	0.0	367	0.3	0.9
	$58,665	53.1%	$50,434	45.7%	$1,328	1.2%	110,427	100.0%	100.0%
Adjustments							(4,002)		
Net revenue							$106,425		

For the second straight quarter USSMD was the top revenue generating channel, with revenue of $58.7 million, representing 53% of Applications' gross revenue. USSMD Applications revenues were $8.7 million above plan of $50.0 million, while International Retail was $382,000 below plan of $50.8 million.

As a percentage of net revenues, cost of revenues was 23.3% compared to a budget of 27.5%. Product costs were 17.2% of net revenues, versus plan of 18.6%. USSMD's product cost percentage mirrored the budget percentage of 17.7%, while International Retail's product cost percentage was 15.7%, compared to a budget of 18.1%. USSMD's product cost percentage was affected by the high volume sales of Mac Excel 2.2, Mac Word 4.0 and PC Word 5.0. Their lower than budgeted product costs combined with heavy volume to create a favorable product cost variance in July and August. However, this variance was offset by the unbudgeted, low margin, sales of PC Works 2.0 to IBM. International Retail's product costs were lower than plan due to strong sales of high margin Mac Word 4.0 and PC Word 5.0. Non-product costs, as a percentage of net revenues, were 6.1% ($6.5 million), compared to budget of 8.9% ($8.8 million). The variance is due to favorable manufacturing variances, particularly from Ireland, and the reversal of free upgrade expense which was accrued in earlier periods in order to offset the cost of fulfilling free updates for PC and Mac Word.

Operating expenses of $28.7 million, 27.0% of net revenues, were $3.1 million below budget of $31.8 million, 32.5% of net revenues. The favorable variance was primarily due to below planned expenditures in third-party development ($1.0 million), payroll ($703,000) and marketing ($687,000).

The third-party development variance is the result of lower than planned domestic spending on purchased code ($370,000), freelancers ($281,000), and documentation ($99,000). KK and Ireland were also well below budgeted product development expenditures.

Payroll is below plan of $8.2 million by 9%. The variance is the result of headcount ramping up at a slower rate than anticipated in budget. Applications' headcount has been below plan for each month and the product group ended the quarter with 650 employees versus plan of 696. While headcount will likely catch up to the budget, the current quarter's variance should represent a permanent savings.

Actual Applications marketing of $7.1 million was $5.1 million under plan of $12.2 million. Domestic marketing was responsible for $2.7 million of this variance with the subsidiaries, particularly LTD, SARL and AG, making up the rest of the variance. The marketing variance was spread across all product and Corporate marketing plans, with Win Excel and Win Word representing the two largest variances. The marketing variance represents timing differences, which can be expected to turn around. Furthermore, actual marketing commitments have been made for which we have not been billed. In order to minimize the impact of the turnaround in subsequent quarters, we have accrued $4.4 million in marketing expenses. The accrual reduced the net marketing variance to $687,000.

Allocations to Applications were $32.2 million compared to plan of $37.2 million. As a percentage of net revenues, actual allocations were 30.3% versus budget of 38.0%. Favorable allocations from International Retail ($2.2 million) and USSMD ($1.7 million) made up the lion's share of the variance.

The Q90-1 burdened operating income for Applications was $20.7 million, 19.4% of net revenues, compared to a plan of $1.9 million, 1.9%. Strong revenues combined with lower than expected cost of revenues, operating expenses and allocations resulting in a burdened operating income which exceeded plan by a factor of ten.

Systems

The condensed burdened operating income statement for Systems for Q90-1 follows (in thousands):

	Actual		Plan		Variance
Net revenues	$75,232	100.0%	$65,640	100.0%	$9,592
Cost of revenues	6,474	8.6	5,900	9.0	(574)
Operating expenses	15,329	20.4	17,891	27.2	2,562
Allocations - Research and development	1,203	1.5	1,464	2.2	261
Allocations - Sales and marketing	8,519	11.4	8,774	13.4	255
Allocations - General and administrative	910	1.2	993	1.6	83
Burdened operating income	$42,797	56.9%	$30,618	46.6%	$12,179

Systems net revenues by channel for Q90-1 were as follows (in thousands):

	Actual		Plan		Variance
International OEM	$27,036	35.9%	$26,360	40.2%	$ 676
Domestic OEM	23,374	31.1	20,298	30.9	3,076
International Retail	12,975	17.3	10,639	16.2	2,336
USSMD	4,535	6.0	3,242	4.9	1,293
MSU	4	-	-	-	4
Subtotal	67,924	90.3	60,539	92.2	7,385
Adjustments (Includes GAAP and UPB)	7,308	9.7	5,101	7.8	2,207
Total	$75,232	100.0%	$65,640	100.0%	$9,592

In terms of revenue generation, the Systems product group's leading products (compared with plan) for the quarter were as follows (revenue in thousands):

Actual	Plan		Actual Units	Actual Revenue	Plan Units	Plan Revenue
1	1	MS-DOS/GW-Basic	3,519,434	$51,691	2,986,351	$41,255
2	2	Windows 286	539,131	7,522	555,736	7,874
3	3	Windows 386	103,671	5,554	85,739	4,177
4	4	OS/2	25,639	1,015	81,168	3,663
				$65,782		$56,969
Percent of net revenues*				87%		87%

*Remainder of net revenue results from software development kits, updates and UPB/GAAP allocations.

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Table of significant International OEM Systems customers, by product (in thousands):

	MS-DOS		Windows/Windows 386		OS/2		Other		Total	
Epson	$ 3,402	14.0%	$ –	–%	$ 24	7.6%	$ –	–%	$ 3,426	12.7%
Olivetti SpA	1,132	4.7	723	37.1	44	13.9	45	9.1	1,944	7.2
Toshiba	1,697	7.0	39	2.0	90	28.4	–	–	1,826	6.8
Acer	1,186	4.9	171	8.8	6	1.9	–	–	1,363	5.0
Samsung Elec.	1,015	4.2	–	–	–	–	–	–	1,015	3.8
Mitsubishi Elec.	871	3.6	74	3.8	–	–	–	–	945	3.5
Tatung	815	3.4	–	–	–	–	102	20.6	917	3.4
Hitachi	881	3.6	–	–	–	–	–	–	881	3.3
Fujitsu	700	2.9	20	1.0	37	11.7	–	–	757	2.8
Nixdorf	715	2.9	–	–	13	4.1	–	–	728	2.7
Sharp	690	2.8	2	0.1	–	–	–	–	692	2.6
Gold Star	689	2.8	–	–	–	–	–	–	689	2.5
Sanyo	642	2.6	11	0.6	–	–	5	1.0	658	2.4
Philips Elec.	574	2.4	–	–	–	–	72	14.5	646	2.4
Nokia Data	391	1.6	246	12.6	6	1.9	–	–	643	2.4
Bull S.A.	474	2.0	–	–	62	19.6	95	19.2	631	2.3
Copam Elec.	473	1.9	–	–	–	–	–	–	473	1.7
Schneider Rund.	456	1.9	–	–	–	–	–	–	456	1.7
Trigem	449	1.8	–	–	–	–	–	–	449	1.7
Datatech	430	1.8	–	–	–	–	5	1.0	435	1[illegible]
Matsushita Elec.	373	1.5	38	1.9	3	0.9	–	–	414	1.5
Peacock GmbH	339	1.4	52	2.7	–	–	16	3.2	407	1.5
Other Customers	5,881	24.3	573	29.4	32	10.0	155	31.4	56,641	24.5
Total	$24,275	100.0%	$1,949	100.0%	$ 317	100.0%	$ 495	100.0%	$27,036	100.0%
Plan	$20,749		$1,811		$2,300		$1,500		$26,360	

Table of significant Domestic OEM Systems customers, by product (in thousands):

	MS-DOS		Windows/Windows 386		OS/2		Other		Total	
Compaq	$ 2,879	14.4%	$ 1	–%	$ 65	9.4%	$ –	–%	$ 2,945	12.6%
Zenith	2,042	10.2	694	28.4	25	3.6	30	10.0	2,791	11.8
Phoenix	2,672	13.4	13	0.5	4	0.6	–	–	2,689	11.5
AST Research	1,013	5.1	–	–	11	1.6	–	–	1,024	4.4
Tandon	506	2.5	387	15.9	–	–	–	–	893	3.8
Tandy	876	4.4	1	–	4	0.6	–	–	881	3.8
Compuadd	725	3.6	–	–	–	–	99	33.1	824	3.5
NCR	800	4.0	4	0.2	12	1.7	4	1.3	820	3.5
Commodore	776	3.9	10	0.4	–	–	6	2.0	792	3.4
Wyse	675	3.4	–	–	6	0.9	–	–	681	2.9
Hewlett Packard	463	2.3	146	6.0	47	6.8	1	0.3	657	2.8
AT&T	371	1.9	105	4.3	18	2.6	93	31.0	587	2.5
Supercom	535	2.7	–	–	–	–	–	–	535	2.3
Unisys	22	0.1	432	17.8	32	4.6	(3)	(1.0)	483	2.1
Dell	431	2.2	10	0.4	26	3.7	–	–	467	2.0
DEC	217	1.1	217	8.9	1	0.1	–	–	435	1.9
Wang	194	1.0	176	7.2	27	3.9	–	–	397	1.7
Atari	213	1.1	176	7.2	–	–	–	–	389	1.7
Other Customers	4,528	22.7	69	2.8	417	59.9	70	23.3	5,084	21.8
Total	$19,938	100.0%	$2,441	100.0%	$ 695	100.0%	$300	100.0%	$23,374	100.0%
Licensing	$17,645	88.5%	$2,139	87.6%	$650	93.5%	$300	100.0%	$20,731	88.7%
Packaged Product	2,293	11.5	302	12.4	45	6.5	–	–	2,643	11.3
Total	$19,938	100.0%	$2,441	100.0%	$695	100.0%	$300	100.0%	$23,374	100.0%
Plan	$16,165		$2,272		$1,363		$500		$20,298	

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Net Systems revenues were $75.2 million, or 15% over the plan of $65.6 million. All revenue channels had favorable variances. Included in the number was an allocation of UPB ($9.6 million) and GAAP adjustment (negative $2.2 million).

International OEM generated $3.5 million in excess MS-DOS revenues, offset by a shortfall in OS/2 revenues. The major factors behind the MS-DOS variance were higher volumes reported by Epson (674,000 units for $3.4 million against a plan of 357,000 units for $1.3 million), Mitsubishi (75,000 units for $871,000 compared to a plan of 25,000 units for $333,000) and Nixdorf (30,000 units for $715,000 versus a plan of 3,800 units for $152,000). The OS/2 deficiency was primarily created by the following individual shortfalls: Fujitsu ($373,000), Tatung ($338,000), Philips ($250,000), Schneider Rundfunkwerke ($162,000) and Copam ($135,000).

The $3.1 million favorable variance from Domestic OEM is the net result of greater than plan revenue for MS-DOS ($3.8 million) offset by lower revenue for OS/2 ($668,000). Contributing to the MS-DOS variance were Phoenix Computer (74,000 units for $2.7 million against a plan of 38,000 units for $1.2 million), AST Research (57,000 units for $1 million against a plan of 35,500 units for $612,000), Compuadd (28,000 units for $725,000 against a plan of 14,000 units for $440,000) and Atari (11,000 units for $213,000 against a plan of 3,300 units for $11,000). The major contributors to the OS/2 shortfall were Zenith (295 units for $25,000 against a plan of 1,700 units for $145,000), Compaq (636 units for $65,000 against a plan of 1,500 units for $150,000) and Hewlett Packard (367 units for $47,000 against a plan of 1,100 units for $105,000). International Retail's positive performance resulted from greater than planned sales of packaged MS-DOS, particularly the Portuguese version ($1.4 million versus $130,000). The $1.3 million favorable USSMD variance resulted from higher sales of Windows 386 (25,400 units for $2.3 million against a plan of 12,700 units for $1.1 million).

A factor in the favorable revenue variance was the allocation of a portion of UPB and the GAAP adjustment (UPB and GAAP for both Domestic and International OEM are allocated 60% to Systems and 40% to Networks). UPB results from due on signings and minimum commitments from OEM license agreements, many of which pertain to Systems products. The GAAP adjustment is an accrual for royalties earned during the quarter but not yet reported, net of deferred revenue relating to billings prior to product acceptance (refer to Domestic and International OEM channel discussions for further information).

Cost of revenues was $574,000 greater than plan, but as a percentage of net revenues was slightly less than plan (8.6% versus 9.0%). In terms of dollars, the main factor affecting this variance was the high volume of packaged product sales (MS-DOS and Windows), partially offset by reduced OS/2 royalty expense associated with below-plan OS/2 sales. In terms of percentage, the decrease can be explained by favorable licensing variances in the OEM channels and by the net positive variance in the allocation of UPB and GAAP. Such revenue increases are essentially free of additional costs.

The Systems commodity incurred lower operating expenses than were budgeted, primarily due to less than anticipated payroll expenses ($1.3 million) and third-party development expenses ($1.2 million). The $261,000 favorable research and development allocation variance resulted from the International R&D pool (aka localization) being under plan. The sales and marketing allocation was also less than plan as a result of fewer non-commodity specific costs incurred by the International Retail, USSMD and Domestic OEM channels, partially offset by a greater amount of such expenses incurred by the International OEM channel.

In summary, favorable variances in revenues, operating expenses and allocations, with only a proportional increase in cost of revenues, produced a burdened operating income of $42.8 million, or 40% over the plan of $30.6 million.

Systems, Peripherals and Accessories Group (SPAG)

The condensed burdened operating income statement for SPAG for Q90-1 follows (in thousands):

	Actual		Plan		Variance
Net revenues	$25,297	100.0%	$21,886	100.0%	$3,411
Cost of revenues	12,220	48.3	10,653	48.7	(1,567)
Operating expenses	2,257	8.9	2,643	12.1	386
Allocations - Research and development	217	0.9	254	1.2	37
Allocations - Sales and marketing	4,843	19.1	5,554	25.3	711
Allocations - General and administrative	203	0.8	220	1.0	17
Burdened operating income (loss)	$ 5,557	22.0%	$ 2,562	11.7%	$2,995

SPAG revenues by channel for the quarter were as follows (in thousands):

	Actual		Plan		Variance
USSMD	$13,441	53.1%	$10,689	48.8%	$2,752
International Retail	11,889	47.0	11,443	52.3	446
Domestic OEM	686	2.7	398	1.8	288
International OEM	-	-	140	0.6	(140)
Adjustments	(719)	(2.8)	(784)	(3.5)	65
	$25,297	100.0%	$21,886	100.0%	$3,411

In terms of revenue generation, SPAG's leading products (compared with plan) for the quarter were as follows (dollars in thousands):

	Actual		Plan		Variance
	Units	Dollars	Units	Dollars	
Serial Mouse	176,261	$16,332	146,706	$14,180	$2,152
Bus Mouse	83,156	7,853	93,274	7,622	231
OEM Mouse	44,915	1,052	10,000	208	844
		$25,237		$22,010	$3,227
Percent of SPAG net revenues		100%		101%	

Fueled by the simultaneous release of the 400 ppi Mouse in the US and Europe, net revenues of $25.3 million exceeded plan of $21.9 million by 16%. Although hampered by raw material shortages, SPAG continues to enjoy strong demand for its Mice. In addition to the retail mouse, the OEM Mouse greatly exceeded plan. This favorable variance is due to a concentrated effort to increase penetration in the OEM market.

USSMD revenue of $13.4 million was $2.7 million above plan. The variance was primarily due to strong sales of Mouse SKUs with Paintbrush. International Retail revenue of $11.9 million exceeded plan of $11.4 million by $446,000. International Retail represented 47.0% of Q90-1 net revenue versus plan of 52.3%.

Cost of revenues was $12.2 million, 48.3% of net revenues, versus plan of $10.7 million, 48.7% of planned net revenues. Product costs at 42.9% of net revenues approximated budget of 42.4%. Favorable product cost variances in both the USSMD and International Retail channels were offset by higher than planned product casts from Domestic OEM. Non-product costs, included in cost of revenues, were 5.4% of net revenues ($1.4 million) compared to budget of 6.3% ($1.4 million). Unfavorable inventory adjustments associated with the obsolescence of the Mach 20 were offset by lower than planned allocations of manufacturing and distribution expenses. Royalties were also favorable due to below forecast sales of Mouse SKUs with Easycad.

SPAG operating expenses for Q90-1 were $2.3 million, 8.9% of net revenues, compared to a plan of $2.6 million, 12.1% of planned net revenues. Favorable variances in product development ($238,000), marketing ($53,000) and payroll ($53,000) accounted for the majority of the variance. A significant variance in miscellaneous development ($418,000) was partially offset by an unfavorable variance in purchased code ($180,000 related to a two month acceleration of amortization of PC Paintbrush 4.0 from Zsoft). Actual marketing of $518,000 was $673,000 below plan, primarily due to a decision to delay marketing of the 400 ppi Mouse in order to allow the US channel to sell through existing inventcry of the older version. As a result, an accrual of $620,000 was made to offset the effects in future quarters. The payroll variance is due to headcount ramping up at a slower rate than anticipated in the budget.

Allocations to SPAG of $5.3 million were under plan of $6.0 million. Allocations were 20.8% of net revenues, compared to a plan of 27.5%. Favorable allocations from International Retail ($379,000) and USSMD ($320,000) were primarily responsible for the variance.

Burdened operating income for Q90-1 of $5.6 million far exceeded projected operating income of $2.6 million. Vigorous sales of the new 400 ppi Mouse were the primary causes of the strong operating results.

Languages

The condensed burdened operating income statement for Languages for Q90-1 follows (in thousands):

	Actual		Plan		Variance
Net revenues	$12,973	100.0%	$11,178	100.0%	$1,795
Cost of revenues	4,032	31.1	3,045	27.2	(987)
Operating expenses	3,943	30.4	4,882	43.7	939
Allocations - Research and development	436	3.4	552	4.9	116
Allocations - Sales and marketing	2,733	21.0	3,126	28.0	393
Allocations - General and administrative	335	2.6	365	3.3	30
Burdened operating income (loss)	$1,494	11.5%	$ (792)	(7.1)%	$2,286

Language revenues by channel for the quarter were as follows (in thousands):

	Actual		Plan		Variance
USSMD	$7,366	56.8%	$5,374	48.1%	$1,992
International Retail	5,598	43.2	6,090	54.5	(492)
Domestic OEM	329	2.5	89	0.8	240
International OEM	105	0.8	66	0.6	39
Microsoft University	1	-	0	-	1
Adjustments	(426)	(3.3)	(441)	(4.0)	15
	$12,973	100.0%	$11,178	100.0%	$1,795

Net revenues for Q90-1, at $13.0 million, were $1.8 million above plan. In terms of revenue generation, the product group's leading products (compared with plan) for the quarter were as follows (dollars in thousands):

			Actual		Plan		Variance
Actual	Plan		Units	Revenue	Units	Revenue	
1	1	Pro C	37,859	$5,493	19,827	$4,757	$ 736
2	2	Pro Fortran	6,883	1,580	7,029	1,553	27
3	3	Quick C	20,786	1,137	19,995	1,206	(69)
4	4	Macro Assembler	11,141	931	9,186	834	97
5	-	Fortran Update	7,810	814	6,000	510	304
				$9,955		$8,860	$1,095
Percentage of Languages net revenues				77%		79%	

Plan #5 - Pro Cobol ($763)

Once again Pro C, with sales of $5.5 million, was the top-selling Language product, representing 42% of the product group's net revenue. This occurred in spite of the slippage of version 6.0 until Q90-3. The low revenue per unit is the result of 15,767 units sold through the Domestic OEM channel at $9.63 per unit compared to its plan of 1,750 units at $50.00 per unit. Pro Fortran sales continue to be strong, slightly above plan in revenue but below plan in units. Although Quick C revenue was 6% under plan, it increased 44% over Q89-4 revenue. A significant backlog of Macro Assembler orders at the end of Q89-4 contributed to its current higher than planned revenue. In an encouraging look at OS/2's future, it is noteworthy that revenues from Presentation Manager Tool Kits and Softsets were $595,000 compared to plan of $62,000, (2,999 units against a plan of 795 units).

As a percentage of net revenues, cost of revenues was 31.1% ($4.0 million) compared to a planned 27.2% ($3.0 million). Product costs were 22.6% of net revenue compared with a budget of 19.5% of net revenues. USSMD product costs were 20.0% of net revenue compared to a budget of 16.4%, while

International Retail product costs were 25.4% compared to a budget of 21.3%. The unfavorable USSMD product cost was the result of several unrelated incidents. Product costs were significantly higher than expected for the Pro Fortran and Quick C updates and revenue exceeded forecast for the lower margin Quick products, Quick C and Quick Pascal. Finally, the introduction of C Compiler 6.0, with product costs of 11%, slipped until Q90-3. As a result, C Compiler 5.1 is still shipping, representing 42% of net revenues with a product cost of 19%. International Retail product costs were negatively impacted by sales of low margin updates in excess of plan. Updates were forecast at 8% ($885,000) of net revenues, while actual was 12% ($1.6 million). Non-product costs included in the cost of revenues were 8.5% of net revenues ($1.1 million), compared to a plan of 7.7% ($869,000). The variance is due to greater than anticipated obsolescence (primarily Quick Basic), rework charges to convert C 5.1 updates to finished goods and higher than expected manual costs for Pro C and Quick C.

Languages operating expenses for Q90-1 were $3.9 million, 30.4% of net revenues, compared to a plan of $4.9 million, 43.7% of net revenues. Favorable variances occurred in third-party product development ($307,000), payroll ($251,000), recruiting ($126,000) and several other expense categories.

The favorable variance in third-party product development is primarily due to below planned spending by KK and Ireland IPG. The favorable variance in payroll is due to headcount ramping up at a slower rate than forecast. The recruiting variance is due to lower than anticipated relocation costs. Marketing, with a net favorable variance of $63,000, consisted of a $278,000 favorable variance in actual spending, offset by a marketing accrual of $215,000.

Allocations to Languages of $3.5 million were $542,000 under plan. As a percentage of net revenue, total allocated expenses were 27.0% compared to a plan of 36.2%. Nearly every allocated expense category was under plan, the most significant being International Retail ($196,000) and USSMD ($183,000).

The Q90-1 burdened operating income for Languages was $1.5 million, 11.5% of net revenues, compared to a planned loss of $792,000, -7.1% of net revenues. The $1.8 million favorable variance in net revenues, combined with favorable operating and allocated expense variances, more than offset the unfavorable variance in cost of revenues.

Books

The condensed burdened operating income statement for Books for Q90-1 follows (in thousands):

	Actual		Plan		Variance
Net revenues	$3,038	100.0%	$3,107	100.0%	$ (69)
Cost of revenues	1,484	48.8	1,454	46.8	(30)
Operating expenses	1,283	42.2	1,588	51.1	305
Allocations - General and administrative	148	4.9	164	5.3	16
Burdened operating income (loss)	$ 123	4.1%	$ (99)	(3.2)%	$222

Books revenue by channel of distribution for the quarter were as follows (in thousands):

	Actual		Plan		Variance
Press	$2,888	95.1%	$3,107	100.0%	$(219)
International Retail	34	1.1	-	-	34
Domestic OEM	1	0.0	-	-	1
Adjustments	115	3.8	-	0.0	115
	$3,038	100.0%	$3,107	100.0%	$ (69)

The product group's ten leading revenue generating titles, compared to plan, for the quarter were as follows (dollars in thousands):

	Actual		Plan		Variance
	Units	Revenue	Units	Revenue	
Running MS-DOS-4th Edition	48,409	$ 564	49,500	$ 568	$ (4)
Learn C Now	13,229	264	8,000	160	104
Mouse Programmer's Reference	8,176	152	7,000	105	47
Learn. DOS/Running DOS-4th Edition	3,570	117	-	-	117
DBase IV: Command Reference	9,577	115	15,500	193	(78)
Word Processing Power-3rd Edition	9,654	109	8,500	93	16
MS Quickbasic-3rd Edition	8,576	100	12,500	125	(25)
MS Works on Apple Mac-2nd Edition	8,241	83	3,750	37	46
1990 Desk Calendar	9,514	81	12,500	125	(44)
Programming the OS/2 PM	4,072	73	4,100	61	12
		$1,658		$1,467	$191
Percentage of Books' net revenues		55%		47%	

Book net revenues of $3.0 million were below plan of $3.1 million by 2%. The revenue shortfall may be attributed to several things. Despite shipping all forecasted titles during the quarter, orders for new titles were substantially lower than initially projected. This trend is expected to continue but should act to reduce the rate of returns in future periods. Returns continue to be higher than projected, Q90-1 returns were 27% of domestic gross revenues. The return levels, however, appear to be decreasing (from 47% in July to 16% in September) and should be less significant in future periods. Finally, this was the first quarter in which sales to retail computer stores were made directly by Press and not through the USSMD sales channel. The transition resulted in the loss of almost a month's sales. By September, the switchover was complete and all accounts that were previously sold through USSMD are moderately exceeding the previous rate of sales.

The top ten titles contributed $1.7 million (55% of net revenues) against a plan of $1.5 million (47% of net revenues). Running MS-DOS 4th Edition once again topped the charts with sales of $564,000 or 19% of Books' net revenue (48,409 units). Learning DOS/Running DOS, an application software product bundled with a book, represented 4% of net revenues. This is significant because the bundle represents a new method of reaching end-users with combined Microsoft products. The bundle is still in the test phase and is being offered on a trial basis.

Cost of revenues were $1.5 million, 48.8% of net revenues, compared to a plan of $1.5 million, 46.8% of net revenues. Product costs as a percent of net revenues were 18.5%, approximating a plan of 19.3%. Non-product costs, included in cost of revenues, were $921,000 (30.3% of net revenues) against a plan of $854,000 (27.5% of net revenues). Inventory adjustments were over plan due to an increase of $110,000 in the reserve for obsolete inventory. The increase was made in anticipation of destroying slow-moving titles prior to the move to a new distributor (Harper & Row notified us they would be terminating the relationship at the end of the current contract). Freight, shipping and other were over plan as a result of a change in Harper & Row's policy to give customers free freight (the actual cost of this decision will not be known until the end of October, when the September settlement statement is received). Royalties were $135,000 under plan as a result of sales mix favoring non-royalty bearing titles. Finally, inter business unit royalties of $61,000 were not forecast. The majority of the inter business unit royalty was to the Entry Business Unit for the Learning DOS/Running DOS bundle.

Operating expenses of $1.3 million were below plan of $1.6 million by $305,000. Significant favorable variances occurred in marketing ($136,000 versus plan of $278,000), third-party product development ($162,000 versus plan of $231,000), and payroll ($437,000 versus plan of $460,000). Marketing is below projected levels due to a decision to cancel a direct mail effort, slated for September, and implement an overall reduction in marketing due to unfavorable revenue results. Product development's favorable variance may be attributed to a reduction in the use of third-party product development. Payroll had a favorable variance of $23,000 due to delays in hiring approved headcount. The only unfavorable variance of significance occurred in professional fees ($28,000 actual versus plan of $12,000), resulting from consultants that were hired to assist in decisions related to choosing a new distributor.

Allocated expenses of $148,000 (4.9% of net revenues) were slightly lower than plan of $164,000 (5.3% of net revenues).

In summary, Q90-1 burdened operating income of $123,000 (4.1% of net revenues) was well above the anticipated burdened operating loss of $99,000 (-3.2% of net revenues). Despite the revenue shortfall and cost of revenues that were marginally above plan, the significant favorable variance in operating expenses was enough to create the favorable results. Q90-2 burdened operating income of $491,000 will be considerably more difficult to achieve. The planned change in distributors from Harper & Row to Ingram Publishing Services may create a temporary decrease in revenues, and will also create a significant unplanned expense related to the transfer of inventory.

Xenix

The condensed burdened operating income statement for Xenix for Q90-1 follows (in thousands):

	Actual		Plan		Variance
Net revenues	$2,309	100.0%	$1,889	100.0%	$420
Cost of revenues	1,164	50.5	756	40.0	(408)
Operating expenses	108	4.7	120	6.3	12
Allocations - Sales and marketing	135	5.8	152	8.1	17
Allocations - General and administrative	19	0.8	21	1.1	2
Burdened operating income	$ 883	38.2%	$ 840	44.5%	$ 43

Xenix net revenues by channel for Q90-1 were as follows (in thousands):

	Actual		Plan		Variance
Domestic OEM	$2,082	90.2%	$1,876	99.3%	$206
International OEM	227	9.8	13	0.7	214
	$2,309	100.0%	$1,889	100.0%	$420

Table of significant OEM customers (in thousands):

	Actual		Plan		Variance
SCO	$1,614	77.5%	$1,610	85.9%	$ 4
Altos	211	10.1	254	13.5	(43)
Interactive Systems	154	7.4	-	-	154
AT&T	32	1.5	-	-	32
IBM	24	1.2	-	-	24
Other Customers	47	2.3	12	0.6	35
Total Domestic	$2,082	100.0%	$1,876	100.0%	$206
Siemens AG	$136	59.9%	$ 6	46.2%	$130
Triumph Adler	68	30.0	-	**	68
Other Customers	23	10.1	7	53.8	16
Total International	$227	100.0%	$13	100.0%	$214

**Customer not individually forecasted.

Domestic OEM generated $206,000 of the product group's total $420,000 variance. SCO was right on plan with revenues of $1.6 million. Interactive Systems provided $154,000 in unplanned revenue, with the remainder of the variance generated by AT&T, IBM, Tandy, and Zenith Data. Most International OEMs were not forecasted to generate Xenix-based revenue since they have migrated to SCO. However, Siemens continues to license directly from Microsoft and contributed $136,000 in revenue against a plan of $6,000.

The $408,000 unfavorable variance in cost of revenues was due to an increase in Xenix-related royalty expense corresponding to the greater than anticipated volume, combined with a shift in product mix to higher royalty-bearing versions.

Operating expenses were 10% below plan due primarily to a favorable payroll variance ($14,000) stemming from headcount levels at 50% of plan. Unfavorable variances of bad debt expense ($7,000) and taxes ($6,000) were a direct result of the favorable revenue variance. All allocation pools were at or under plan, with Domestic OEM creating the $15,000 sales and marketing variance.

In summary, the favorable revenue, operating expense and allocated expense variances, partially offset by increased cost of revenues, resulted in a burdened operating income of $883,000, or 5.1% above the plan of $840,000.

Services

The condensed burdened operating income statement for Services product group for Q90-1 follows (in thousands):

	Actual		Plan		Variance
Net revenues	$ 1,926	100.0%	$ 2,252	100.0%	$(326)
Cost of revenues	523	27.2	847	37.6	324
Operating expenses	1,811	94.0	1,535	68.2	(276)
Allocations - Sales and marketing	1,021	53.0	1,209	53.6	188
Allocations - General and administrative	223	11.6	242	10.8	19
Burdened operating (loss)	$(1,652)	(85.8)%	$(1,581)	(70.2)%	$ (71)

Services net revenues by channel of distribution for Q90-1 were as follows (in thousands):

	Actual		Plan		Variance
Microsoft University	$1,205	62.6%	$1,389	61.7%	$(185)
Product Support Services	381	19.8	327	14.5	54
International Retail	264	13.7	68	3.0	195
International PSS	18	0.9	342	15.2	(324)
International OEM	2	0.1	-	-	2
International MSU	-	-	130	5.8	(130)
Adjustments	60	3.1	-	-	60
Rebates	(4)	(0.2)	(4)	(0.2)	--
	$1,926	100.0%	$2,252	100.0%	$(326)

The Services product group primarily consists of two product types: Microsoft University (MSU) courses, which are training seminars on a wide range of Microsoft products aimed at ISVs and other software developers, and Microsoft OnLine, an on-line technical assistance subscription service. Revenue related to MSU courses is recognized upon completion of the course. OnLine revenue recognition is tied to the customers' utilization of the system. In addition, the subsidiaries generate Services revenue via miscellaneous training courses given to dealers, distributors and end-users, as well as through local OnLine service.

The Services product group experienced a net unfavorable revenue variance of $326,000. MSU channel revenues were under planned revenues by $185,000, primarily due to low attendance in LAN Manager and SQL Server classes. PSS's OnLine produced revenues of $381,000 which were $54,000 over plan. The International PSS channel had a negative variance of $324,000, due to the delay in implementing the International OnLine service. No revenue was generated by the International MSU channel (the plan called for $130,000). The International Retail channel experienced a positive variance of $195,000 due to increased training activities and imprecise channel accounting in the subsidiaries.

Cost of revenues incurred a $324,000 favorable variance, primarily due to the International PSS OnLine product being delayed. Operating expenses for the quarter of $1.8 million were $276,000 over plan. This resulted from unfavorable variances in administrative services ($109,000) and marketing ($205,000). Sales and marketing allocations were $187,000 under plan due to favorable expense variances within PSS operations.

In summary, unfavorable variances in revenues and operating expenses, only partially offset by lower cost of revenues and allocated expenses, resulted in a burdened operating loss of $1.7 million, $71,000 greater than planned. Services is planned to incur a loss in each quarter of the fiscal year.

Networks

The condensed burdened operating income statement for Networks for Q90-1 follows (in thousands):

	Actual		Plan		Variance
Net revenues	$7,650	100.0%	$7,380	100.0%	$270
Cost of revenues	78	1.0	291	3.9	213
Operating expenses	5,123	67.0	5,291	71.7	168
Allocations - Research and development	459	6.0	597	8.1	138
Allocations - Sales and marketing	385	5.0	391	5.3	6
Allocations - General and administrative	303	4.0	330	4.5	27
Burdened operating income	$1,302	17.0%	$ 480	6.5%	$822

Networks net revenues by channel of distribution for Q90-1 were as follows (in thousands):

	Actual		Plan		Variance
Domestic OEM	$2,433	31.9%	$2,698	36.6%	$ (265)
International OEM	225	2.9	962	13.0	(737)
International Retail	18	0.2	77	1.0	(59)
Subtotal	2,676	35.0	3,737	50.6	(1,061)
Adjustments (incl. GAAP and UPB)	4,974	65.0	3,643	49.4	1,331
Total	$7,650	100.0%	$7,380	100.0%	$ 270

In terms of revenue generation, the Network product group's leading products (compared with plan) for the quarter were as follows (revenue in thousands):

			Actual		Plan	
Actual	Plan		Units	Revenue	Units	Revenue
1	2	MS-Net	59,594	$1,537	39,156	$1,101
2	1	LAN Manager	2,806	1,104	6,962	1,960
3	3	Other*	344	35	2,571	676
				$2,676		$3,737

*Actual figures are primarily LAN Manager updates.
Plan figures are primarily SQL Server.

Networks revenue exceeded plan for the quarter by $270,000 as a result of an allocation of UPB ($6.4 million) and GAAP adjustment (negative $1.4 million), which outweighed shortfalls from the Domestic OEM, International OEM and International Retail channels.

In the Domestic OEM channel, revenues from LAN Manager and SQL Server were under budget by $286,000 and $575,000, respectively. This was partially offset by a favorable $590,000 variance for MS-Net. The favorable MS-Net variance (48,000 units against a plan of 26,000 units) resulted from higher revenues from Digital Equipment Corporation (25,000 units for $846,000) and AT&T (877 units for $176,000). The LAN Manager shortfall stemmed from a net correction by IBM which resulted in -232 units for -$46,000 versus a plan of 3,000 units for $600,000 and below plan performance by Ungermann Bass (90 units for $39,000 against a plan of 200 units for $95,000). These variances were partially offset by unbudgeted LAN Manager source code fees from Data General ($250,000) and Digital Equipment Corporation ($125,000). Ashton Tate reported 28 units of SQL Server for $12,100 against a plan of 2,500 units for $588,000.

The International OEM channel was $737,000 under plan because of LAN Manager and MS-Net variances. Acer, Apricot, Mitac, Olivetti, and SMT Goupil all reported zero units of LAN Manager against a combined plan of 1,080 units for $480,000. International Retail reported a $59,000 shortfall owing to the lack of planned sales of LAN Manager NDKs ($77,000), partially offset by unplanned SQL server revenue ($16,000).

A factor in the favorable revenue variance was the allocation of a portion of UPB and the GAAP adjustment to the Networks commodity (UPB and GAAP for both Domestic and International OEM are allocated 60% to Systems and 40% to Networks). UPB results from due on signings and minimum commitments from OEM license agreements, many of which pertain to Networks products. The GAAP adjustment is an accrual for royalties earned during the quarter but not yet reported, net of deferred revenue relating to billings prior to product acceptance (refer to Domestic and International OEM channel discussions for further information).

Cost of revenues was negatively impacted in the Domestic OEM channel because of expenses relating to LAN Manager updates. Costs were also higher than planned, owing to unbudgeted manufacturing variances ($39,000) and inventory adjustments resulting from the scrapping of obsolete inventory ($12,000). However, these were outweighed by a $276,000 favorable variance in royalty expense related to LAN Manager. Operating expenses were lower than plan by $168,000. The most significant favorable variance was that of payroll ($1.9 million against $2.3 million planned), which is directly related to headcount figures (148 actual versus 170 planned). This was partially negated by unfavorable variances in professional fees ($160,000) and supplies and equipment ($129,000). The $138,000 favorable variance in research and development allocations resulted from the Systems Development and International R&D pools being under plan.

In summary, favorable variances in all categories resulted in a burdened operating income of $1.3 million, 171% over plan. As a result of the UPB allocation, the Networks commodity incurred its first profitable quarter.

Systems Journal

The condensed burdened operating income statement for Systems Journal product group for Q90-1 follows (in thousands):

	Actual		Plan		Variance
Net revenues	$ 266	100.0%	$ 285	100.0%	$ (19)
Cost of revenues	152	57.2	158	55.4	6
Operating expenses	204	76.6	346	121.4	142
Allocations - General and administrative	22	8.2	24	8.4	2
Burdened operating income (loss)	$(112)	(42.0)%	$(243)	(85.2)%	$131

Microsoft Systems Journal net revenue for Q90-1 was $266,000, 7% below plan of $285,000. The unfavorable variance was due to a subscription base of 43,000 subscribers at the end of Q90-1 compared to plan of approximately 44,000 subscribers. Currently, the average renewal rate is 44%, down slightly from the Q89-4 renewal rate of 50%. The average rate was lower than plan due to On-Line subscribers and Microsoft subsidiaries renewing at a lower than expected rate.

Cost of revenues was $152,000 versus a plan of $158,000. Cost of revenues was 57.2% of net revenues, slightly above plan of 55.4%.

Operating expenses for Q90-1 were $204,000 compared to a plan of $346,000. The most significant favorable variances were in marketing ($89,000), third-party product development ($27,000), payroll ($12,000), and postage and freight ($10,000). The marketing variance can be attributed to delays in marketing efforts which are now expected to occur later in FY90. The product development variance was due to lower than planned expenditures on illustrations and freelancers. The payroll variance is due to below forecast headcount. The postage and freight variance was the result of sliding a foreign direct mailing until October.

Allocated expenses for Q90-1 of $22,000 approximated a plan of $24,000.

In summary, the burdened operating loss for Q90-1 was $112,000, significantly less than the anticipated loss of $243,000. The variance was a result of operating expenses that were substantially lower than originally projected. A majority of the operating expense variance will likely be absorbed in Q90-2.

Multimedia

The condensed burdened operating income statement for Multimedia for Q90-1 follows (in thousands):

	Actual		Plan		Variance
Net revenues	$ 240	100.0%	$ 445	100.0%	$(205)
Cost of revenues	31	12.7	89	19.9	58
Operating expenses	1,589	662.5	1,950	438.4	361
Allocations - Sales and marketing	190	79.1	212	47.8	22
Allocations - General and administrative	126	52.8	136	30.5	10
Burdened operating income (loss)	$(1,696)	(707.1)%	$(1,942)	(436.6)%	$ 246

Multimedia net revenues by channel for Q90-1 were as follows (in thousands):

	Actual		Plan		Variance
USSMD	$ 75	31.2%	$461	103.7%	$(386)
International OEM	75	31.1	–	–	75
International Retail	50	20.7	24	5.4	26
Domestic OEM	9	3.8	–	–	9
Adjustments	31	13.2	(40)	(9.1)	71
	$240	100.0%	$445	100.0%	$(205)

In terms of revenue generation, the Multimedia product group's leading products (compared with plan) for the quarter were as follows (revenue in thousands):

Actual	Plan		Actual Units	Actual Revenue	Plan Units	Plan Revenue	Variance
1	1	Programmers Library	232	$ 69	1,479	$379	$(310)
2	–	DOS Extensions	41,577	84	–	–	84
3	2	Bookshelf	524	44	617	84	(40)
4	4	Stat Pack	95	6	180	10	(4)
5	3	Small Business Consultant	48	3	180	12	(9)
				$206		$485	$(283)
		Percent of Multimedia net revenues		86%		109%	

Multimedia net revenues for Q90-1 were $240,000, 46% below plan of $445,000. The revenue shortfall resulted from below forecast sales on all products except DOS extensions. DOS Extensions, which was not forecasted, contributed $84,000 to net revenues.

Revenue through the USSMD channel was $75,000 against a plan of $461,000. Revenue adjustments contain an accrual for $62,000 in USSMD revenue derived from an agreement with Denon. Under this agreement, Microsoft is bundling Programmer's Library with a Denon drive in an effort to get more CD-ROM drives into the marketplace. Bookshelf is being offered at a reduced rate as part of the same promotion. Year-to-date, the promotion has generated $167,000 in sales through the USSMD channel. The difference between this and actual may be attributed to heavy returns. Programmer's Library had 395 units returned representing a $88,000 reduction in revenue. It appears the forecast greatly over estimated domestic demand for these products.

The unfavorable variance in USSMD revenues was partially offset by unforecast revenue through the International and Domestic OEM channels ($75,000 and $9,000, respectively). Additionally, International Retail exceeded plan by $26,000.

Cost of revenues was $31,000, 12.7% of net revenues, compared to a plan of $89,000, 19.9% of net revenues. Product costs were 6.8% of net revenues against a plan of 4.8%. Non-product costs were 5.9% of net revenues versus budget of 15 1%. The most significant favorable variance was in manufacturing and distribution allocations (-$2,000 actual versus plan of $39,000). This occurred as a result of a credit for non-specific manufacturing allocations in the USSMD channel. Another factor contributing to the low cost of revenues was royalties at 2.9% of net revenues, in contrast to plan of 6.5%. The low royalty rate was due to the fact that 35% of net revenues were generated from the non-royalty-bearing DOS Extensions.

Operating expenses, at $1.6 million, were 19% below plan of $2.0 million. The largest favorable variances occurred in third-party product development ($227,000), travel and entertainment ($93,000), and payroll ($75,000). The favorable variances were partially offset by a $57,000 unfavorable variance in marketing. The favorable variance in product development was the result of a continued trend away from the use of contract developers, while the travel and entertainment and payroll variances are the result of below forecast headcount. The unfavorable marketing variance may be attributed to expenses related to the 1989 CD ROM Conference that continue to trickle in.

Allocated expenses of $316,000 (131.9% of net revenues) were below forecast of $348,000 (78.3% of net revenues). Allocations from USSMD, $19,000 below plan, and Administration, $10,000 below plan, comprised the majority of the favorable variance.

In summary, the burdened operating loss for Q90-1 was $1.7 million, compared to the planned loss of $1.9 million. Although revenue was significantly below plan, all other elements of Multimedia's profit model experienced favorable variances. With the projected continuation of heavy returns and revenue that is likely to fall short of plan, Multimedia will need to continue streamlining forecasted operating expenses in order to improve upon the projected Q90-2 burdened operating loss of $2.0 million.

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3 YEAR PLAN
REVENUE PROJECTIONS

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MICROSOFT CORPORATION
GROSS REVENUE PROJECTIONS
THREE YEAR PLAN 1990 THRU 1992
(In Thousands)

21-Oct-89

	FY 89	PLAN FY 90	FORECAST FY 91	FORECAST FY 92	FY 89 % Increase	FY 90 % Increase	FY 91 % Increase	FY 92 % Increase
CORPORATE	823,671	1,073,748	1,384,584	1,812,825	37.0%	30.4%	28.9%	30.9%
USSMD	250,264	353,859	474,466	627,028	24.7%	41.4%	34.1%	32.2%
INTL RETAIL	300,684	434,045	583,290	796,644	47.6%	44.4%	34.4%	36.6%
WORLDWIDE RETAIL	550,948	787,904	1,057,756	1,423,671	36.2%	43.0%	34.2%	34.6%
US OEM	114,834	122,777	138,200	167,200	14.9%	6.9%	12.6%	21.0%
INTL OEM	138,797	133,686	149,000	173,200	73.2%	-3.7%	11.5%	16.2%
WORLDWIDE OEM	253,631	256,464	287,200	340,400	40.8%	1.1%	12.0%	18.5%
OTHER	19,092	29,380	39,628	48,754	13.6%	53.9%	34.9%	23.0%

MICROSOFT CORPORATION
THREE YEAR PLANNED REVENUES
FISCAL YEARS 1990 THRU 1992
(In thousands)

21-Oct-89

	FY88 ACTUAL	%	FY89 ACTUAL	%	FY90 PLAN	%	FY91 FORECAST	%	FY92 FORECAST	%
By CHANNEL										
US SALES & MKTG	200,738	33.4%	250,264	30.4%	353,859	33.0%	474,466	34.3%	627,078	34.6%
OEM	99,943	16.6%	114,834	13.9%	122,777	11.4%	138,200	10.0%	167,200	9.2%
PRESS	9,826	1.6%	12,049	1.5%	16,001	1.5%	17,762	1.3%	19,893	1.1%
MULTIMEDIA	376	0.1%	50	0.0%	0	0.0%	0	0.0%	0	0.0%
INTERNATIONAL RETAIL	203,761	33.9%	300,684	36.5%	434,045	40.4%	583,290	42.1%	796,644	43.9%
INTERNATIONAL OEM	80,142	13.3%	138,797	16.9%	133,686	12.5%	149,000	10.8%	173,200	9.6%
US PSS SALES	4,858	0.8%	926	0.1%	2,000	0.2%	2,605	0.2%	3,935	0.2%
INTL PSS SALES	0	0.0%	0	0.0%	1,748	0.2%	2,000	0.1%	2,500	0.1%
SYSTEMS JOURNAL	1,753	0.3%	1,328	0.2%	1,608	0.1%	2,106	0.2%	2,453	0.1%
US MSU	0	0.0%	4,739	0.6%	6,517	0.6%	9,155	0.7%	12,073	0.7%
INTL MSU	0	0.0%	0	0.0%	846	0.1%	1,000	0.1%	1,200	0.1%
US CONSULTING	0	0.0%	0	0.0%	659	0.1%	3,000	0.2%	3,700	0.2%
INTL CONSULTING	0	0.0%	0	0.0%	0	0.0%	2,000	0.1%	3,000	0.2%
GROSS REVENUES	601,398	100.0%	823,671	100.0%	1,073,748	100.0%	1,384,584	100.0%	1,812,825	100.0%
% Growth	71.4%		37.0%		30.4%		28.9%		30.9%	
By COMMODITY										
BOOKS	11,352	1.9%	13,443	1.6%	16,001	1.5%	17,762	1.3%	19,893	1.1%
HARDWARE	66,450	11.0%	95,383	11.6%	115,910	10.8%	123,908	8.9%	148,005	8.2%
LANGUAGES	59,963	10.0%	51,028	6.2%	62,500	5.8%	73,984	5.3%	89,050	4.9%
SYSTEMS JOURNAL	1,753	0.3%	1,328	0.2%	1,608	0.1%	2,106	0.2%	2,453	0.1%
NETWORK	2,288	0.4%	9,625	1.2%	24,814	2.3%	26,695	1.9%	35,243	1.9%
SERVICES	4,858	0.8%	6,909	0.8%	12,053	1.1%	19,760	1.4%	26,408	1.5%
MULTIMEDIA	1,849	0.3%	1,430	0.2%	3,432	0.3%	4,263	0.3%	17,936	1.0%
SYSTEMS	199,334	33.1%	279,134	33.9%	301,079	28.0%	358,544	25.9%	423,655	23.4%
APPLICATIONS	243,951	40.6%	354,140	43.0%	528,258	49.2%	748,062	54.0%	1,039,183	57.3%
XENIX	9,599	1.6%	11,258	1.4%	8,092	0.8%	9,500	0.7%	11,000	0.6%
NON-SPECIFIC	0	0.0%	-8	0.0%	0	0.0%	0	0.0%	0	0.0%
GROSS REVENUES	601,398	100.0%	823,671	100.0%	1,073,748	100.0%	1,384,584	100.0%	1,812,825	100.0%

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MICROSOFT CORPORATION
THREE YEAR PLANNED REVENUES
FISCAL YEARS 1990 THRU 1992
(In thousands)

21-Oct-89

	FY88 ACTUAL	%	FY89 ACTUAL	%	FY90 PLAN	%	FY91 FORECAST	%	FY92 FORECAST	%
SYSTEMS REVENUE										
WINDOWS					73,698	6.9%	110,560	8.0%	149,119	8.2%
DOS					188,302	17.5%	215,673	15.6%	236,681	13.1%
OS/2					31,079	2.9%	23,811	1.7%	24,857	1.4%
SYSTEMS PRINTER					8,000	0.7%	8,500	0.6%	13,000	0.7%
GROSS SYSTEMS REVENUE	199,334	33.1%	279,134	33.9%	301,079	28.0%	358,544	25.9%	423,655	23.4%
% Growth	71.4%		40.0%		7.9%		19.1%		18.2%	
APPLICATIONS REVENUE										
ANALYSIS					185,342	17.3%	266,184	19.2%	341,927	18.9%
DATA ACCESS					29,897	2.8%	56,312	4.1%	120,453	6.6%
ENTRY					91,454	8.5%	111,316	8.0%	136,224	7.5%
GRAPHICS					25,295	2.4%	52,442	3.8%	74,522	4.1%
OFFICE					196,270	18.3%	261,808	18.9%	366,057	20.2%
GROSS APPS REVENUE	243,951	40.6%	354,140	43.0%	528,256	49.2%	748,062	54.0%	1,039,183	57.3%
% Growth	83.3%		45.2%		49.2%		41.6%		38.4%	

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MICROSOFT CORPORATION
USSMD GROSS REVENUE PROJECTIONS
THREE YEAR PLAN 1990 THRU 1992
(In Thousands)

21-Oct-89

	FY 89	PLAN FY 90	FORECAST FY 91	FORECAST FY 92	FY 89 % Increase	FY 90 % Increase	FY 91 % Increase	FY 92 % Increase
USSMD	250,264	353,859	474,466	627,028	24.7%	41.4%	34.1%	32.2%
HARDWARE	46,989	53,445	52,077	61,024	40.7%	13.7%	-2.6%	17.2%
LANGUAGES	23,972	30,505	33,605	40,153	-30.8%	27.3%	10.2%	19.5%
MULTIMEDIA	805	3,301	4,112	17,726	180.5%	310.2%	24.6%	331.1%
SYSTEMS	16,571	31,294	45,318	44,955	62.6%	88.8%	44.8%	-0.8%
APPLICATIONS	160,742	235,314	339,355	463,171	32.9%	46.4%	44.2%	36.5%
OTHER	1,186	0	0	0	-9.5%	na	na	na

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MICROSOFT CORPORATION
INTL. RETAIL GROSS REVENUE PROJECTIONS
THREE YEAR PLAN 1990 THRU 1992
(In Thousands)

21-Oct-89

	FY 89	PLAN FY 90	FORECAST FY 91	FORECAST FY 92	FY 89 % Increase	FY 90 % Increase	FY 91 % Increase	FY 92 % Increase
INTL RETAIL	300,684	434,045	583,290	796,644	47.6%	44.4%	34.4%	36.6%
HARDWARE	47,618	60,240	70,331	84,981	48.5%	26.5%	16.8%	20.8%
LANGUAGES	24,729	31,311	39,679	48,197	20.9%	26.6%	26.7%	21.5%
MULTIMEDIA	134	131	152	210	6.3%	-2.2%	16.0%	38.2%
SYSTEMS	41,360	55,257	71,426	94,600	21.3%	33.6%	29.3%	32.4%
APPLICATIONS	184,990	286,485	401,307	568,112	58.5%	54.9%	40.1%	41.6%
OTHER	1,853	621	395	543	501.6%	-66.5%	-36.4%	37.5%

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ADMINISTRATION

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TAX MATTERS

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TAX MATTERS

DOMESTIC

"Spread" From Stock Plans - For the first quarter of fiscal year ended June 30, 1990, the spread on stock options exercised equaled $12.9 million. The spread continues to reduce the amount of federal and state estimated taxes Microsoft is required to deposit quarterly and the amount of tax due annually.

"Quick" Federal Refund - Due to the large amount of dividends paid at the end of FY 89 to Microsoft Corporation by its foreign subsidiaries ($33.5 million) and the related tax credits ($34.8 million), Microsoft was able to ask for a "quick" federal refund of $11.5 million in July. Using the latest technology available to taxpayers, the refund was wire transferred from the U.S. Treasury to Microsoft which dramatically accelerated our receipt of the funds.

Tax Returns For FY 89 - We have extended the due date for the federal and state income tax returns for the fiscal year ended June 30, 1989 from September 15, 1989 to March 15, 1990 (the date for some states varies). We have completed a draft copy of these returns, however some information must still be obtained. The tax returns will be finalized in the beginning of the third quarter of FY 90.

First Quarter Estimates For FY 90 - The federal and state income tax estimates for the first quarter of FY 90 were filed on October 16, 1989 (the date for some states varies). These estimates were based on the draft federal and state returns completed for FY 89. The federal and state estimates were for $3 million and $61,000 respectively.

Forecasted Rate for Fiscal Year 1990 - Due to the potential delay of the commencement of operations in Puerto Rico stemming from the destruction caused by Hurricane Hugo and Congress' apparent failure to extend the R&D credit beyond December 31, 1989, we decided for Q90-1 to provide taxes at a 32% effective rate rather than the planned 30%. We will monitor this situation closely during the balance of the fiscal year, but we do expect the FY90 rate to be very close to 30%.

R&D Proposed Regulations - As discussed last quarter the Internal Revenue Service issued proposed and final regulations dealing with the treatment of research and development (R&D) expenditures. On October 10, 1989 we submitted formal comments on the proposed regulation to the Commissioner of Internal Revenue. The date for the Public Hearing on these proposed regulations has been set for December 5, 1989. We will report on the comments made at this hearing in the next Report.

Payroll Examinations - The federal and state payroll examinations will be completed during the second quarter of FY 90. A complete report on the results of these examinations will be in the next Report.

State Examinations - The Virginia Income Tax examination for fiscal years 86 - 88 was closed during the first quarter of FY 90. The total deficiency assessed was $18,768. A reserve was set up in excess of the deficiency, so there was no income statement impact.

The Ohio Franchise Tax examination for fiscal year ended 1986 was closed during the first quarter of FY 90. The total deficiency assessed was $19,686. A reserve was set up in excess of the deficiency, so there was no income statement impact.

An examination for Illinois Income and Replacement tax is scheduled to start during the second quarter of FY 90.

During the first quarter of FY 90 we started a California sales and use tax examination was started and is still in progress. Microsoft has a sufficient reserve to cover this liability, so any deficiency would not have an income statement impact. We anticipate this examination to be concluded during the second quarter of FY 90.

Sales and Use Tax - As discussed in the last Report we are continuing to file tax returns in additional states where we have sales and use tax liabilities. Currently we are in the process of adding District of Columbia, Idaho, Georgia, Nebraska, Nevada, New Jersey, North Carolina and Ohio.

Legislative Update - On October 13 the Senate approved a "stripped down" version of the House of Representatives budget reconciliation legislation (H.R. 3299). The Senate bill does not include much talked about provisions such as IRAs, capital gains tax or the extensions of many expiring provisions. Members of the House and Senate will meet in Conference Committee to reconcile the two bills. After that is completed both the House and the Senate will vote on the agreement for final approval. We continue to track all of these provisions and as final legislation develops will keep you informed.

INTERNATIONAL

Puerto Rico - A manufacturing tax exemption has been approved for Microsoft Puerto Rico, Inc. and is awaiting signature by the Governor of Puerto Rico. It is anticipated that the Governor will sign this document within the next few days.

The Tax Department has been very active in planning for the new Puerto Rican manufacturing operations, as there are some strict tax rules which must be met in order to obtain tax benefits. Microsoft Puerto Rico, Inc. should be manufacturing in January.

Puerto Rican Statehood - Puerto Rican statehood will be up for a vote in 1991. The citizens of Puerto Rico will vote at this time whether to become the 51st state, remain a commonwealth or to become independent of the United States. It is anticipated that it will be a close vote between statehood and commonwealth status. Should the citizens of Puerto Rico vote for statehood, it will take several years for Puerto Rico to be admitted to the United States. In addition, the tax credit associated with Puerto Rico's special status would be phased out over several years (the Puerto Rican government is suggesting a 25 year phase out). Thus, since Microsoft Puerto Rico, Inc. would cover fixed and variable incremental costs and make a handsome profit in the first full year of operations, the vote on Puerto Rican statehood does not affect Microsoft's decision to manufacture in Puerto Rico.

Dividends - For purposes of Microsoft's U.S. income tax return, dividends paid by Microsoft's foreign subsidiaries must be increased by the amount of the foreign taxes paid or accrued. These amounts (in thousands, below) have been calculated but are subject to change based upon translation rates in effect on the date of payment for taxes accrued at the foreign subsidiary as of June 30, 1989 but paid after year end.

	Amt Paid	Taxes	Total
SARL	$12,995	$15,045	$28,040
GMBH	14,968	12,693	27,661
SPA	1,461	1,994	3,455
INC	1,802	2,181	3,983
KK	2,326	2,845	5,171
TOTAL	$33,552	$34,758	$68,310

The $33.6 million in dividends paid includes the $26.3 million in dividends paid shortly before June 30 and the balance which was paid earlier in FY 89.

In addition, under U.S. tax laws Microsoft IBV will be deemed to have declared a gross dividend (after inclusion of taxes) of $4.861 million. The tax credit associated with this deemed dividend will be $1.702. Thus, total dividends from foreign subsidiaries amounts to $73.171 million and credits amount to $36.460 million.

PFIC - A foreign corporation will be classified as a PFIC if 50% or more of its assets for the year produce passive income. This computation is based upon the average value of the foreign corporation's assets at the end of each quarter. Upon becoming a PFIC the I.R.S. begins accruing interest on the earnings of the foreign corporation. The rationale is that the earnings are available to be distributed to the United States and subject to U.S. taxation immediately; however, the U.S. recipient is attempting to avoid paying U.S. taxes currently by delaying the declaration of the dividend. Thus, upon payment of a dividend from a PFIC to a U.S. taxpayer, the U.S. taxpayer will pay taxes on the dividend received and will pay the U.S. government interest.

Microsoft IBV avoided being a PFIC for FY 89 by placing a series of loans to the foreign subsidiaries shortly prior to year end.

During the first quarter of FY 90 it was possible to avoid PFIC status through the use of a temporary solution; however, it will be increasingly difficult for Microsoft IBV to avoid PFIC status. In order to avoid the income statement impact of PFIC status, the Tax Department is looking at a number of tax planning opportunities. One of the options being reviewed, is the possibility of creating a second corporation and transferring the manufacturing operations into this second corporation. The existing corporation would retain all of the current passive assets and would become a PFIC. Next, the PFIC would make an election to be currently taxed on its passive income. Thus, the corporation which becomes an electing PFIC would avoid all interest charges because it would be currently taxed in the United States. (Since Microsoft Corp. pays U.S. income taxes currently on this passive income, we would not owe any additional taxes as a result of electing PFIC status.) The end result would be that Microsoft IBV would continue to defer U.S. taxation on past and future manufacturing profits.

Stock Options - The tax department has been working closely with key personnel at Microsoft GmbH, and stock administration. A program has been developed which enables Microsoft GmbH to meet its German withholding requirements and converts proceeds from stock options into Deutsche marks, if the employee chooses to convert his stock to cash.

Capital Infusions - The tax department has worked closely with the controllers of Microsoft SARL and Microsoft SpA to make recommendations to top management concerning capital structures for each of these subsidiaries. The recommendation was based on a formulary approach taking into account the size of dividends paid and the tax savings received by Microsoft Corp. as a result of these dividend payments.

New Employee - Tracy Neighbors, formerly an International Tax Attorney with Emerson Electric in St. Louis, was hired to work with Mike Boyle in the international tax area.

INSURANCE MATTERS

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INSURANCE MATTERS

There have been no changes in the Company's insurance program since the renewal of our coverages on July 1.

Earthquake - The recent earthquake in California raises the question of its impact on our activities there. GBU has reported minimal damage. The new building where GBU is scheduled to move in November suffered no damage and will be ready on time.

The building where USSMD's Santa Clara sales office is located, suffered some structural damage, and damage to Microsoft property located there is not yet known. However, we do not have a large concentration of values at this location. Neither of these building is owned by Microsoft.

Generally, Microsoft does not carry earthquake coverage on its domestic properties. The buildings at Corporate Campus have been built to meet modern codes; thus, it is felt that structural risk is minimal. $50 million in earthquake coverage has been purchased on the M&D facility because of its expansiveness and minimal roof supports. Chubb Insurance group includes earthquake protection on all EDP equipment it covers outside the State of California.

On an International basis, the Corporate Difference in Conditions coverage purchased for the subsidiaries (except Canada) includes earthquake coverage at a $20 million limit ($4.5 million in Japan).

Expansion: - Recent acquisitions and operation expansions have been incorporated into our existing program.

Apple Lawsuit - Discussion are presently underway with our General Liability carrier, Chubb Insurance Group, regarding reimbursement of defense costs relating to the apple Lawsuit. It is Microsoft's position that such defense coverage is afforded under the Advertising Liability portion of the coverage. To date, bills totaling $1,327,000 have been submitted to Chubb. Chubb has not yet accepted responsibility for this defense, but we feel our position is a strong one.

FACILITIES REPORT

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FACILITIES REPORT

Microsoft controls approximately 155 acres of land at Corporate Campus after the completion of the September 1989 East Tech purchase from MONY (see below). With the addition of the East Tech Buildings, now owned by Microsoft and renumbered accordingly, coupled with the completion of Buildings 11 and 11a, 780,610 square feet of building space is currently managed and occupied. To continue with the dynamic growth of Microsoft, Buildings 10, 16 and 17, a combined total of 468,000 square feet, are currently under development.

LAND ACQUISITIONS

Purchase of the MONY (Mutual of New York) property, located in the northeast corner of Corporate Campus (now referred to as Phase V), closed the beginning of September at a negotiated price of $18.250 million. Microsoft occupies 83,430 square feet of the total 137,873 square feet located at the East Tech complex, now Microsoft Buildings 12 - 15. (See site plan)

The Terra Savants land, the wooded "square" located at the northeast corner of the MONY land, consisting of 1.79 acres (now referred to as PhaseVI), closed in early October, 1989 at a negotiated price of $650,000. (See site plan)

Currently, parcels of land located immediately adjacent to existing Microsoft property are being monitored for possible changes in ownership, buyer/seller activity and market conditions.

MICROSOFT PLACE

The office park in which Microsoft Corporate Campus is located, is now known, officially and legally as "Microsoft Place". The name change was announced and took effect the day of the Company Meeting, September 8, 1989. To compliment this change, "One Microsoft Way" is now the official postal address of Microsoft Corporation.

CORPORATE CAMPUS DEVELOPMENT

As headcount and space requirements continue to grow at a dynamic pace, development continues in all areas of Corporate Campus Facilities.

Owned Facilities

The overall Master Plan of Corporate Campus has been and continues to undergo revisions to meet and address the changing needs of Microsoft both now and for future use. This involves the re-examining of size, use and potential of the various individual lots in creating a new overall scheme to aid in the planning of Buildings 16 and 17 and future building needs.

Buildings 16 and 17 development continue with the refinement of design and planning. Because of ongoing discussions and restrictions imposed by the City of Redmond concerning floor size and building height , the current plan is to design buildings of three stories rather than four stories as originally anticipated. The originally presented and designed floor plates will remain as planned and the square footage will not change. With the use of three stories instead of four, the scheduled delivery date of building completion will remain on target.

Building 10 construction is on schedule with final grades for the site and parking area set and the erection of the steel structural members progressing. Project completion and occupancy is still tentatively set for April, 1990.

Buildings 11 and 11a were completed and occupied with the move of MIS/Corporate Systems September 8, 1989. The complex is 100% operational with communication capability facilitated worldwide.

LEASED CORPORATE SPACE

To accommodate short term needs, leased space has been acquired for various Corporate related groups.

The Koll Overlake Building (approximately one block from campus) is the new home for part of the IPG group. The move to this 18,000 square foot office space was complete in early September, 1989.

The McDonnell Douglas Building will soon house both SPAG (Hardware) and The Bauer Group. The move into the 25,000 square foot office space is scheduled for December 1989.

PSS Corporate is scheduled to move from Building 9 to team up with the rest of PSS in new space at Lincoln Plaza in Bellevue (across from the Bellevue Athletic Club). The additional space will be occupied by November 1, 1989. PSS space at Lincoln Plaza will then total 73,300 square feet.

CAMPUS MOVES AND REMODELS

The Facilities Operations Group has the responsibility of implementing and overseeing activity associated with building management after occupancy. This involves campus reshuffle moves, remodel projects and all areas needed for efficient building use. During the first quarter of FY90, 822 employee moves took place coupled with 41 completed remodel projects affecting 35,000 square feet. Major moves and remodels included:

- Reshuffle of the Books and Multimedia groups within Buildings 12, 13 and 15. Construction activity was complete on 10,000 square feet to accommodate the move.

- After moving part of IPG to leased offsite space, Building 9 is being reshuffled and remodeled to give needed growth room.

- With the move of MIS/Corporate Systems to Building 11, existing computer room remodels were complete in Buildings 1 - 5.

- The remaining PSS Corporate group will relocate to Lincoln Plaza which will facilitate the move of Human Resources to building 9 resulting in a reshuffle of the Systems group in Building 1.

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LID/ROAD WORK

•156th LID (improvements of 156th from Microsoft south boundary past its connection with Bel-Red Road) reached resolution involving the pending lawsuit with Rainier NorthWest. Construction is underway and expected to be completed by Spring, 1990. Part of this work will involve the installation of a traffic light located at 31st street and 156th (near Building 11).

•Bel Red LID (improvements to Bel-Red from 156th to 40th) is scheduled to be out for construction bids this fall. Issues that have delayed the project's commencement still need to be resolved between the three governing jurisdictions (Redmond, Bellevue and King County) and local property owners. Building 7 may not be constructed until this improvement is completed.

•E-line is a planned connecting road from Bel-Red to 156th across the south end of Microsoft property. Although work-around was reached involving Building 10, ongoing discussions are still underway with both Bellevue and Redmond in an attempt to reach agreement on whether or not this public road will be on the Microsoft Campus. Our goal is not to have it there.

Athletic Fields on lots 20 and 21 are complete after seeding and planting in early September, 1989. The three fields (soccer, baseball and multi purpose) are scheduled for use at the beginning of January 1990.

The use and implementation of Campus Photo ID was approved by executive staff in August 1989. The systematic Corporate photo ID process (employees, vendors, freelancers, etc) and distribution of combined cardkey and photo ID is in progress. There are currently 4,721 active cardkeys, all of which will take part in the photo ID change over. A redesign of existing Microsoft building lobbies is under review to better control visitors entering the front door/lobby area.

US FIELD DEVELOPMENT

Microsoft field locations consist of 16 occupied domestic offices. In the past three month period, 12 proposed projects were worked in the Domestic field; 8 for USSMD, 3 for OEM, and 1 for the Graphics Business Unit. All of these projects involve many steps: financial approval, site selection, lease negotiations, construction project management, space planning, telecommunications, cabling and furniture purchase, and finally the actual move in.

For USSMD, 8 separate projects have been worked during the last three month period. These involved either the move or expansion of an existing office to accommodate current and future headcount growth, or the opening of a new office.

The Atlanta office moved to a larger space located in their existing building in August 1989.

The New York office expansion started in early October 1989 with completion scheduled for the end of November. Expansion work includes more private offices and remodelling the current space.

Philadelphia shared office space (2 offices) was occupied in September 1989.

In Washington DC, both the Commercial and Government groups will expand in their current space. Financial (CER) approval is in process.

The Chicago office moved into a new building early August 1989. The vacated space (which is still under lease obligation) is subleased for the remainder of the lease term.

In Dallas, lease negotiations are finalized with building management for a move into more space on the existing floor. With the completion of a fully executed lease document and architectural drawings, construction should start by November 1, 1989.

Detroit is in the process of site selection for an office to accommodate increased headcount and space needs. Occupancy is targeted for the later part of January 1990.

The Seattle Sales office is scheduled to move into new space the first part of November 1989.

For OEM, 3 projects are underway in different areas of OEM field growth.

MSU will expand in its current space. The space will became available the first part of October with construction to commence after permits are granted from the city of Bellevue.

MSU - Boston is in the process of site selection to house a teaching facility similar to a scaled down version of MSU in Bellevue. Occupancy is scheduled for the early part of January 1990.

PSS Lincoln Plaza will expand to accommodate the move of the remaining PSS group from Corporate Campus. The additional space will be occupied during October, 1989.

The Graphics Business Unit at Menlo Park is scheduled to move into their new building November 1, 1989. Construction is nearing completion with move in details under finalization. Early reports indicate no damage from the October 17, 1989 earthquake.

INTERNATIONAL FACILITY DEVELOPMENT

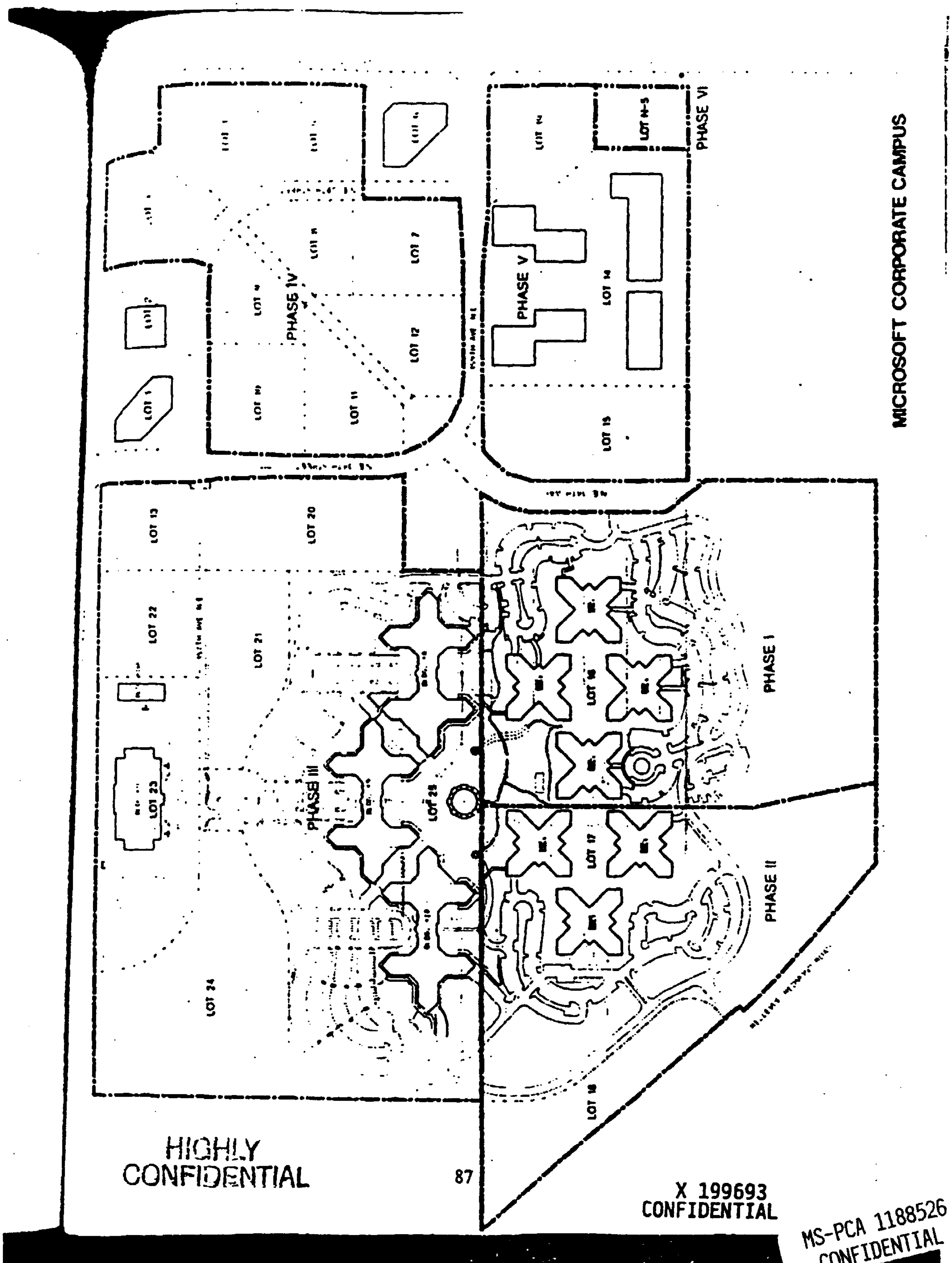
Facilities Development is becoming more active in the development planning for international offices so that the learning curve gained in Redmond development can be leveraged to international operations.

PTY (Microsoft Australia) signed a lease for a 100,430 square foot manufacturing/distribuiton and office facility. The new building will be a three story complex with a separate warehouse facility. Microsoft will occupy 2 of the floors initially with future expansion options for the third floor. The lease has a term of 10 years. Construction is scheduled to commence November 1989 with completion set for February 1991. Current activity involves preliminary space planning and tenant improvement design work. (see building site plan)

INC (Microsoft Canada) is in the process of finalizing lease terms for a new 65,000 square foot warehouse and office facility. The proposed building will have a three story office section with an adjoining warehouse. Initially, 40,000 square feet will be occupied with the remaining square footage used as needed expansion space. The lease has a term of 15 years. Construction is scheduled to commence early October 1989 with completion estimated for early May 1990. (see building site plan)

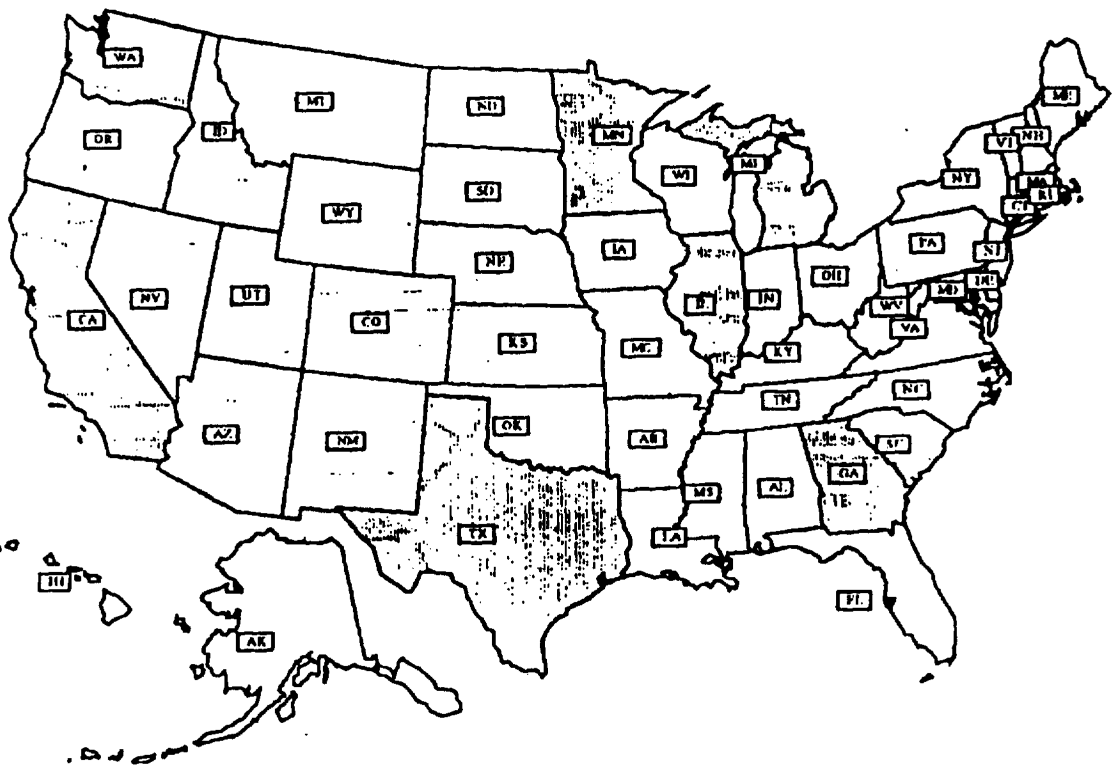
A new disk duplication facility in Puerto Rico is planned for occupancy January, 1990. A 41,500 square foot portion of an existing office/warehouse facility is proposed for this project. Lease negotiations are in progress as well as selection of a local architect and construction contractor. (see building site plan)

Preliminary work is underway for proposed facility projects involving SARL, Spain, Taiwan, Sweden and Limited.



MICROSOFT CORPORATE CAMPUS

MICROSOFT DOMESTIC LOCATIONS



WASHINGTON	
Corporate (Buildings 1-15)	521,994
Corporate (Leased)	258,616
Canyon Park (M&D)	264,136
CorpCom Warehouse	33,221
Microsoft University	18,248
PSS Lincoln Plaza	49,021
Seattle (USSMD)	770
Off Site Storage	5,454
SUBTOTAL WASHINGTON	1,151,460
CALIFORNIA	
Los Angeles (USSMD)	11,822
Santa Clara (USSMD)	7,158
Menlo Park (GBU)	19,260
TEXAS	
Dallas(USSMD)	6,953
MINNESOTA	
Minneapolis (USSMD)	4,179
ILLINOIS	
Chicago (USSMD)	7,551
MICHIGAN	
Detroit (USSMD)	1,924
NEW YORK	
New York City (USSMD)	6,621
New York City (Sys Journal)	3,200
MASSACHUSETTS	
Boston (USSMD)	10,022
DELAWARE	
Wilmington (USSMD)	1,160
MARYLAND	
Chevy Chase (USSMD)	8,990
GEORGIA	
Atlanta (USSMD)	5,255
SUBTOTAL DOMESTIC	92,095
GRAND TOTAL OCCUPIED	1,243,555

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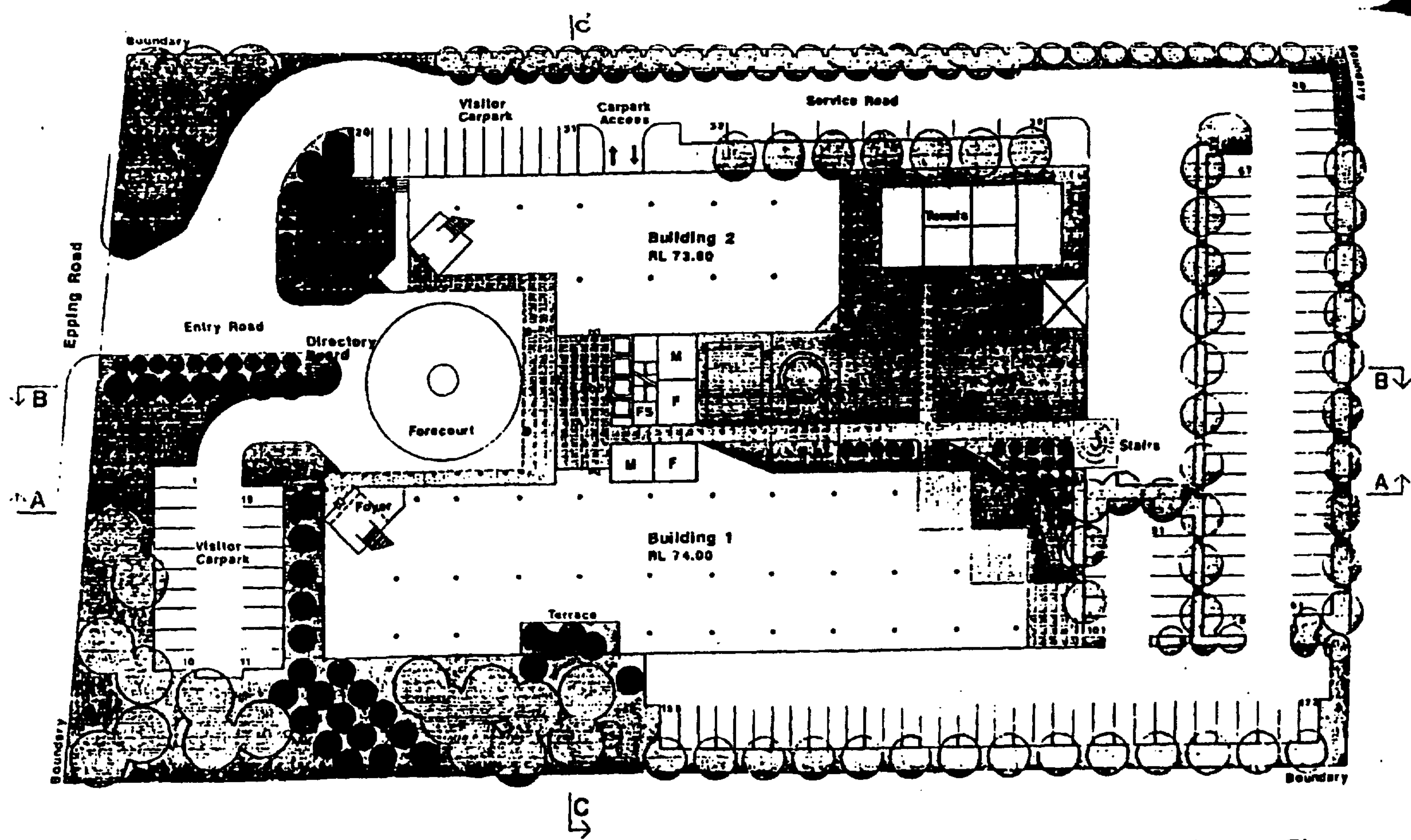
MICROSOFT DOMESTIC SQUARE FOOTAGE

	MANAGED	DEVELOPMENT
CORPORATE		
phase I (1 - 4)	240,000	
phase II (5 - 6)	120,000	
phase III (8 - 9)	235,000	
phase III (10)		117,500
phase III (11, 11a)	83,565	
phase IV (16 - 17)		350,000
phase V (12 - 15)	83,429	6,066
toll overlake	18,616	25,000
mcdonnell douglas		
offsite storage	5,454	
•corporate subtotal•	786,064	498,566
MANUFACTURING/DISTRIBUTION		
canyon park	264,136	102,000
corp com warehouse	33,221	
•m&d subtotal•	297,357	102,000
WASHINGTON FIELD		
pss offsite	49,021	34,509
ms university	18,248	7,989
•washington field•	67,269	42,498
USSMD FIELD		
atlanta	5,255	
boston	10,022	
new york	6,621	3,000
wash dc	6,990	4,000
philadelphia	1,160	
•eastern subtotal•	30,048	7,000
chicago	7,551	
chicago sublease	4,846	
dallas	6,953	9,500
detroit	1,924	5,255
minneapolis	4,179	
•central subtotal•	25,453	14,755
los angeles	11,822	
santa clara	7,158	
seattle	770	3,900
•western subtotal•	19,750	3,900
•USSMD subtotal•	75,251	25,655
MISCELLANEOUS FIELD		
msu - boston		3,500
menlo park (GBU)	19,260	30,000
ny systems journal	3,200	
email group sublease	1,105	
•miscellaneous field subtotal•	23,565	33,500
TOTAL SQUARE FOOTAGE	1,249,506	702,219
GRAND TOTAL SQUARE FOOTAGE		1,951,725



Landscape Plan

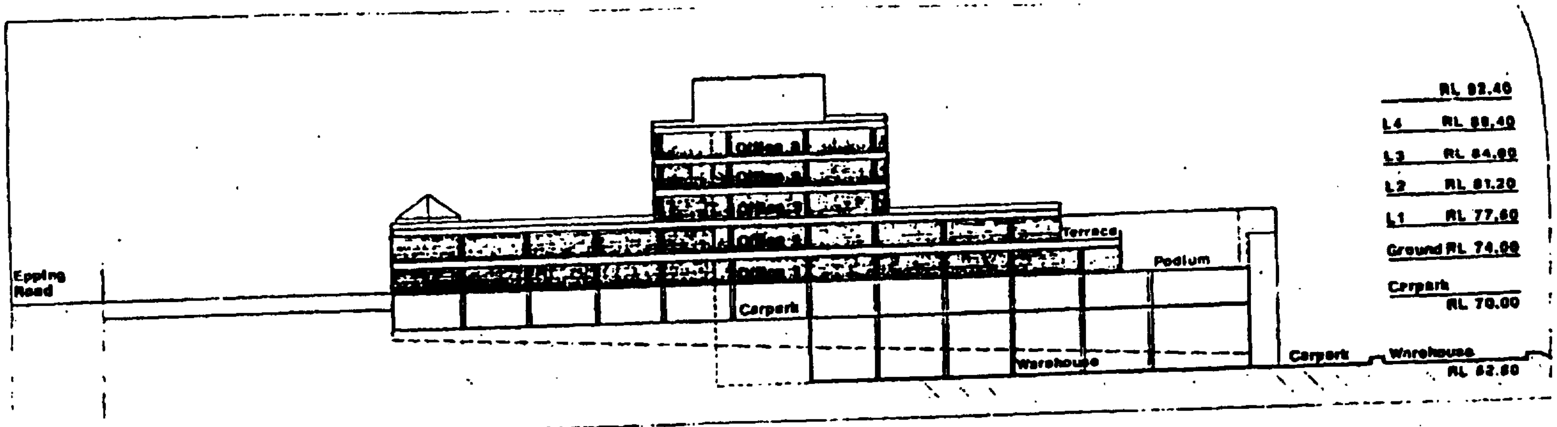
PROPOSED DEVELOPMENT
65 Epping Rd, North Ryde
for Microsoft Pty. Ltd.

TRIDEN
TRIDEN PROPERTIES
PTY LIMITED

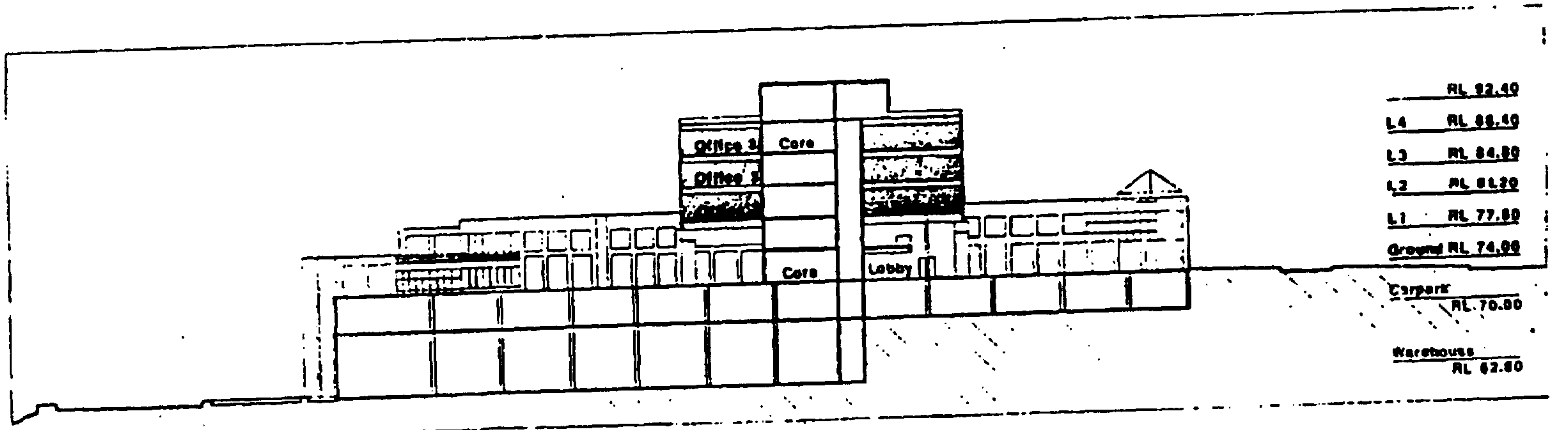
Rice Daubney
Architects
110 Walker Street,
North Sydney 2060
Telephone (02) 956 2666
Fax (02) 959 3015

July 1989
89116 SK 10

[redacted]



Section A



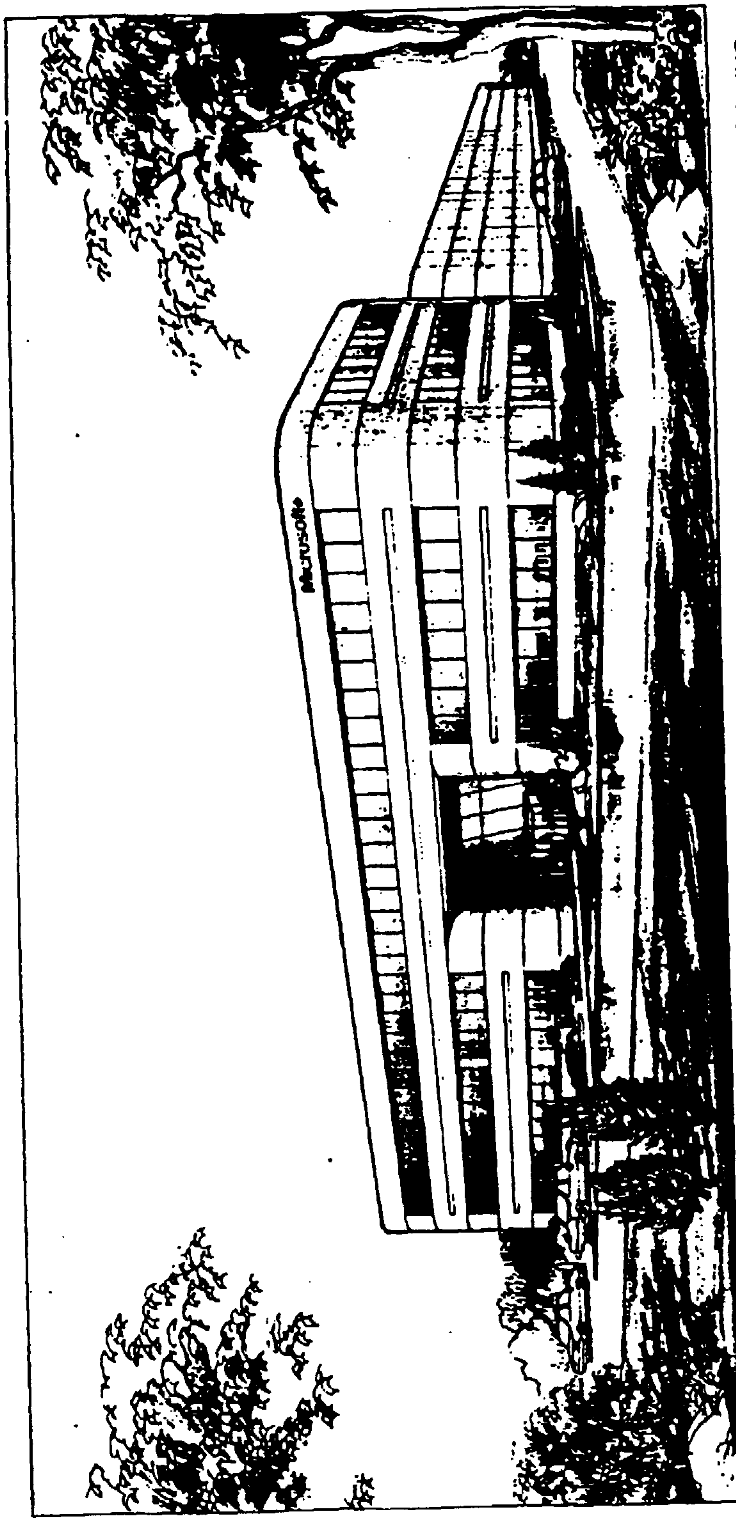
Section B

PROPOSED DEVELOPMENT
65 Epping Rd, North Ryde
for Microsoft Pty. Ltd.

TRIDEN
TRIDEN PROPERTIES PTY LIMITED

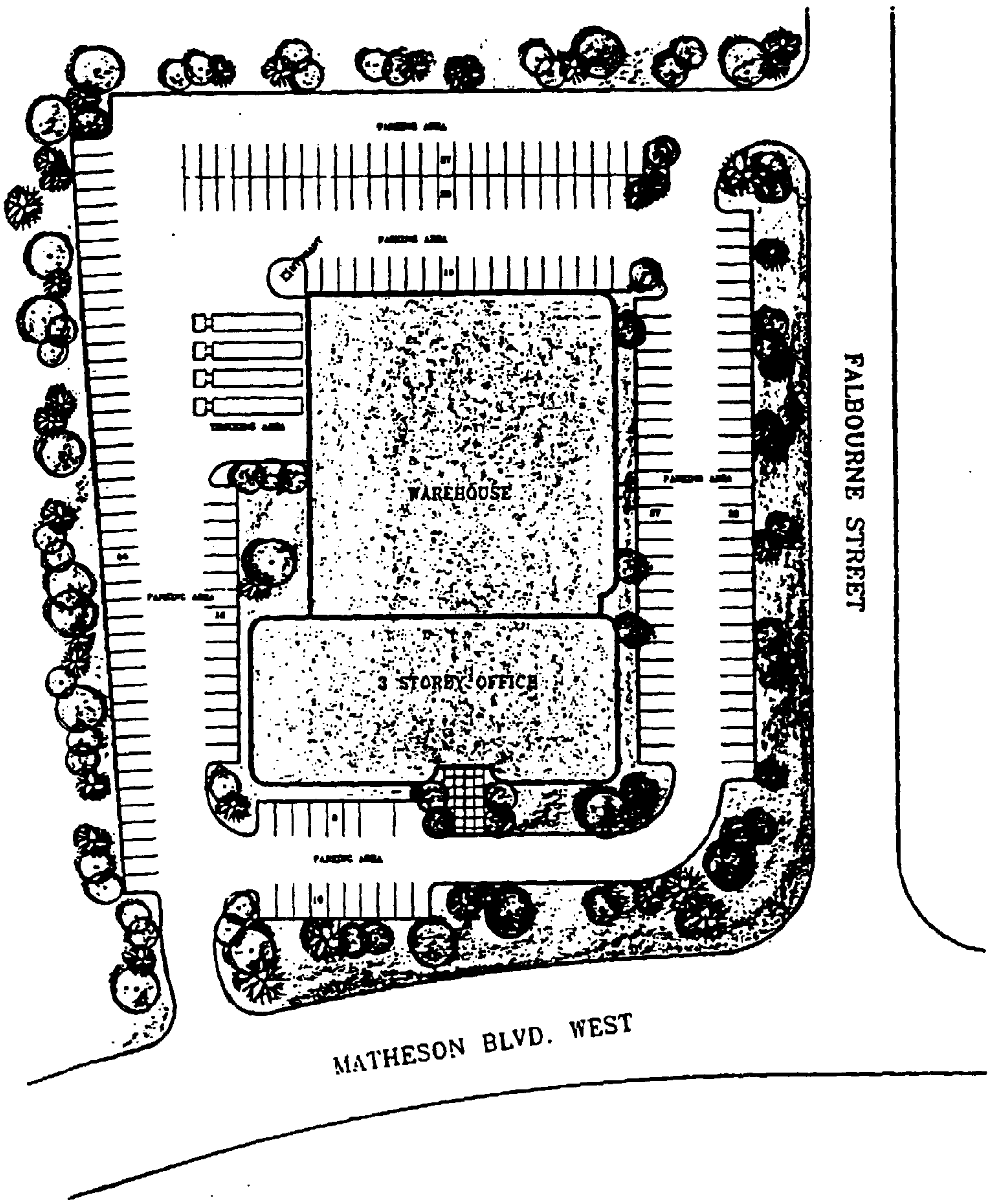
Rice Daubney
Architects

July 1989
SK 08



MICROSOFT CANADA INC.

ORLANDO CORPORATION



MICROSOFT CANADA INC.

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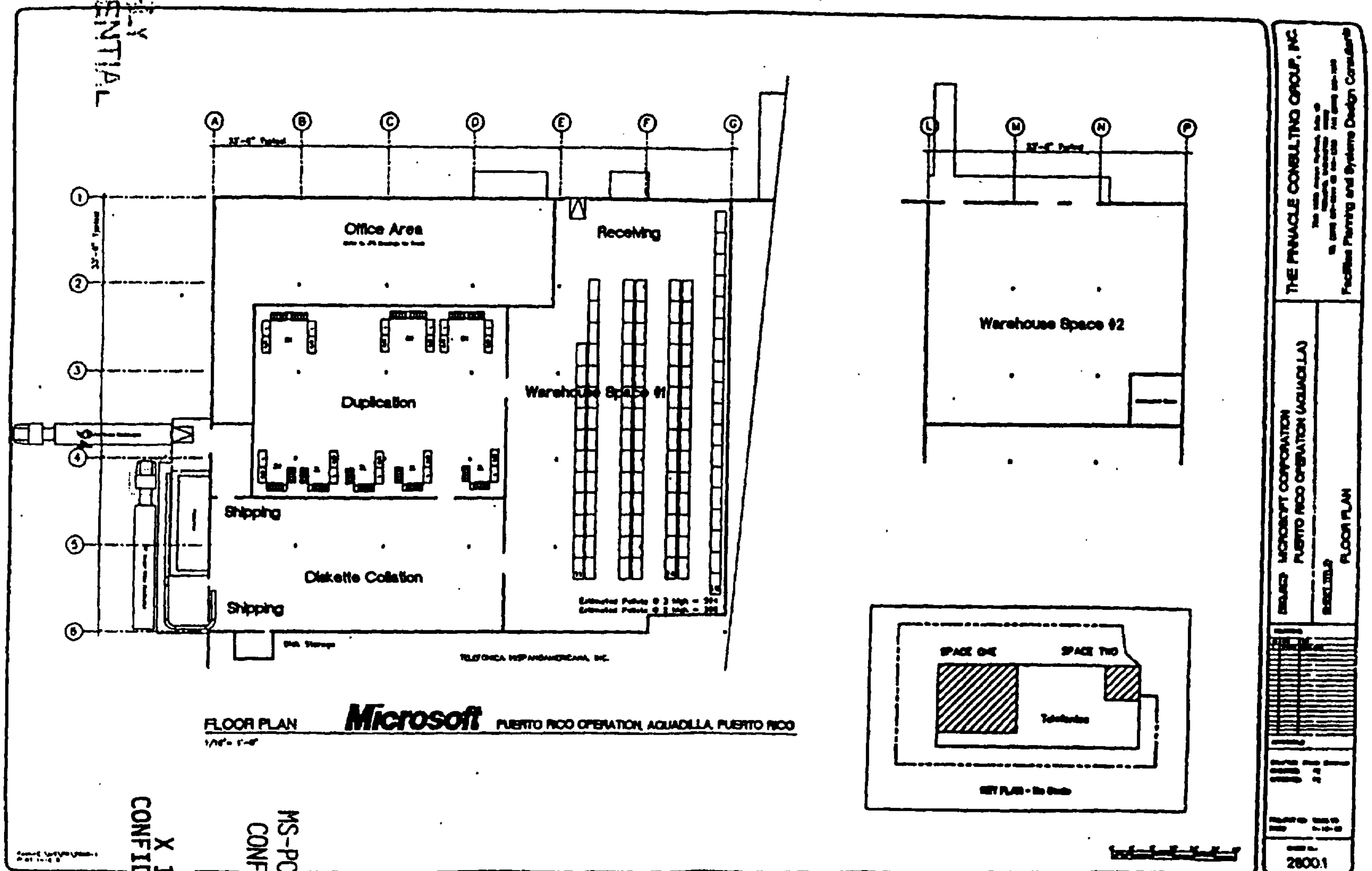

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STOCK/INVESTOR RELATIONS

INVESTOR RELATIONS/STOCK ACTIVITY

Financial Releases - On September 14, 1989, the planned Stock Buy Back was announced. See copy attached.

On October 4, 1989, in conjunction with the Alex. Brown Technology Conference at which Microsoft presented, the annual announcement of projected revenues of $235 million was issued. See copy attached.

On October 17, 1989, the full earnings release for the first quarter was issued at the close of the market.

Meetings/Conference Call - In an effort to provide more direct and regular contact for financial analysts with Microsoft senior management, a breakout session was held with Bill Gates and Steve Ballmer after the PM Excel announcements on October 10 in New York City. It was well received with more than 45 financial analysts from both the sell-side and buy-side attending. In attendance were analysts from as far away as San Francisco. Future such breakout sessions will be held in conjunction with major product announcements. The next one is planned for the WIN/Word announcement on October 31 with Mike Maples and Frank Gaudette.

As part of the first quarter earnings release, Microsoft hosted its first conference call to discuss the financial results. This was scheduled for one hour after the earnings were released to enable the more than 90 call invitees to receive a fax copy of the results. As the attached invitation letter indicates, the logistics of scheduling such a call are simple. In our case, the 100 lines reserved were divided 70 to the East Coast (defined as New York and east) and 30 for the West Coast (the Hudson River and west).

Conference calls are becoming the standard means for communicating financial results to the Street because they enable all analysts, both sell-side and buy-side, to have a level field of information. Other companies using this method include IBM, Compaq, DEC, HP and Tate, etc. Lotus has a full analyst meeting in New York each quarter. Based on the positive feedback received, conference calls are now an integral part of our financial communications.

Reports: - The most noteworthy report issued during the quarter was that by Scott Smith of Donaldson, Lukin and Jenrette. This DLJ report, it s first on Microsoft, rated MSFT a buy and was issued in early September when MSFT was trading at $66. A copy of the first page of the report is attached.

In its recently released "All-American Research Team", three of the top four analysts have focused coverage of MSFT: Number one Rick Sherlund, Goldman Sachs; Number two Steve McClellan, who covers software services for Merrill-Lynch; Number three, Scott Smith, DLJ; and Runner-Up, David Readerman, Shearson-Lehman.

Float - Microsoft public float, excluding Officers, Directors and Paul Allen, as of September 30, 1989, is approximately 37% or 20,119,032 shares out of the 54,995,610 shares outstanding.

Employee Stock Purchase Plan - There are approximately 1600 participants, both foreign and domestic, enrolled in the current ESPP period which ends December 31, 1989. The fair market value on July 3, 1989, was $54.25 which means that if the stock price remains at the present level, the purchase price will be $46.11.

An overview of past periods is as follows:

Period	Fair Market Value Beginning	Fair Market Value Ending	Purchase Price
08/01/86 - 12/31/86	$ 28.375*	$ 48.25*	$ 24.12*
01/01/87 - 06/30/87	$ 23.875*	$ 51.00*	$ 20.294*
07/01/87 - 12/31/87	$ 51.25	$ 54.25	$ 43.56
01/01/88 - 06/30/88	$ 56.00	$ 67.00	$ 47.60
07/01/88 - 12/31/88	$ 69.625	$ 53.00	$ 45.26
01/01/89 - 06/30/89	$ 53.675	$ 53.00	$ 45.05

* Pre-Split

Cashless Exercise/Alex. Brown & Sons - As of September 30, 1989, approximately 750 employees have opened accounts with Alex. Brown. During Q90-1 280,000 shares of Microsoft stock were traded via Alex. Brown.

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icrosoft News Release

For Release: Immediate

Contact: Raymond B. Ferguson
Microsoft Corporation
(206) 882-8080

Pam Edstrom
The Waggener Group
(503) 245-0905

MICROSOFT ANNOUNCES STOCK BUY BACK PLAN

REDMOND, WASHINGTON--September 14, 1989. Microsoft announced today that its Board of Directors has authorized the purchase of up to 1,000,000 shares of its common stock. Purchases will be made on the open market from time to time during the fiscal year ending June 30, 1990. Francis J. Gaudette, Senior Vice President and Chief Financial Officer, stated that the purpose of this limited purchase program is to reduce the dilutive effect to shareholders of stock issuances pursuant to Microsoft's stock option and employee stock purchase plans.

Microsoft Corporation (NASDAQ "MSFT") develops, markets, and supports a wide range of microcomputer software for business and professional use, including operating systems, languages and applications programs, as well as books, CD-ROM products, and hardware for the microcomputer marketplace.

Microsoft

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MICROSOFT ANTICIPATES REVENUES OF APPROXIMATELY $235 MILLION

Redmond, Washington--October 4, 1989. Microsoft Corporation expects to report revenues of approximately $235 million for the first quarter of fiscal year 1990 which ended September 30, 1989, an increase of approximately 34 percent over the $176 million for the same period of fiscal 1989. Complete earnings information will be released October 17, 1989.

Microsoft Senior Vice President and Chief Financial Officer Frank Gaudette attributed the positive first quarter showing to strong revenue generation across all product groups and all sales channels for the summer months both here and abroad.

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# # #

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MICROSOFT REPORTS FIRST QUARTER REVENUES OF $235.2 MILLION

Redmond, Washington--October 17, 1989. Microsoft Corporation today reported revenues of $235.2 million for the first quarter of fiscal year 1990 which ended September 30, 1989, a 33 percent increase over the $176.4 million for the same period of fiscal 1989. Net income for the quarter was $49.6 million, an increase of 36 percent over the $36.6 million for the corresponding period of fiscal 1989. Earnings per share were $.87 as compared to $.65 a year ago.

Jon Shirley, President and Chief Operating Officer, said: "These first quarter results were achieved due to record revenue on a worldwide basis from both the retail and the OEM sales channels."

"As anticipated, these operating results reflect a continuing shift to retail applications products and increased expenditures on research and development," added Frank Gaudette, Senior Vice President and Chief Financial Officer. "Notwithstanding these trends, net income as a percent of revenues was 21.1 percent, compared to 20.7 percent in the first quarter last year. A major contribution to this result was a lower cost of goods at 21.6 percent as compared to 26.0 percent in the first quarter last year and 24.8 percent for the quarter which ended June 1989. The lower cost of goods was achieved by better economies of scale and efficiencies in manufacturing."

In product activity during the quarter, Microsoft delivered OS/2 operating system version 1.2 to IBM during September on schedule. This enhanced version of the operating system includes a new high-performance file system and improved Presentation Manager shell. Other OEMs will begin shipping version 1.2 shortly. Microsoft also began shipping Microsoft Works version 2.0 for IBM PCs and compatibles. In early October, Microsoft announced a major order for the product in which purchasers of IBM PS/2 Models 25, 30, 50Z and 55SX through IBM Authorized Dealers will receive a free copy of Microsoft Works as part of the software included in IBM's holiday promotion.

Two important announcements from this quarter underscore the Company's continuing commitment to the development of products for Apple Macintosh systems. At the August Macworld trade show in Boston, version 2.0 of Microsoft Mail for AppleTalk networks was demonstrated. Microsoft Mail is a second-generation electronic mail program designed to support enterprise-wide connectivity over a large multivendor network. In the other Macintosh-related news from this quarter, the Company announced the CD-ROM version of The Microsoft Office, which combines four of its most popular applications for the Macintosh on a single CD-ROM disc.

Microsoft Corporation (NASDAQ "MSFT") develops, markets, and supports a wide range of microcomputer software for business and professional use, including operating systems, languages and application programs, as well as books and hardware for the microcomputer marketplace.

Microsoft Corporation

Consolidated Statements of Income (Unaudited)

(In thousands, except net income per share)

	Three Months Ended September 30	
	1989	1988
Net revenues	$235,161	$176,393
Cost of revenues	50,759	45,931
Gross profit	184,402	130,462
Operating expenses:		
Research & development	39,690	22,938
Sales & marketing	66,974	48,673
General & administrative	8,349	6,297
Total operating expenses	115,013	77,908
Operating income	69,389	52,554
Non-operating income	5,037	3,346
Stock option program expense	(1,500)	(2,101)
Income before income taxes	72,926	53,799
Provision for income taxes	23,338	17,217
NET INCOME	$ 49,588	$ 36,582
Average shares outstanding	57,180	56,076
NET INCOME PER SHARE	$ 0.87	$ 0.65

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Microsoft Corporation

Consolidated Balance Sheets

(In thousands)

	September 30, 1989 (1)	June 30, 1989
Assets		
Current assets:		
Cash & short-term investments	$336,496	$300,791
Accounts receivables - net	130,332	111,180
Inventories	35,974	37,755
Other	24,011	19,223
Total current assets	526,813	468,949
Property, plant & equipment - net	232,096	198,825
Other assets	50,270	52,824
Total	$809,179	$720,598
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	$ 52,409	$ 41,953
Customer deposits & deferred revenue	14,074	10,043
Accrued compensation & employee benefits	20,201	25,718
Notes payable	27,477	25,419
Income taxes payable	51,314	30,269
Other	19,126	25,416
Total current liabilities	184,601	158,818
Stockholders' equity:		
Common stock	55	55
Paid-in capital	125,634	110,425
Retained earnings	505,140	455,552
Translation adjustment	(6,251)	(4,252)
Total stockholders' equity	624,578	561,780
Total	$809,179	$720,598

(1) Unaudited

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Microsoft

October 9, 1989

Mr. Rick Sherlund
Goldman Sachs & Company
85 Broad Street
New York, NY 10004

Dear Rick:

On behalf of the management of Microsoft Corporation, I would like to invite you to participate in our inaugural conference call which will cover our earnings release for the first quarter of fiscal year 1990. It will be held at 2:00 p.m., P.D.T./5:00 p.m., E.D.T./4:00 p.m., C.D.T. on Tuesday, October 17, 1989. To participate in this conference, please call Darome Connection at 212/968-1604 fifteen minutes prior to the designated time and provide them with your name and organization. (If at any time during the call you experience static or get disconnected, please contact the Darome Connection telephone number, 212/968-1604, not Microsoft, for reconnecting your call.)

This conference call will be hosted by Frank Gaudette, Senior Vice President and Chief Financial Officer. The conference call will last no longer than one hour including questions and answers (one question per person, please).

We will release the Balance Sheet and Income Statement numbers at 1:00 p.m. on Tuesday, October 17, 1989, on the wire and fax the same to you simultaneously.

Please confirm your participation in this conference call no later than Friday, October 13, by calling Susan Severns at Microsoft, 206/867-3703.

We thank you for your interest in Microsoft Corporation and look forward to your participation in this conference call.

Sincerely,

Raymond B. Ferguson
Director of Administration

RBF:sks

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Donaldson, Lufkin & Jenrette

Donaldson, Lufkin & Jenrette Securities Corporation • 140 Broadway, New York, N.Y. 10005 • (212) 504-3000

Action Recommendation

Scott M. Smith
Vice President
(212) 504-4204

September 25, 1989
1142-89

MICROSOFT (MSFT)*

A Window of Opportunity

Rating: DLJ Buy

FACTBOOK Bracket: (1)
Relative Return Projection: Over 20%

Price	Earnings Per Share			P/E Ratios		Return on Equity		Dividend
09/22/89	06/89	06/90E	06/91E	06/89E	06/90E	06/89E	06/90E	
66	$3.03	$3.70	$4.90	17.8	13.7	30.4%	32.9%	Nil

DJIA: 2681.61
SPII: 395.84

Shares outstanding (mil.):	56.5
Market capitalization (bil.):	$3.69
6/30/89 book value/share:	$9.85
Price/book value ratio:	6.7
52-week price range:	66 3/4-45 1/4

Capitalization as of 6/30/89	Amount $ Millions	% Total
Short-term liabilities	$158.8	22%
Stockholders' equity	561.8	78
Total	$720.6	100%

VIEWPOINT

On September 13, we recommended purchase of Microsoft and added the shares to DLJ's *Recommended List* at 60 1/4 because we expect the company to deliver a wave of new product releases that could accelerate earnings growth for many years to come. Microsoft is far and away the dominant player in the PC software industry, offering an array of both applications and systems products for IBM and Macintosh machines. The company's most prominent products are its operating systems, notably DOS, which is now installed on more than 25 million machines, and OS/2, the next generation system. As with other PC software companies, MSFT has experienced delays in delivering new products; however, we believe that the company is poised to strike in the fourth quarter with Windows 3.0, Presentation Manager (PM) 1.2, Word for Windows and Excel for PM. Windows and PM are graphical user interfaces (GUI--pronounced *gooey*) that act as

NASDAQ NATIONAL MARKET SYSTEM STATISTICAL REPORT
FOR MONTH ENDING 29 SEP 89

NASD NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC. 1735 K STREET NORTHWEST, WASHINGTON, D.C. 20006

NASDAQ/NMS SYSTEM STATISTICS

	COMPOSITE INDEX	ASSIGNED INDEX (INDUSTRIAL)
HIGH	474.56	460.74
LOW	464.83	449.84
CLOSE	472.92	458.97
PREVIOUS CLOSE	469.33	455.49
% CHANGE	+0.76	+0.76

TOTAL NASDAQ VOLUME: 2,623,719,900
TOTAL NMS VOLUME: 1,866,372,174
TOTAL NMS TRADES: 890,588
TOTAL NMS SECURITIES: 2,740

NASDAQ SYMBOL: MSFT
SECURITY DESCRIPTION: Common Stock ($0.001 Par Value)
TOTAL SHARES OUTSTANDING: 54,586,000
SHORT INTEREST REPORTED: 664,990 AS OF 09/15/89
PLEASE NOTIFY NASDAQ OF ANY CHANGE IN COMPANY CONTACT OR ADDRES

SUMMARY FOR THIS SECURITY

1. PRICE RANGE: HIGH 69 1/2 LOW 57 3/4
2. LAST PRICE: (AUG) 58 3/4 PERCENT CHANGE: +16.60
   (SEP) 68 1/2
3. VOLUME FOR MONTH: 8,940,721
4. TOTAL TRADES 7,281
5. BLOCKS. NUMBER OF BLOCKS 131 NUMBER OF SHARES 2,030,100

Microsoft Corporation
Mr. Francis J. Gaudette
Senior Vice President Finance
One Microsoft Way
Redmond WA 980526399

DATE	HIGH	LOW	LAST	NET CHANGE	SHARE VOLUME	TRADES	NMS VOLUME	NASDAQ VOLUME	COMPOSI CLO
FRI 1	60 1/4	58 3/4	59 7/8	+ 1 1/8	309,888	359	76,485,537	113,463,000	471.
WEEK	60 1/4	58 3/4	59 7/8	+ 1 1/8	309,888	359	76,485,537	113,463,000	471.
MON 4	HOLIDAY								
TUE 5	61	59 5/8	60	+ 1/8	649,572	418	77,860,911	121,138,200	471.
WED 6	60	58 3/4	59 1/4	- 3/4	294,657	212	81,703,889	135,432,100	469.
THU 7	59 1/4	58	58 1/4	- 1	291,309	206	94,434,208	133,997,300	469.
FRI 8	59 1/2	57 3/4	59	+ 3/4	276,364	202	89,170,039	130,063,200	471.
WEEK	61	57 3/4	59	- 7/8	1,511,902	1,038	343,168,847	521,630,800	471.
MON 11	59 1/2	58 1/2	59 3/8	+ 3/8	194,316	180	76,490,335	113,494,200	470.
TUE 12	61	59 1/4	60 1/4	+ 7/8	471,672	387	101,035,920	151,059,600	471.
WED 13	63 1/2	60 1/2	62 1/4	+ 2	1,260,458	937	120,109,346	159,935,900	471.
THU 14	64 1/2	62 1/4	63 3/4	+ 1 1/2	844,671	578	101,741,787	142,031,700	468.
FRI 15	64 1/2	62 1/2	62 3/4	- 1	620,007	424	95,400,730	130,917,100	467.
WEEK	64 1/2	58 1/2	62 3/4	+ 3 3/4	3,091,124	2,506	494,778,118	697,438,500	467.
MON 18	63 1/2	62 1/2	63 1/2	+ 3/4	272,193	195	81,564,422	105,052,200	466.
TUE 19	64	62 1/2	62 1/2	- 1	342,126	288	100,279,324	136,708,600	467.
WED 20	65	62 1/4	65	+ 2 1/2	501,769	339	99,089,680	137,051,000	466.
THU 21	66 3/4	64 1/2	65 1/2	+ 1/2	621,682	591	100,707,515	138,620,000	467.
FRI 22	66	64 3/4	66	+ 1/2	305,639	266	93,515,500	148,885,600	468.
WEEK	66 3/4	62 1/4	66	+ 3 1/4	2,043,409	1,679	475,156,441	666,317,400	468.
MON 25	68	65 1/2	67	+ 1	487,181	455	79,245,903	108,800,600	466.
TUE 26	67 1/2	66 1/2	67 1/4	+ 1/4	278,244	287	89,566,721	123,381,200	467.
WED 27	67 3/8	65 3/4	66 5/8	- 5/8	481,388	330	99,355,387	123,179,200	467.
THU 28	68	66 1/2	68	+ 1 3/8	289,429	246	100,732,718	133,132,600	471.
FRI 29	69 1/2	67 3/4	68 1/2	+ 1/2	448,156	383	107,882,496	136,376,600	472.
WEEK	69 1/2	65 1/2	68 1/2	+ 2 1/2	1,984,398	1,701	476,783,231	624,870,200	472.

NASDAQ MARKET MAKERS IN THIS SECURITY AS OF 09/29/89

DEAN WITTER REYNOLDS, INC.	181,455 ALEX BROWN & SONS	420,509 SMITH BARNEY/HARRIS UPHAM 120.
GOLDMAN, SACHS & CO	699,809 MERRILL LYNCH, PIERCE, FENNER	894,649 TROSTER SINGER CP 500.
SALOMON BROS INC	451,500 COWEN & CO.	440,537 MONTGOMERY SECS INC 140.
SHEARSON LEHMAN HUTTON INC	393,533 MAYER & SCHWEITZER INC	213,791 WEEDEN AND CO INC 71.
KIDDER, PEABODY & CO INC	116,578 DREXEL BURNHAM LAMBERT, INC.	132,300 HERZOG, HEINE, GEDULD INC 834.
MIDWEST STOCK EXCHANGE	50,850 NASH WEISS/DIV OF SHATKIN INV	22,320 CYRUS J. LAWRENCE, INC. 10.
DONALDSON, LUFKIN & JENRETTE	593,422 PAINEWEBBER INC	248,310 PRUDENTIAL-BACHE SECS INC 215.
JEFFERIES & CO INC	345,800 THE FIRST BOSTON CP	357,709 PIPER, JAFFRAY & HOPWOOD, INC 122.
BEAR, STEARNS & CO	115,095 SHERWOOD SECS CP	250,750 HAMBRECHT & QUIST INC 62.

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NASDAQ NATIONAL MARKET SYSTEM STATISTICAL REPORT | **NASD** | NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC. 1735 K STREET NORTHWEST, WASHINGTON, D.C. 20006

FOR MONTH ENDING 31 AUG 89

NASDAQ/NMS SYSTEM STATISTICS

	COMPOSITE INDEX	ASSIGNED INDEX (INDUSTRIAL)
HIGH	469.42	455.61
LOW	452.41	439.24
CLOSE	469.33	455.49
PREVIOUS CLOSE	453.84	441.05
% CHANGE	+3.41	+3.27

TOTAL NASDAQ VOLUME: 3,012,841,800
TOTAL NMS VOLUME: 2,145,306,440
TOTAL NMS TRADES: 1,090,377
TOTAL NMS SECURITIES: 2,780

NASDAQ SYMBOL: MSFT
SECURITY DESCRIPTION: Common Stock ($0.001 Par Value)
TOTAL SHARES OUTSTANDING: 54,353,000
SHORT INTEREST REPORTED: 694,248 AS OF 08/15/89
PLEASE NOTIFY NASDAQ OF ANY CHANGE IN COMPANY CONTACT OR ADDRES

SUMMARY FOR THIS SECURITY

1. PRICE RANGE: HIGH 60 1/2 LOW 54
2. LAST PRICE: (JUL) 54 3/4 PERCENT CHANGE: +7.31
   (AUG) 58 3/4
3. VOLUME FOR MONTH: 9,605,969
4. TOTAL TRADES 6,957
5. BLOCKS: NUMBER OF BLOCKS 190 NUMBER OF SHARES 2,813,390

Microsoft Corporation
Mr. Francis J. Gaudette
Senior Vice President Finance
16011 N.E. 36th Way
Box 97017
Redmond WA 980739717

DATE	HIGH	LOW	LAST	NET CHANGE	SHARE VOLUME	TRADES	NMS VOLUME	NASDAQ VOLUME	COMPOSIT CLOS
TUE 1	55 1/4	54	54 1/4	- 1/2	432,163	301	103,154,178	136,876,900	453.2
WED 2	54 3/4	54	54 1/4	0	197,490	151	96,048,001	130,100,200	454.0
THU 3	55 1/4	54 1/4	55	+ 3/4	191,819	153	108,261,837	146,005,100	456.9
FRI 4	57 1/2	54 1/2	57	+ 2	1,224,089	578	98,800,129	133,671,400	457.4
WEEK	57 1/2	54	57	+ 2 1/4	2,045,561	1,183	406,264,143	548,733,600	457.4
MON 7	58	57	57 3/4	+ 3/4	650,593	345	102,256,561	135,246,300	461.7
TUE 8	59 1/4	57 1/2	59	+ 1 1/4	783,967	512	122,602,862	160,270,600	463.3
WED 9	60	58 3/4	58 3/4	- 1/4	791,282	518	116,685,100	155,689,500	462.4
THU 10	59	58 1/4	58 1/2	- 1/4	336,463	236	102,931,854	134,432,900	463.5
FRI 11	59 1/2	57 3/4	57 3/4	- 3/4	427,412	282	102,992,921	139,264,300	462.4
WEEK	60	57	57 3/4	+ 3/4	2,989,717	1,893	547,468,998	724,903,600	462.4
MON 14	57 3/4	57	57	- 3/4	479,611	204	67,325,250	100,446,600	459.
TUE 15	58	56 5/8	57 1/2	+ 1/2	124,320	146	82,565,876	133,485,500	460.
WED 16	58	55 1/2	55 7/8	- 1 5/8	324,352	259	88,882,609	129,245,700	460.7
THU 17	56 3/4	55 1/4	56 1/2	+ 5/8	277,690	223	89,924,446	136,318,800	460.
FRI 18	57 3/4	56 1/2	57 1/2	+ 1	173,206	160	81,868,883	134,619,600	461.
WEEK	58	55 1/4	57 1/2	- 1/4	1,379,179	992	410,567,064	634,016,200	461.
MON 21	57 7/8	56	56 1/8	- 1 3/8	223,361	186	75,463,825	108,623,600	458.
TUE 22	58 3/4	56	58 3/8	+ 2 1/4	450,281	373	81,598,775	119,029,400	459.
WED 23	59 5/8	58	59 1/4	+ 7/8	321,162	355	99,396,984	139,687,700	461.
THU 24	60 1/2	58 1/4	59	- 1/4	647,186	729	108,129,074	144,808,400	465.
FRI 25	59 1/4	57 3/4	58 7/8	- 1/8	592,138	301	90,143,122	126,728,300	466.
WEEK	60 1/2	56	58 7/8	+ 1 3/8	2,234,128	1,944	454,731,780	638,277,400	466.
MON 28	59 1/2	58 1/4	59 1/8	+ 1/4	198,715	221	67,692,866	100,242,200	467.
TUE 29	60	58 3/8	58 1/2	- 5/8	378,592	350	93,602,752	128,611,900	466.
WED 30	59 5/8	58 1/2	59 1/4	+ 3/4	280,993	223	86,657,887	121,701,400	468.
THU 31	59 3/4	58 3/4	58 3/4	- 1/2	99,084	151	78,320,950	117,755,500	469.
WEEK	60	58 1/4	58 3/4	- 1/8	957,384	945	326,274,455	468,311,000	469.

NASDAQ MARKET MAKERS IN THIS SECURITY

AS OF 08/31/89

DEAN WITTER REYNOLDS, INC.	113,552	ALEX BROWN & SONS	297,048	SMITH BARNEY/HARRIS UPHAM	179.
GOLDMAN, SACHS & CO	1,275,885	MERRILL LYNCH, PIERCE, FENNER	1,662,272	TROSTER SINGER CP	395.
SALOMON BROS INC	525,020	COWEN & CO.	140,115	MONTGOMERY SECS INC	219.4
SHEARSON LEHMAN HUTTON INC	399,899	MAYER & SCHWEITZER INC	222,786	WEEDEN AND CO INC	40.
KIDDER, PEABODY & CO INC	151,502	DREXEL BURNHAM LAMBERT, INC.	131,850	HERZOG, HEINE, GEDULD INC	776.
MIDWEST STOCK EXCHANGE	65,909	NASH WEISS/DIV OF SHATKIN INV	18,200	CYRUS J. LAWRENCE, INC.	28.1
DONALDSON, LUFKIN & JENRETTE	114,484	PAINEWEBBER INC	364,531	PRUDENTIAL-BACHE SECS INC	221.1
JEFFERIES & CO INC	99,874	THE FIRST BOSTON CP	419,692	PIPER, JAFFRAY & HOPWOOD, INC	102.
BEAR, STEARNS & CO.	256,975	SHERWOOD SECS CP	234,090	HAMBRECHT & QUIST INC	126.

NASDAQ/NMS MONTHLY STATISTICAL REPORT
FOR MONTH ENDING 31 JUL 89

NASD NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.
1735 K STREET NORTHWEST, WASHINGTON, D.C. 2006

NASDAQ/NMS SYSTEM STATISTICS

	COMPOSITE INDEX	ASSIGNED INDEX (INDUSTRIAL)
HIGH	453.86	441.12
LOW	434.35	421.19
CLOSE	453.84	441.05
PREVIOUS CLOSE	435.29	421.71
% CHANGE	+4.26	+4.58

TOTAL NASDAQ VOLUME: 2,500,471,800
TOTAL NMS VOLUME: 1,791,955,479
TOTAL NMS TRADES: 901,585
TOTAL NMS SECURITIES: 2,782

NASDAQ SYMBOL: MSFT
SECURITY DESCRIPTION: Common Stock ($0.001 Par Value)
TOTAL SHARES OUTSTANDING: 54,353,000
SHORT INTEREST REPORTED: 617,897 AS OF 07/14/89
PLEASE NOTIFY NASDAQ OF ANY CHANGE IN COMPANY CONTACT OR ADDRESS

SUMMARY FOR THIS SECURITY

1. PRICE RANGE: HIGH 57 LOW 51 1/2
2. LAST PRICE: (JUN) 53
   (JUL) 54 3/4 PERCENT CHANGE: +3.30
3. VOLUME FOR MONTH: 8,485,473
4. TOTAL TRADES 5,864
5. BLOCKS: NUMBER OF BLOCKS 146 NUMBER OF SHARES 2,162,000

Microsoft Corporation
Mr. Francis J. Gaudette
Senior Vice President Finance
16011 N.E. 36th Way
Box 97017
Redmond WA 980739717

DATE	HIGH	LOW	LAST	NET CHANGE	SHARE VOLUME	TRADES	NMS VOLUME	NASDAQ VOLUME	COMPOSITE CLOSE
MON 3	54 1/4	53 1/8	54 1/4	+ 1 1/4	102,025	110	37,030,105	53,203,000	436.00
TUE 4	HOLIDAY								
WED 5	55 1/2	54	55 1/4	+ 1	184,540	175	66,581,895	94,518,100	436.94
THU 6	56	52 3/8	52 3/4	- 2 1/2	658,395	448	79,815,521	118,053,500	439.57
FRI 7	54 1/4	52 5/8	53 1/2	+ 3/4	288,042	218	85,956,022	120,314,900	442.42
WEEK	56	52 3/8	53 1/2	+ 1/2	1,233,002	951	269,383,543	386,089,500	442.42
MON 10	55	53 1/2	54 7/8	+ 1 3/8	189,575	169	75,439,649	112,742,700	442.69
TUE 11	55 1/2	53 1/4	53 1/2	- 1 3/8	302,516	283	105,097,439	143,141,600	444.50
WED 12	53 1/2	52	53 1/4	- 1/4	362,405	272	95,556,611	147,263,800	446.81
THU 13	53 3/4	52 1/2	53	- 1/4	232,179	193	92,481,963	130,109,800	447.89
FRI 14	53 1/2	51 3/4	52 3/4	- 1/4	297,377	274	92,967,120	128,852,200	448.90
WEEK	55 1/2	51 3/4	52 3/4	- 3/4	1,384,052	1,191	461,542,782	662,110,100	448.90
MON 17	53 1/2	52 1/2	53 1/4	+ 1/2	217,512	169	76,929,171	107,487,700	449.88
TUE 18	54 1/4	53 1/4	53 1/2	+ 1/4	298,615	220	96,432,505	131,376,800	447.86
WED 19	54 1/2	53 1/4	54 1/8	+ 5/8	206,893	184	114,181,781	159,875,700	451.23
THU 20	55 1/4	53 1/2	53 1/2	- 5/8	310,017	302	125,979,978	166,617,700	449.24
FRI 21	56 1/2	52 3/4	55 1/4	+ 1 3/4	692,531	561	96,037,207	144,762,900	449.29
WEEK	56 1/2	52 1/2	55 1/4	+ 2 1/2	1,725,568	1,436	509,560,642	711,020,800	449.29
MON 24	55 3/4	54 1/4	55 1/4	0	268,675	241	78,344,028	108,084,600	445.98
TUE 25	57	51 1/2	52	- 3 1/4	2,265,008	993	94,910,092	127,653,600	446.47
WED 26	53 1/4	52	52 3/4	+ 3/4	859,234	377	88,300,993	124,474,900	449.12
THU 27	54	53 1/4	[illegible]	[illegible]	316,697	252	111,245,002	140,254,800	452.48
FRI 28	54 1/2	53 1/4	[illegible]	[illegible]	203,292	210	97,757,787	128,903,900	452.82
WEEK	57	51 1/2	54 1/4	- 1	3,910,906	2,073	468,557,902	629,351,800	452.82
MON 31	55	53 3/4	[illegible]	[illegible]	231,945	213	82,910,610	111,599,600	453.84
WEEK	55	53 3/4	[illegible]	[illegible]	231,945	213	82,910,610	111,599,600	453.84

NASDAQ MARKET MAKERS IN THIS SECURITY

AS OF 07/31/89

DEAN WITTER REYNOLDS, INC.	89,260	ALEX BROWN & SONS	214,111	SMITH BARNEY/HARRIS UPHAM	164,5[illegible]
GOLDMAN, SACHS & CO	1,285,051	MERRILL LYNCH, PIERCE, FENNER	539,094	TROSTER SINGER CP	424,1[illegible]
SALOMON BROS INC	530,850	COWEN & CO.	360,100	MONTGOMERY SECS INC	184,2[illegible]
SHEARSON LEHMAN HUTTON INC	352,283	MAYER & SCHWEITZER INC	171,118	WEEDEN AND CO INC	60,4[illegible]
KIDDER, PEABODY & CO INC	130,256	DREXEL BURNHAM LAMBERT, INC.	82,600	HERZOG, HEINE, GEDULD INC	872,1[illegible]
MIDWEST STOCK EXCHANGE	97,600	NASH WEISS/DIV OF SHATKIN INV	15,100	CYRUS J. LAWRENCE, INC.	26,[illegible]
DONALDSON, LUFKIN & JENRETTE	138,860	PAINEWEBBER INC	249,975	PRUDENTIAL-BACHE SECS INC	210,4[illegible]
JEFFERIES & CO INC	171,100	THE FIRST BOSTON CP	284,900	PIPER, JAFFRAY & HOPWOOD, INC	110,3[illegible]
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]

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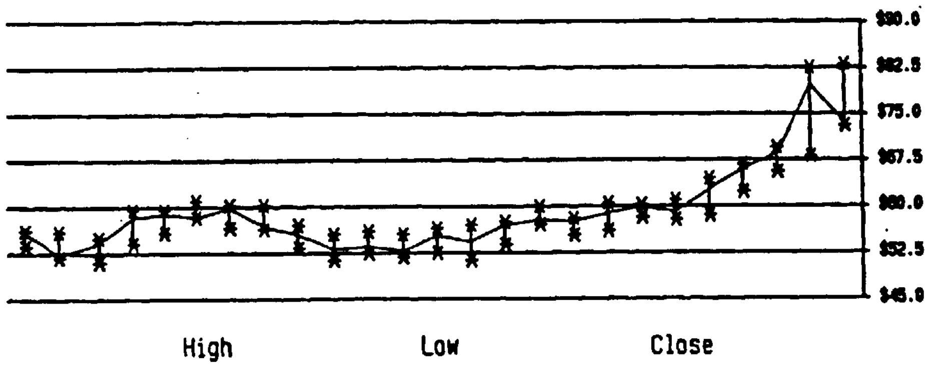
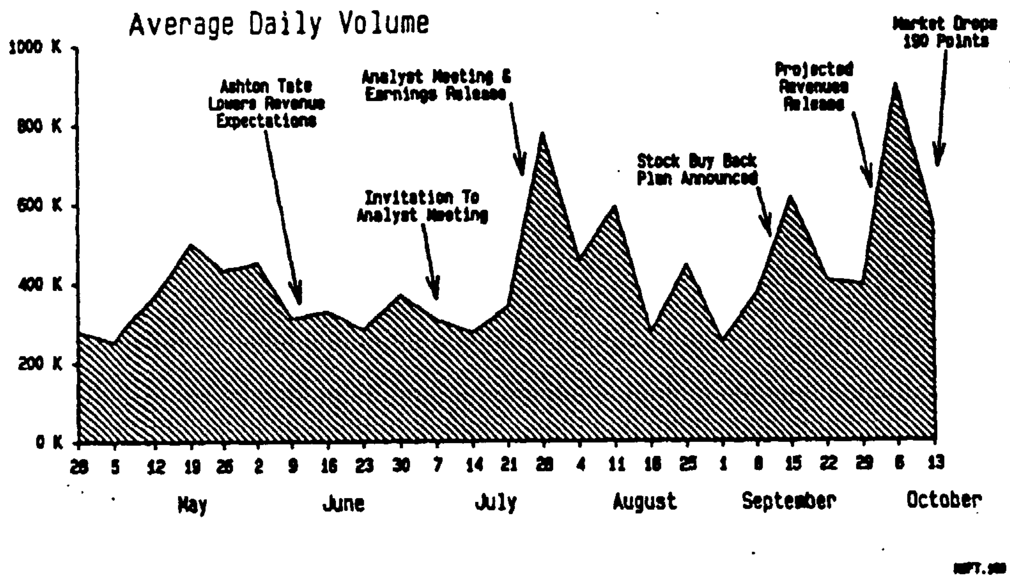
Weekly Stock Performance

Price





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MICROSOFT CORPORATION
SUMMARY OF STOCK OPTION PLAN ACTIVITY
AS OF SEPTEMBER 30, 1989

Shares Available For Grant

	Available Beginning Of Period	Additions: New Approvals	Additions: Forfeited Shares	Reductions: Net Shares Granted (1)	Available End Of Period
Fiscal 1982	0	6,040,000	0	(1,714,000)	4,326,000
Fiscal 1983	4,326,000	0	209,800	(1,858,800)	2,677,000
Fiscal 1984	2,677,000	0	830,702	(1,516,230)	1,991,472
Fiscal 1985	1,991,472	0	469,086	(1,313,430)	1,147,128
Fiscal 1986	1,147,128	2,800,000	416,489	(2,469,158)	1,894,459
Fiscal 1987	1,894,459	4,000,000	345,271	(2,409,200)	3,830,530
Fiscal 1988	3,830,530		464,203	(3,881,520)	413,213
Fiscal 1989	413,213	5,000,000	553,089	(5,021,770)	944,532
Fiscal 1990					
Q90-1	944,532		123,172	(2,358,665)	(1,290,961) (2)
Since Inception	0	17,840,000	3,411,812	(22,542,773)	(1,290,961)

Outstanding Stock Options

	Outstanding Beginning Of Period	Additions: Net Shares Granted (1)	Reductions: Shares Exercised	Reductions: Forfeited Shares	Outstanding End Of Period
Fiscal 1982	0	1,714,000	0	0	1,714,000
Fiscal 1983	1,714,000	1,858,800	(3,800)	(209,800)	3,359,200
Fiscal 1984	3,359,200	1,516,230	(143,584)	(830,702)	3,901,144
Fiscal 1985	3,901,144	1,313,430	(429,806)	(469,086)	4,315,682
Fiscal 1986	4,315,682	2,469,158	(1,208,032)	(416,489)	5,160,319
Fiscal 1987	5,160,319	2,409,200	(1,682,832)	(345,271)	5,541,416
Fiscal 1988	5,541,416	3,881,520	(926,211)	(464,203)	8,032,522
Fiscal 1989	8,032,522	5,021,770	(1,023,549)	(553,089)	11,477,654 (3)
Fiscal 1990					
Q90-1	11,477,654	2,358,665	(373,607)	(123,172)	13,339,540
Since Inception	0	22,542,773	(5,791,421)	(3,411,812)	13,339,540

Footnotes:

(1) Net shares granted is equal to gross shares less ISOs converted to NQSOs.

(2) Microsoft is seeking the approval of an amendment to reserve an additional 6,000,000 shares of common stock under the 1981 Stock Option Plan at the 1989 Annual Meeting of Shareholders. If approved, shares available at the beginning of Q90-2 will be 4,709,039.

(3) Due to the issuance of options for prior periods, the number of stock options outstanding as of the end of Q89-4 has increased 266,535 shares as compared with what was previously reported (11,211,119).

TRAINING
AND
PERSONNEL ADMINISTRATION

TRAINING AND PERSONNEL ADMINISTRATION

Management and Development: During First Quarter Fiscal Year 1990 235 managers and employees attended 12 sessions of 9 different seminars. This is in comparison to the 170 participants in First Quarter Fiscal Year 1989 (see following chart for courses conducted).

The management curriculum consists of five levels. The courses are designed to build a foundation and develop high levels of management and leadership skills. Currently available are programs in effective management techniques, time/project management, persuasive presentations, conducting meetings, management styles, and team building. All programs have the connecting thread of maintaining or increasing effective communications at all levels in the organization. Two new courses were successfully introduced: Effective Management Skills and Conducting Effective Meetings.

The employee courses are built into a curriculum with three class levels. Courses for employees are designed to help them structure their time and develop communication skills and methods to work more effectively with their lead on review and career planning.

We are in the process of introducing several new training programs designed to meet the needs of our Technical Leaders.

There are 20 sessions scheduled in 2nd Quarter FY 90 with 362 projected attendees (see the following chart for courses offered).

COURSES CONDUCTED DURING THE FIRST QUARTER OF 1990

Course Title	Number of Sessions	Number of Participants
Interpersonal Review Skills-Managers	1	6
Managing Interpersonal Relationships-Employees	2	48
Managing Interpersonal Relationships-Managers	1	23
Effective Management Skills	1	18
Presentation Skills-Managers	1	14
Selling Your Ideas	1	23
Conducting Effective Meetings	2	25
Time/Business Organization Workshop-Employees	1	41
Time/Business Organization Workshop-Managers	2	37
TOTALS	12	235

COURSES TO BE OFFERED DURING THE SECOND QUARTER OF 1990

Course Title	Number of Sessions	Number of Participants
Career Planning and Development	1	24
Conducting Effective Meetings	2	30
Effective Management Skills	1	24
Interpersonal Review Skills-Employees	3	45
Interpersonal Review Skills-Managers	5	45
Microsoft Management Styles Seminar	2	30
Presentation Skills-Managers	1	15
Selling Your Ideas	1	15
Team Building and Staff Development	1	24
Time/Business Organization Workshop-Employees	1	65
Time/Business Organization Workshop-Managers	2	45
TOTALS	20	362

Employee Relations: Assisting managers and employees in the resolution of distractions from our work such as performance problems, internal conflict, career counseling, and personal issues, is the primary goal of our employee relations effort.

Activity for 1st Quarter FY 90 consisted of 153 counseling sessions. Of these sessions 78% were performance related resulting in 8 probations and 21 terminations. The remaining were divided with 3% related to disability issues, 10% for career counseling, 6% to sexual harassment concerns, and 3% to personal issues. Fifty-six exit interviews were conducted.

In addition to the on-site exit interviews, an exit questionnaire is mailed to employees after their separation. Several trends are seen company wide.

The most common reason employees gave for leaving Microsoft was the lack of opportunities for career growth. Following this concern were dissatisfaction with management, salary, organization/position, and stress.

Affirmative Action: The Conciliation Agreement with the Department of Labor OFCCP requires us to submit quarterly reports. As a result of our second quarterly report, we were directed to focus on the recruitment of minorities into our Recruiting group and the Product Support Services Co-op Program.

Our Affirmative Action/Equal Employment Opportunity administrator has aggressively pursued contacts with local minority organizations and minority affairs groups at targeted College and University campuses. The response has been favorable.

To ensure success, with the appropriate campuses, we need to continue our support and follow-up with aggressive campus recruiting efforts to minorities and women. Several functions specific to minorities and women are scheduled during the next six months.

Overall our minority and female representation has increased slightly from last fiscal year. Organizations in need of continued focus are Systems, Applications, Product Support, and Manufacturing.

Employee Communications: The *Micronews* is the only corporate-wide communication vehicle for news, announcements, and recognition. During the 1st Quarter there were 13 issues of *Micronews*, with an average size of 16 pages. Circulation is over 5,000 copies per week. A four-page *It's To Your Benefit* bulletin was attached to the September 1 edition. There were also seven editions of *Micronews North*, which runs every other week and is targeted to the staff at Campus North.

Micronews articles over the past three months have kept employees informed on the acquisition of Bauer Enterprises, the new Taiwan subsidiary, the national and international sales meetings, Microsoft University, new books from Microsoft Press, the Microsoft/Apple font, printer technology licensing agreements, and the sale of another million mice. There were also announcements about the new usability testing lab, new buildings on campus, QuickPascal, The Microsoft Office on CD-ROM, Microsoft OnLine Plus, and Microsoft Mail 2.0. In addition, there were features on the Microsoft Picnic, the annual Company Meeting, and the company's United Way campaign.

In September a new feature was added, the Microsoft Calendar, which appears at the first of every month, listing important company events, special exhibits where Microsoft is participating, and holidays at all Microsoft locations.

Applications Training: Microsoft employees learn about the company's applications products and become proficient in Basic and Advanced Email, WZMail, basic MS-DOS, Learning Macintosh, Advanced Macintosh, and Hard Disk Management through Applications Training. Classes are held during the day and in the early evening at Corporate, and during the early morning hours at Campus North.

The Applications Training group issued its redesigned, twice-yearly descriptive catalog as well as the September-October schedule. Work has been progressing on the training database being developed on Advanced Revelation, and the program will be installed and running by the end of October.

Compensation: Salary ranges and career paths were developed for the Finance and Administration Division and implemented in conjunction with the August review process. This has provided a comprehensive, systematic, and consistent method of salary administration across a diverse employee population and has resulted in a streamlined review process. Salary adjustments were made during the August review cycle for certain groups of employees, primarily software design engineers and testers who were negatively impacted by higher campus recruiting rates in 1989. An analysis of stock classes and salaries for the Systems and Applications divisions showed a consistent and equitable implementation of the new stock program across both divisions. In conjunction, a revised set of procedures for putting new hires into the HR-1 database has eliminated duplication of effort, reduced the amount of paperwork required, and has improved accuracy of stock class and technical ladder information. A recent audit by the Washington State Wage and Hour Department has found Microsoft in conformance with the Fair Labor Standards Act (FLSA) in properly classifying positions as either exempt or non-exempt from overtime payment regulations.

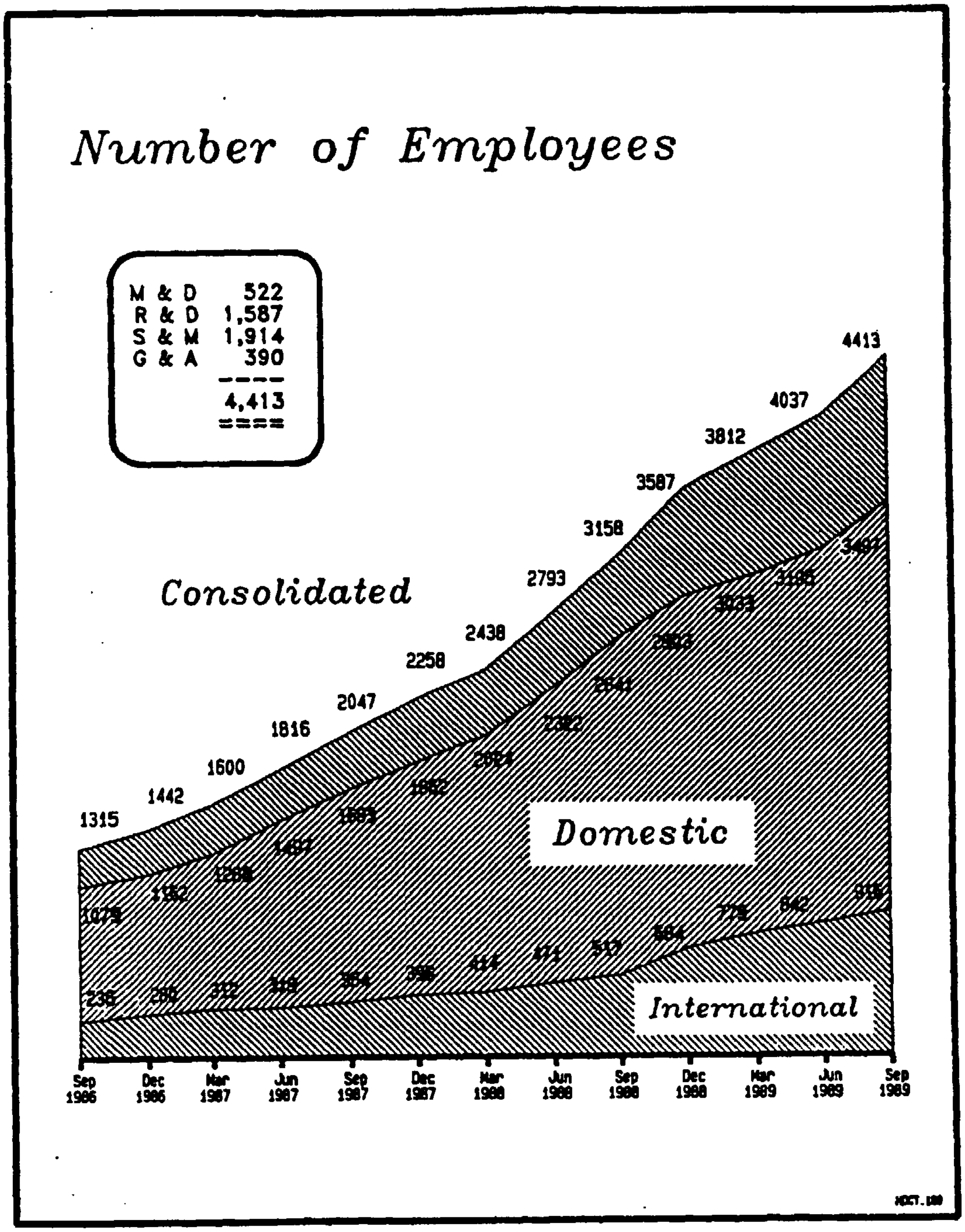
Personnel Systems: As of September 30, total corporate work force was 4,413 a net increase of 39.7% from one year ago with 3,497 domestic and 916 subsidiary employees (see the following charts, Number of Employees, Domestic Headcount, International Headcount, and Headcount by Location for more specific headcount information).

Based on the average headcount and number of terminations for the last three quarters, the estimated annual domestic turnover rate is 18.92% (see the following chart, Domestic Employee Turnover Analysis, for annualized figures).

Employee Benefits: The Savings Plus 401(k) Plan began 2nd Quarter FY 90 with 1,753 active employees participating in the plan. This represents an overall participation rate of 64% as compared to 63% at the beginning of 2nd Quarter FY 89. The average deferral percentage into the Savings Plus Plan is 7%.

Mental health claims continue to be the largest expense within the health benefit plans followed closely by maternity related benefit claims. The new Employee Assistance Program, CARES, will be introduced to employees and their families nationwide effective November 1, 1989. CARES (Counseling, Assistance, Referrals, and Education Services) will offer employee households three visits per year, paid in full by the plan, to a Family Services (United Way agency) program for care in areas such as substance abuse, stress, bereavement and family counseling. The short term goal is to provide employees with quality care through a referral network of mental health care professionals. The long term goal of CARES will be to help control mental health benefit plan costs by having employees accessing care through quality and cost effective mental health care professionals.

Freelance Contract Administration: With the centralization of freelance and independent contractor sourcing, screening, testing, and orientation, we continue to establish rates, contract parameters and briefings for managers. Currently we have 571 active freelance contracts, a decrease of 6 from 4th Quarter FY 90 (see the following chart, Active Freelance Contracts, for divisional use of freelance talent).



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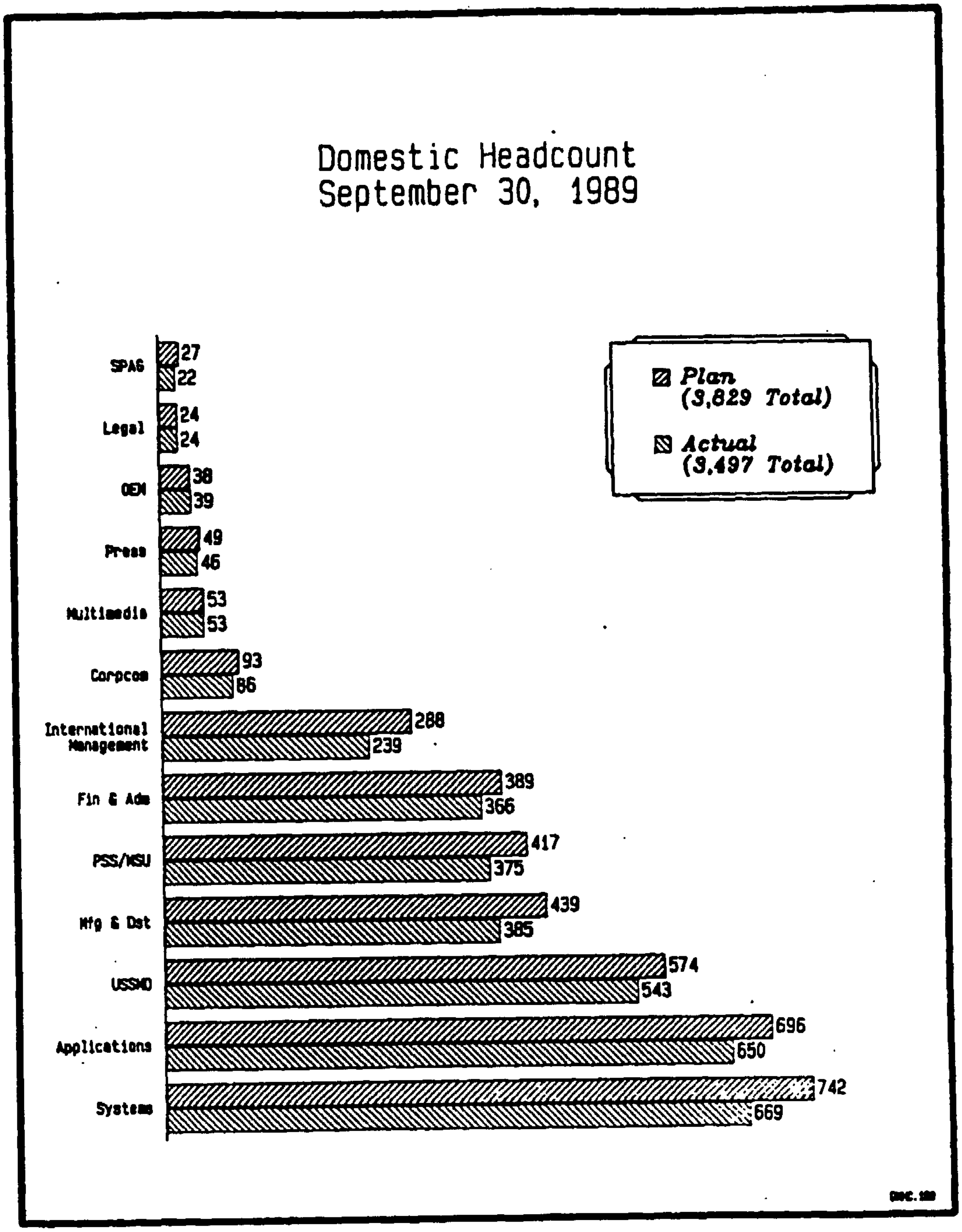
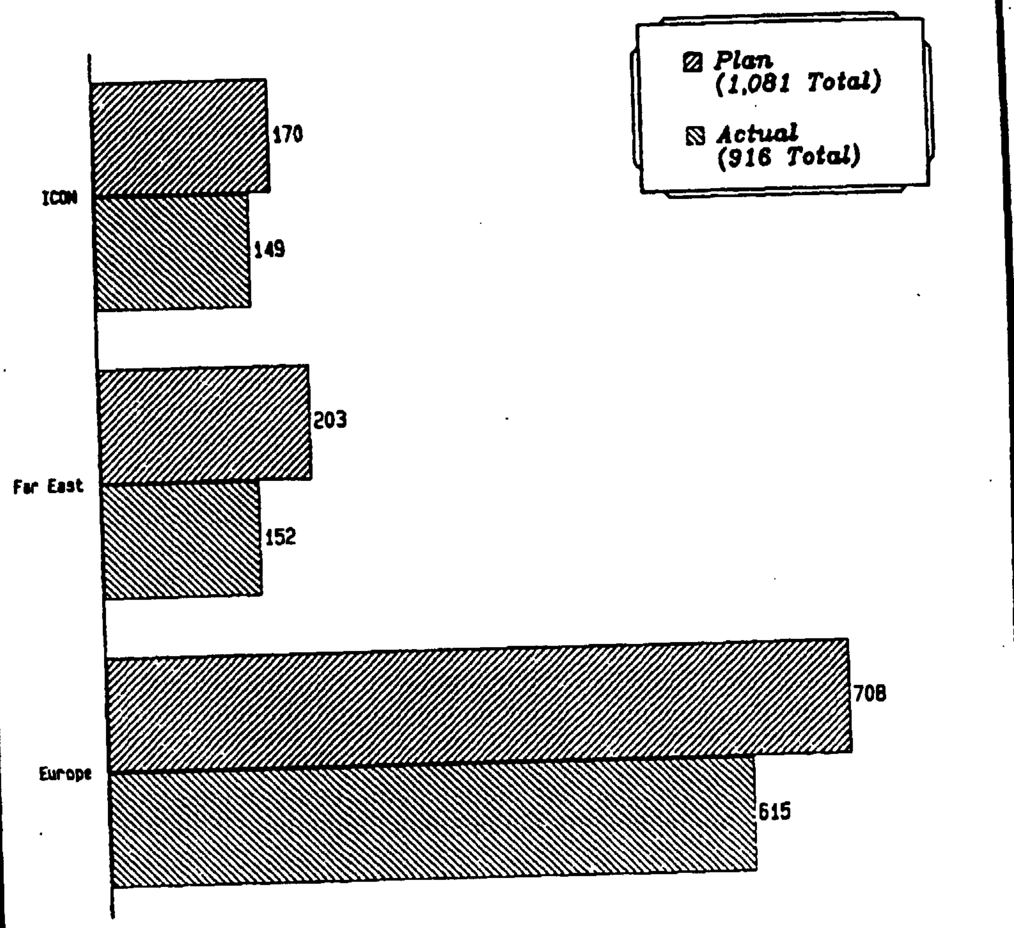

Domestic Headcount
September 30, 1989
Plan
(3,829 Total)
Actual
(3,497 Total)
SPAG
27
22
Legal
24
24
OEM
38
39
Press
49
46
Multimedia
53
53
Corpcom
93
86
International Management
288
239
Fin & Adm
389
366
PSS/MSU
417
375
Mfg & Dst
439
385
USSMD
574
543
Applications
696
650
Systems
742
669

International Headcount
September 30, 1989



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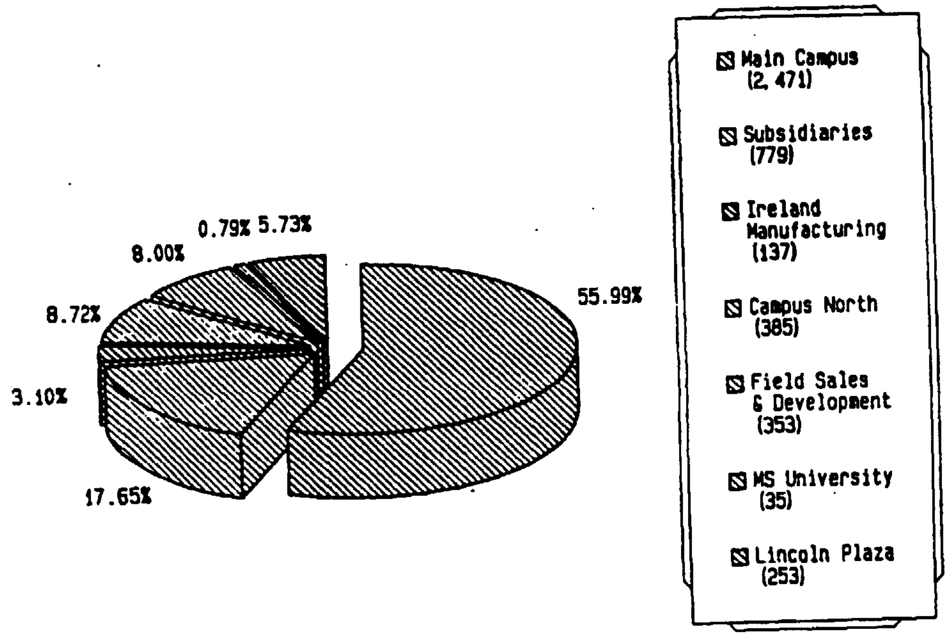
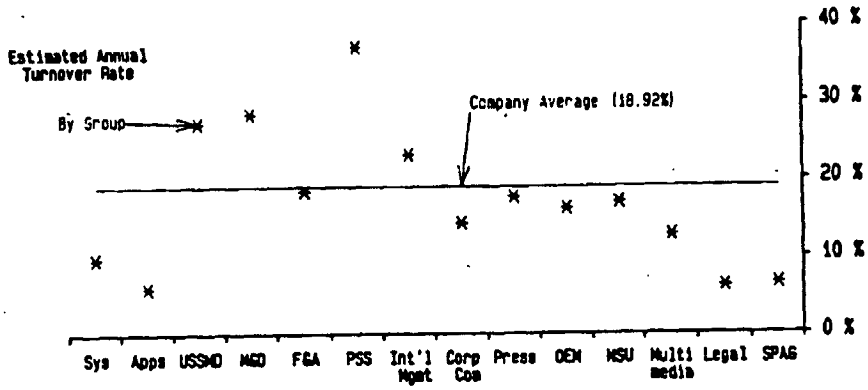
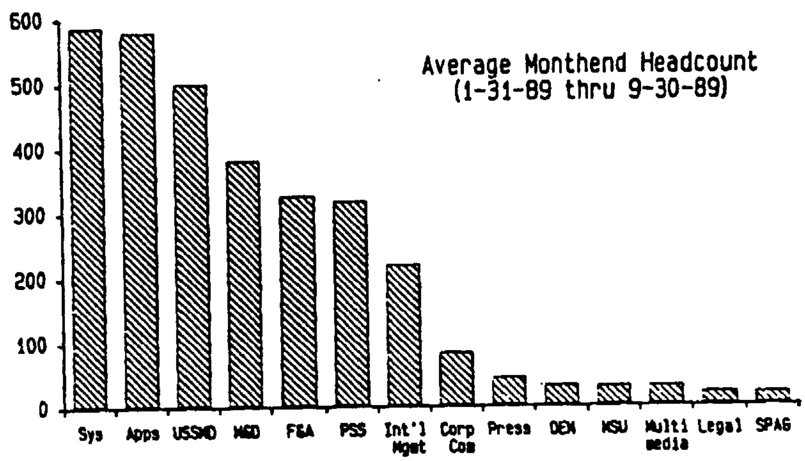
Headcount By Location
September 30, 1989



Total Headcount: 4,413

Domestic Employee Turnover Analysis
Q89-3, Q89-4 & Q90-1 Annualized





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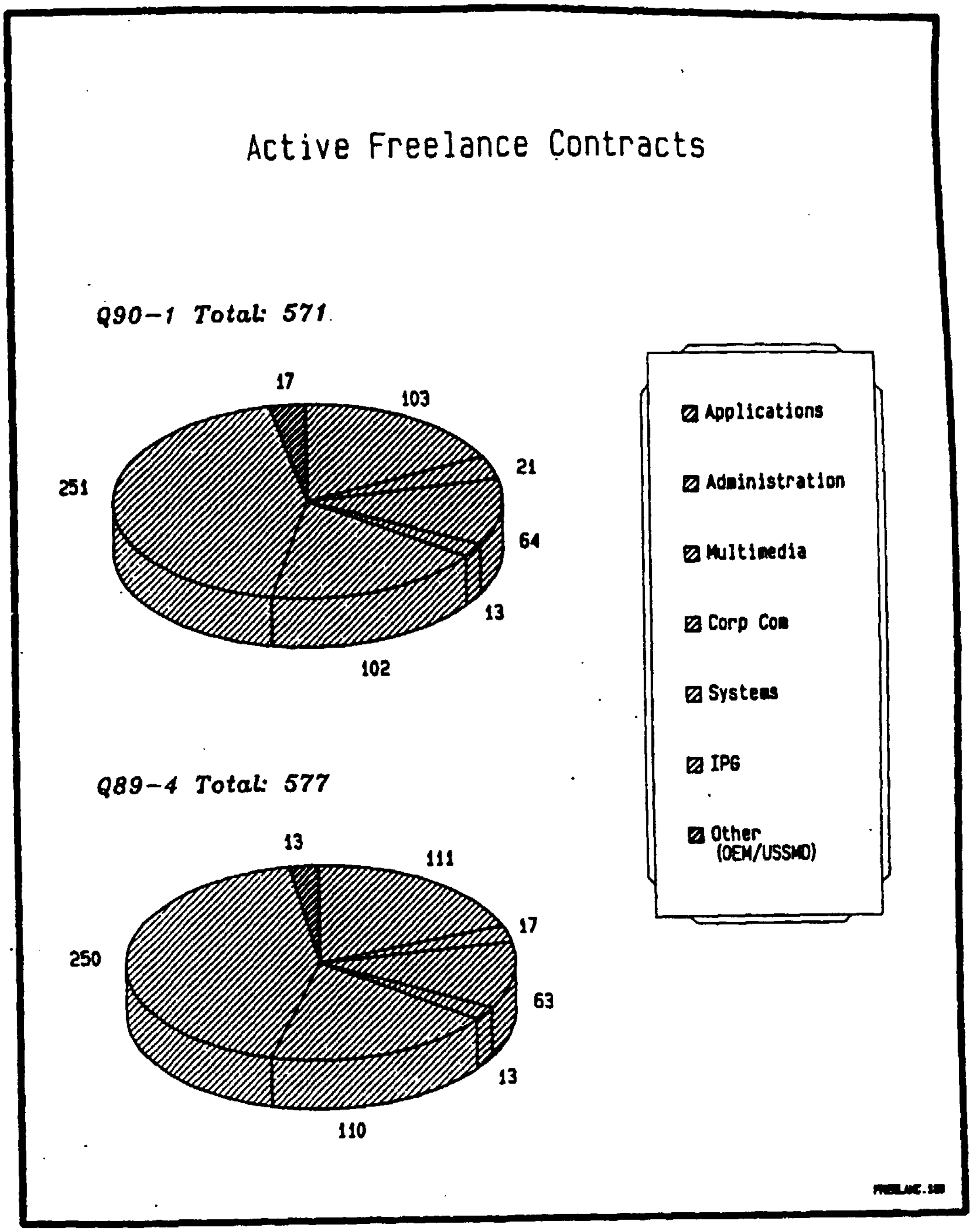
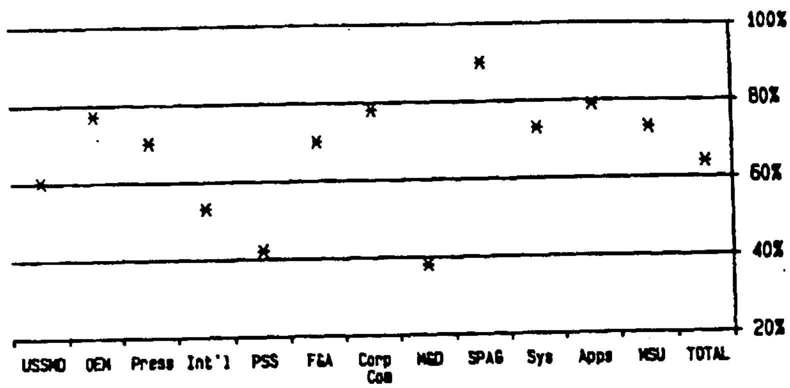
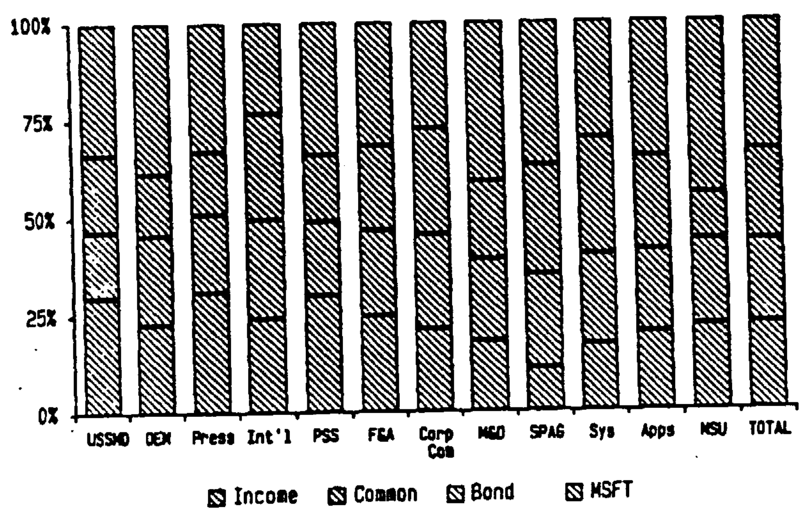

Active Freelance Contracts
Q90-1 Total: 571
17
103
21
64
13
102
251
Q89-4 Total: 577
13
111
17
63
13
110
250
Applications
Administration
Multimedia
Corp Com
Systems
IPG
Other
(OEM/USSMD)

Savings Plus
Participation Analysis For Q90-1

Participation Rate



Investment Split



Savings Plus
Investment Option Participation